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EDITOR

William A. Hancock — Member of the Ohio and California Bars. J.D. 1966 and LL.M. 1974, Case Western Reserve University. Author of many articles and books on business law. Experience: Associate then Partner in Cleveland law firm, 1966-1970; Counsel then Senior Counsel, TRW Inc., 1970-1980; Editor, Author, and Publisher of Business Laws, Inc. publications, 1980-present.

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Handling a Search Warrant

*Nick J. Vizy**

I. Introduction

The Fourth Amendment to the U.S. Constitution protects against unreasonable searches and this protection extends to both individuals and corporations. On the other hand, reasonable searches are allowed and, in general, a reasonable search is one which is conducted pursuant to a search warrant. The Constitution provides that a warrant can only be issued on the basis of "probable cause … and particularly describing the place to be searched, and the person or things to be seized."

A corollary to this is the so-called exclusionary rule which provides that evidence which is obtained illegally — *i.e.,* through a search not covered by a proper warrant — cannot be introduced against the company in a criminal case.

These two basic rules provide the foundation of corporate counsel's efforts to help the company/client properly handle a search warrant situation.

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* *Nick J. Vizy is an associate editor at Business Laws, Inc. and a member of the Ohio Bar.*

First, it is appropriate to try, to the maximum extent practical, to make sure that the warrant itself is proper, and that the agents enforcing it go only as far as the warrant allows. For example, warrants only allow for the "seizure of persons or things." If the agents enforcing the warrant start to ask questions of employees, the company representative is entitled to step in and stop that. The details of exactly how search warrants are executed will vary widely, and much depends on the individuals involved. For example, if the warrant provides that documents of a certain nature are to be seized, the issue of whether or not the company will be allowed to make copies before the agents seize those documents will likely depend on the personal disposition of the enforcing agents as well as the people skills and negotiation ability of the company representative. If there are questions about the application of the scope of the warrant, there may be negotiation between the agents and the company representative, and how that turns out is likely to depend just as much on the personal demeanor of the actors as it is on legal principles. Selection of the right people as the company representatives is very important, as is sufficient training to give them the confidence to appropriately stick up for the company's legal and constitutional rights.

Second, the relevant company people should monitor the execution of the search warrant very closely, make objections where appropriate, and to, therefore, preserve all of the legal objections to either the warrant itself or how it was enforced. The objective is to limit the use of the seized evidence against the company as much as possible. A corollary of this objective is to prevent waiver of any defects in the warrant or its execution.

II. Legal and Practical Advice and Comments on Search Warrants

A. Warrant Procedures

A search warrant must strictly conform to the constitutional and statutory requirements under which it is issued. This includes its form and caption. In the federal system, Rule 41 of the Federal Rules of Criminal Procedure governs the procedures for obtaining and executing a search warrant. Most states have similar practices.

1. Issuance

Under Federal Rule of Criminal Procedure 41(c), a search warrant permits any law enforcement officer to search for and seize the following:

(1) evidence of a crime;
(2) contraband, fruits of crime, or other items illegally possessed;

(3) property designed for use, intended for use, or used in committing a crime; or
(4) a person to be arrested or a person who is unlawfully restrained.

Under Rule 41(e)(1), the warrant must be issued "to an officer authorized to execute it." The search warrant must describe the place to be searched with particularity, must precisely describe the person to be searched, and must particularly describe the items to be seized. Finally, the search warrant should name a magistrate or judge to whom it shall be returned.

A search warrant must be issued by a neutral and detached magistrate whose function is to determine whether the information presented by the officer seeking the search warrant constitutes probable cause for the issuance of the warrant. The determination of probable cause (defined in greater detail below) is basically a fact question; the magistrate determines whether there is probable cause to believe that article(s) subject to seizure are within the premises sought to be searched. The magistrate cannot participate in the search and seizure, nor can he or she accept a fee for the issuance of the search warrant.

The magistrate need not make a determination of probable cause solely upon the submission of the government's affidavit. The magistrate may require testimony concerning the facts upon which the officer bases the government's right to obtain the warrant. Under Federal Rule of Criminal Procedure 41(d)(2), the magistrate "may require the affiant to appear personally and may examine under oath the affiant and any witness the affiant produces." The magistrate may also dispense with the affidavit and issue a warrant upon sworn testimony in appropriate circumstances. Testimony taken in support of the issuance of the warrant must be taken down by a court reporter or recording equipment, and the transcript or recording of the testimony must be filed with the clerk.

2. Execution

Under 18 U.S.C. § 3105, a search warrant may be executed by "any of the officers mentioned in its direction or by an officer authorized by law to serve such a warrant, 'or by some other person' in aid of the officer requiring it, he being present and acting in its execution." Federal Rule of Criminal Procedure 41(e)(2) adds that a search warrant is required to be executed within ten days after it is issued. Many states have adopted similar statutes. In addition, a warrant must be executed during the daytime, unless the magistrate, for good cause, authorizes execution at another time.

Rule 41(f)(2) requires an officer to prepare an inventory of any property taken. The officer must prepare the inventory in the presence of another and the person from whose possession or premises the property was taken, or, in the alternative, in the presence of at least one other credible person. Further, the inventory shall be verified by the officer.

Under Rule 41(f)(3), the agent or officer taking property under the search warrant is required to provide both a copy of the warrant and a receipt of the property taken "to the person from whom, or from whose premises, the property was taken," or the officer may "leave a copy of the warrant and receipt at the place where the officer took the property."

Under Rule 41(f)(4), the return of the search warrant must be made promptly to the same magistrate issuing the warrant, accompanied by the written inventory. Upon request, the magistrate is required to deliver a copy of the inventory to either the person who owns the property seized or the person who owns the premises.

Some state statutes may permit nonpolice officials to assist in the search if the officer specified in the warrant's direction needs help, but the officer is still responsible for seeing that the warrant is properly executed.

Further, under 18 U.S.C. § 3109, force may be used by the officer if someone is present on the premises, after notice of authority and purpose has been given, and entry has been refused. Since use of force is authorized by the agents, no one should obstruct the agents issuing the warrant. 18 U.S.C. § 1501 states that

> whoever knowingly and willfully obstructs, resists, or opposes any officer of the United States … in serving, or attempting to serve or execute, a legal or judicial writ or process of any court of the United States … shall, except as otherwise provided by law, be fined under this title or imprisoned not more than one year, or both.

Also at 18 U.S.C. § 2231, the federal law states that

> whoever, forcibly assaults, resists, opposes, prevents, impedes, intimidates, or interferes with any person authorized to serve or execute search warrants or to make searches and seizures while engaged in the performance of his duties with regard thereto or on account of the performance

> of such duties, shall be fined under this title or imprisoned not more than three years, or both … .

Thus, physical interference with agents' execution of a warrant is definitely to be avoided and all company people should be so advised in the clearest possible terms.

B. Responding to the Warrant

The issuance of a search warrant should alert management that the conduct of the company or its personnel is under serious scrutiny.

1. Request Identification

The company representative should request that each of the individuals coming onto the premises produce government identification. Note the agency affiliation of the officers. Obtain business cards from all of the individuals and confirm that the identities match. If the officers do not have cards, write down the relevant information, including name, title, office address, agency, and telephone number from the identification or request permission to photocopy the identification. If the company has a sign-in policy, ask that the officers comply.

Be sure to identify the agent in charge. Direct any objections or issues to be addressed to this agent.

2. Do Not Consent to the Search

The company representative should not sign any documents indicating that consent has been given for the search. Specifically state that the search is being conducted without consent. Be courteous and assist the officers in accessing areas identified in the warrant, such as locked cabinets or rooms. Do not provide any form of authorization voluntarily. The search warrant does not entail an obligation to discuss or answer questions concerning the contents of any documents. Do not provide unsolicited guidance concerning the location of documents. Do not alert the officers to the presence of items not identified in the warrant. If an officer states, "I don't see any invoices here," do not volunteer "Those are stored at our downtown office." Rather state, "There are no invoices here."

3. Obtain and Review a Copy of the Warrant

The officer should provide a copy of the warrant, or, in the alternative, counsel should request one. The officer is required to provide a copy under Rule 41(d) and most states have a similar requirement.

The warrant should be read carefully, paying close attention to the following aspects:

— noncompliance with the statutory requirements for a search warrant;
— defects in the caption or command;
— the specific officer assigned to implement the warrant;
— the name of the affiant;
— the date of issuance;
— the specific premises covered;
— whether the warrant was executed within ten days of issuance;
— whether a daytime warrant was issued at night;
— the specific records identified;
— the specific person identified; and
— whether there are any catchall phrases, such as "evidence" or "instrumentalities" of a suspected offense.

Errors in the warrant should be brought to the attention of the agent in charge and a specific objection to the search should be made. Advise the agent that the warrant appears to be deficient and the search is being conducted under protest. Attempts may also be made to contact the prosecuting attorney to advise of the errors in the warrant.

4. Attend to Employees

Ask the agent in charge if anyone is being taken into custody. If no one is being taken into custody, all employees not essential to maintaining the basic functions of the company should be dismissed. Those employees remaining should be instructed to avoid the area being searched to the extent possible. Employees should also be advised that they are not under any legal obligation to submit to an interview or questioning by the officers. Employees should also be cautioned that they should not destroy, alter, conceal, or remove any company records during or after the search.

5. Monitor Officers

Accompany and observe the officers while they conduct the search. Do not impede or obstruct the officers. If the officers split up, make sure there are sufficient responsible employees available to escort each agent or group of agents. Detailed notes should be taken to identify all places searched by each officer and any items seized. This information may alert the company as to the focus of the government's investigation. The search should be videotaped if available.

Careful attention should also be paid to the following:

— whether the search was extended beyond its necessary scope;
— whether articles were seized that were not described in the warrant;
— whether a neutral and detached magistrate issued and signed the warrant;
— whether there was execution by nonpolice official(s); and
— whether there were nonpolice present during the search.

If an officer attempts to search an area or seize an item not within the scope of the warrant, do not interfere with the attempts. However, make clear that the officer's actions appear to exceed the scope of the warrant's parameters and his or her actions are being permitted without consent and under protest. In addition, requests for permission to expand the search, such as "Is it OK if I look in there?" should be denied.

6. Protect Privileged Materials

Be conscious of the presence and location of any records that may be entitled to protection from disclosure by virtue of the attorney-client privilege or the work-product doctrine. Ideally, these records will have been previously identified and contain appropriate markings designating their status.

The officers should already have procedures in place to seal records they may consider subject to a privilege claim for later review by a magistrate or prosecutor not involved in the case. However, any effective procedure will require that the officer review the records in some way. To avoid even a cursory review of the records, alert the agent in charge of the claims of privilege and that the company does not consent to waive the privilege. Insist that the records be immediately sealed without review of the officer. Procedures for determining whether a valid privilege exists with regard to the sealed records can be negotiated at a later time.

Although not entitled to the same protections afforded privileged records, the agent in charge should also be notified on any classified records or records containing trade secrets. The parties may be able to negotiate a limited review of such records.

7. Make a Record of Items Taken

Offer to make copies of the records the officers have identified for seizure so that the company may retain the originals for use in its operations. If the

officers insist on taking the original documents, request permission to make copies for the company.

In some cases, agents will seize everything, claiming that there is no time to review each document and segregate those which are responsive. In such cases, counsel should discuss the matter with the agent in charge. It may be possible to persuade the agent that such a broad seizure is unwarranted and unnecessary under the circumstances.

C. Challenging a Search Warrant

Suppression of evidence can be one of the most effective weapons in the defense of a white-collar prosecution. If counsel has been successful in stopping the search, counsel should then file a motion to quash the warrant. If the search has been conducted, counsel should file a Rule 41(g) motion for return of the materials seized, and possibly a Rule 12 motion to suppress the materials seized and to dismiss any pending prosecution due to the irreparable injury to both the company's and its employees' constitutional rights.

1. Probable Cause

Probable cause exists where the facts and circumstances within the arresting officer's or agent's knowledge, warrant a prudent person in believing that an offense has been committed. The Supreme Court has defined probable cause as existing "where 'the facts and circumstances within [the officers'] knowledge and of which they had reasonably trustworthy information [are] sufficient in themselves to warrant a man of caution in the belief that' an offense has been or is being committed." *Brinegar v. United States,* 338 U.S. 160 (1949) (quoting *Carroll v. United States,* 267 U.S. 132 (1924)). In *Illinois v. Gates,* 462 U.S. 213 (1983), the Supreme Court characterized probable cause as "a fluid concept, turning on the assessment of probabilities in particular factual contexts, not readily, or even usefully, reduced to a neat set of legal rules."

2. Adequate Factual Basis

A search warrant may not be issued on the basis of bare allegations that a defendant has violated the law, unsupported by facts tending to prove the charge. The facts constituting probable cause to search or arrest must appear on the face of the affidavit or complaint upon which the warrant is issued. Further, oral testimony outside the affidavit or complaint cannot be used to buttress and cure its defects. Vague generalizations or conclusions without supporting facts will not suffice.

In addition, hearsay must be corroborated by other facts within the personal knowledge of the officer or agent. When relying upon information supplied by an anonymous informer for the basis of probable cause, it must be clearly shown that this information has been reliable in the past and that there is independent corroboratory observation on the part of the affiant.

3. Date of Information

In *United States v. Triumph Capital Group, Inc.,* 211 F.R.D. 31 (D. Conn. 2002), the government obtained a search warrant to search and seize electronic files stored on a laptop computer under the control of the defendant's general counsel. The defendant argued that the forensic search of the computer's files exceeded Rule 41(e)(2)(A)'s ten-day execution requirement. The court discounted the defendant's argument.

> The purpose of Fed. R. Crim. P. 41(c)(1)'s time limitation is to prevent a stale warrant. Delay in executing a warrant beyond the time set forth in the rule is not unreasonable unless, at the time it is executed, probable cause no longer exists and the defendant demonstrates legal prejudice as a result of the delay. *See Commonwealth v. Ellis,* No. 97-192, 1999 Mass Super. LEXIS 368 (Mass. Superior Aug. 1, 1999).
>
> Here, when the mirror image was made within the ten-day period the evidence was frozen in time. Thus, there was no danger that probable cause ceased to exist during the search of the hard drive. *See United States v. Bedford,* 519 F.2d 650, 655-56 (3d Cir. 1975) (noting that the reasonableness of a search is also determined by whether probable cause had dissipated at the time the warrant was executed); *United States v. Gerald,* 5 F.3d 563, 567 (D.C. Cir. 1993) (declining to suppress evidence where warrant was returned five months after the search and where there was no showing of harm to defendant).
>
> Here, the warrant authorized an off-site search that could take weeks or months. As long as the time was reasonable under the circumstances, a search of such duration does not violate the Fourth Amendment. *See Berger v. New York,* 388 U.S. 41, 58-61, 87 S. Ct. 1873, 18 L. Ed. 2d 1040 (1967); *United States v. Snow,* 919 F.2d 1458, 1461 (10th Cir. 1990); *U.S. Postal Serv. v. C.E.C. Serv.,* 869 F.2d 184, 187 (2d Cir. 1989); *United States v. Henson,* 848 F.2d 1374 (6th Cir. 1988).
>
> The amount of time that SA Rovelli took to complete the complex and technical search in this case was not unreasonable. Indeed, as one court

> recently observed, computer searches are not, and cannot be subject to any rigid time limit because they may involve much more information than an ordinary document search, more preparation and a greater degree of care in their execution. *See Commonwealth v. Ellis,* 1999 Mass. Super LEXIS 368.
>
> Moreover, neither Rule 41 nor the Fourth Amendment impose any time limitation on the government's forensic examination of the evidence seized. *See United States v. Sanchez,* 689 F.2d 508, 512 n.5 (5th Cir. 1982); *United States v. Hernandez,* 183 F. Supp. 2d 468, 480-81 (D.P.R. 2002). Thus, SA Rovelli was not required to complete the forensic examination of the hard drive within the time period required by Rule 41 for return of the warrant.

Apart from the ten-day execution requirement imposed by Rule 41(e)(2)(A), courts may take into consideration a time element when evaluating the existence of probable cause.

In *United States v. $92,422.57,* 307 F.3d 137 (3d Cir. 2002), Kim's Wholesale Distributors, Inc. sought to recover funds that were subject to forfeiture based upon Kim's violation of the money laundering statute. The government alleged that Kim's purchased food stamps for discounted cash payments through staged grocery stores that served as fronts for its operation. The money laundering charges were founded upon business records seized from the stores pursuant to a search warrant.

Kim's argued that the fraudulent transactions described in the affidavit presented in support of the issuance of the warrant had occurred nearly a year prior to the execution of the warrant. Kim's, therefore, asserted that the information was stale and could not support a finding a probable cause.

The court rejected Kim's argument.

> Where "an activity is of a protracted and continuous nature, 'the passage of time becomes less significant.' " *United States v. Tehfe,* 722 F.2d 1114, 1119 (3d Cir. 1983) *quoting United States v. Johnson,* 461 F.2d 285, 287 (10th Cir. 1972). Furthermore, where the items to be seized are created for the purpose of preservation, as are business records, the passage of time is also less significant. *See United States v. Williams,* 124 F.3d 411, 421 (3d Cir. 1997). In the present case, as noted, the relationship between Kim's and the Partnership was of considerable duration,

> and the warrant authorized a search for standard categories of business records. Businesses typically retain such records for an extended period of time — certainly for more than eleven months. For these reasons, we hold that it was objectively reasonable for the executing officers to believe that the evidence supporting the search warrant was not stale. [Footnote omitted.]

4. Good Faith Exception

The court in *United States v. Triumph Capital Group, Inc.,* 211 F.R.D. 31 (D. Conn. 2002), determined that even if it were to hold that the search warrant was overly broad, the good faith exception, recognized by the Supreme Court in *United States v. Leon,* 468 U.S. 897, 104 S. Ct. 3405 (1984), would have excused the lack of probable cause.

> The good faith exception permits the admission of evidence obtained pursuant to a facially valid warrant that is subsequently found to be invalid so long as the executing officer acted in good faith and in objectively reasonable reliance on the warrant. *See id.* at 919, 104 S. Ct. 3405 (holding that the good faith exception applies unless the agents obtained the warrant by deliberately misleading the judge, the judge abdicated his duty, or the warrant was so facially deficient that the agent was unreasonable in relying on it); *see also United States v. Jasorka,* 153 F.3d 58, 60 (2d Cir. 1998).
>
> Thus, under the good faith exception, evidence should not be suppressed unless the court determines that a reasonably well trained officer should have known that the search was illegal despite the judge's authorization. *See United States v. Leon,* 468 U.S. at 922 n.23, 104 S. Ct. 3405; *United States v. Moore,* 968 F.2d 216, 222 (2d Cir. 1992). An officer is not "required to disbelieve a judge who has just advised him, by word and by action, that the warrant he possessed authorizes him to conduct the search he has requested." *United States v. Buck,* 813 F.2d 588, 592 (2d Cir. 1987).

The court concluded that the government agent had executed the warrant in good faith and in objectively reasonable reliance on a belief that the warrant was sufficiently particular and facially valid.

5. Identification of Suspected Criminal Activity

In *United States v. Bridges,* 344 F.3d 1010 (9th Cir. 2003), the government seized records maintained by the defendant in connection with his operation

of a tax consulting business. The defendant filed a motion to suppress the seized records which was granted by the court. The court noted that the government's failure to specifically identify in the warrant the criminal activity the government sought to uncover provided grounds under which to find the warrant deficient.

> Although we have "criticized repeatedly the failure to describe in a warrant the specific criminal activity suspected [by the government]," *Kow,* 58 F.3d at 427, the warrant at issue in this case does not state what criminal activity is being investigated by the IRS. In *Kow,* we found that a warrant's reference to "fraudulent" transactions and possible disparities between actual and reported income is not sufficient to withstand constitutional muster. *Id.* Similarly in *Center Art Galleries-Hawaii, Inc. v. United States,* 875 F.2d 747 (9th Cir. 1989) *abrogated on other grounds, J.B. Manning Corp. v. United States,* 86 F.3d 926, 927 (9th Cir. 1996), we held that a "warrant['s] provision for the almost unrestricted seizure of items which are 'evidence of violations of federal criminal law' without describing the specific crimes suspected is constitutionally inadequate." *Id.* at 750. Such warrants are suspect because "[n]othing on the face of the warrant tells the searching officers for what crime the search is being undertaken." *United States v. George,* 975 F.2d 72, 76 (2d Cir. 1992).
>
> Similarly, this warrant does not describe or allege the fraudulent activities that ATC and Bridges are suspected of having committed. The closest the search warrant comes to any allegation of criminal conduct is its reference to Agent Rodriguez's Affidavit. While the Affidavit sets forth what crimes Bridges and ATC are alleged to have committed, the warrant neither incorporates the Affidavit by reference, nor is a copy of the Affidavit physically attached to the warrant or any of its incorporated parts. *See Kow,* 58 F.3d at 429 n.3 ("An affidavit providing more guidance than an overbroad warrant may cure the warrant's overbreadth only if (1) the warrant expressly incorporated the affidavit by reference and (2) the affidavit either is attached physically to the warrant or at least accompanies the warrant while agents execute the search."). With respect to describing what items are to be seized or the purpose of the search, the warrant refers the reader to Attachment B. Attachment B, however, does not make any specific allegation of criminal conduct. It merely refers to "crimes" in general. In fact, when Bridges asked Agent Rodriguez to show him the Affidavit on the day of the search, she informed him that, "[he] had no legal right to [see the Affidavit]."

> The government's argument that its search warrant is valid because ATC's entire operation was permeated with fraud lacks merit. "A generalized seizure … may be justified if the government establishes probable cause to believe that the entire business is merely a scheme to defraud or that all of the business's records are likely to evidence criminal activity." *Kow,* 58 F.3d at 427. In *Rude,* we explained that such a seizure may be justified if the government's supporting affidavit made it clear that the target business's "central purpose was to serve as a front for defrauding" investors. *See Rude,* 88 F.3d at 1551. This, however, is not such a case. Here, the IRS did not allege in its application that ATC's operations were permeated with fraud. *See id.* at 428 (citing *Center Art,* 875 F.2d at 751 ("permeated with fraud" doctrine not applicable where the supporting affidavit "did not aver that evidence of [the alleged] fraud was inseparable from other [business] documents or that [the business] was permeated with fraud.")). Similarly, Agent Rodriguez's Affidavit does not make it sufficiently clear that ATC's operations were entirely fraudulent in nature. Specifically, it is not clear to us whether or not the government knew at the time it was making its application that ATC's operations were permeated with fraud. If that was the case, the government should have made this clear to the district court, so that the district court could examine the government's evidence with greater depth and fashion a sufficiently tailored warrant consistent with the principles of the Fourth Amendment. In this case, however, there is insufficient evidence in the record to justify the government's claim *ex post facto*.

6. Scope

The appropriate scope of the warrant is basically a function of the probable cause requirement. Generally, all private property is protected from search and seizure by the government under the Fourth Amendment. Evidence of criminal activity is exempted from the Fourth Amendment's protection. However, the government is only entitled to conduct a search and seizure to obtain such evidence upon obtaining a warrant that particularly describes "the place to be searched, and the person or things to be seized." Satisfaction of the particularity requirement is evaluated under the government's showing of probable cause concerning the existence and extent of the criminal activity. The greater and more extensive the showing of probable cause, the broader the scope of the warrant is likely to be. A limited showing of probable cause will not justify an expansive search.

7. Location to Be Searched

In the case *United States v. Humphrey,* 104 F.3d 65 (5th Cir. 1997), the

Humphreys owned and ran a loan brokerage service that ultimately proved to be a scam. Their scheme enabled them to steal millions from unwary individuals seeking loans. They were indicted and subsequently convicted of mail and wire fraud. On appeal, the Humphreys facially attacked the "all records" search warrant that had allowed the agents to search their home as being overbroad. Further, they claimed that the warrant failed to describe with particularity the property to be seized.

The warrant listed the following four kinds of business records to be seized:

1. Books, records, receipts, notes, ledgers, and other documents relating to financial transactions and relationships with financial institutions.

2. Ledger paper, column paper, check registers, checks, U.S. currency, deposit slips, receipts, bank statements, cashier's checks, association checks, check order forms, new account information forms, wire transfers and receipts, signature cards, correspondence, and all other documents relating to banking, banking transactions, and transactions at savings and loan institutions, and in particular all documents relating to the purchasing, cashing, transferring, and depositing of cashier's checks.

3. Credit cards, debit cards, and all statements, receipts, applications, letters, notices, and other documents which relate to the use of credit cards or debit cards.

4. Computer storage devices containing records, documents, and other information described above in paragraphs one through three, and related equipment and materials for adequately retrieving and reviewing the information, including central processing units, printers, monitors, floppy discs, and instruction manuals which could be used to store information regarding customer files and banking information.

In addition, the affidavit placed at least some business property within the Humphreys' home. Other facts established that their home had office furniture in it, they rarely rented office space other than a post office box or telephone message center, and Mrs. Humphrey had previously informed the police after experiencing theft from her house that she had run her business

from her home. Also, the Humphreys had received numerous business complaints concerning their brokerage loan business.

The Fifth Circuit phrased the issue as being "whether the affidavit support[ed] the broad language of the search warrant authorizing the search of the Humphreys' home." The appellate court commented that the Fourth Amendment required much closer scrutiny of an "all records" warrant when the alleged fraudulent business is operated out of a home. However, under the facts of this case, the Fifth Circuit agreed with the district court because the affidavit supporting the warrant application established that the Humphreys were engaged in a fraudulent loan brokerage business that was being conducted from their home. The court pointed to the facts that the Humphreys used their business address only sporadically, that their home had office furniture, that cash was stolen from under a bedroom mattress, and that many complaints had been made about the business. Thus, the appellate court held that although "all records" warrants are upheld only in the most extreme of cases, that this was a situation where it had been properly authorized. The court said that the Humphreys' work and personal lives had significantly overlapped, they held no bank accounts, their fraud was extensive, and the warrant was limited to business records.

8. Items to Be Seized

In *United States v. Hargus,* 128 F.3d 1358 (10th Cir. 1997), Charley Hargus had agreed to purchase stolen oil from an investigator posing as the owner of the dummy company selling the oil. Subsequently, the investigator obtained a search warrant to search both Hargus's home and oil reclaiming yard. The warrant described the following items to be seized:

1. oil and gas gauge books;
2. telephone records, bills, and invoices;
3. business records, receipts, invoices, accounts payable, and other records regarding oil and gas, salt water and other fluid transfers of the business known as Hargus Reclaimers;
4. checkbooks and check stubs;
5. checking account records of all accounts of Charley Hargus and Hargus Reclaimers;
6. oil transfer reports;
7. certificates of deposit;
8. bank deposit statements of savings and other accounts;
9. income tax records;
10. any records relating to the business of Hargus Reclaimers and rec-

> ords pertaining to the purchase and sale of oil, oil by-products, salt water and other fluids by Charles Hargus.
>
> Aplt. Supp. App. at 7.

Records were seized including two file cabinets and items not listed in the warrant. The searches lasted for five hours. Soon after, Hargus was arrested, indicted, and convicted of organizing the scheme to steal the oil, using the mail to carry out that scheme, and money laundering.

Upon reviewing the warrant, the Tenth Circuit disagreed with Hargus's contention that the warrant was a general warrant, and found that the warrant was "sufficiently limited and specific." Although Hargus complained that the officers exceeded the scope of the warrant with respect to his house and the taking of items not mentioned in the warrant, the Tenth Circuit responded:

> Although we are given pause by the wholesale seizure of file cabinets and miscellaneous papers and property not specified in the search warrant, the officers' conduct did not grossly exceed the scope of the warrant. Their conduct was motivated by the impracticability of on-site sorting and the time constraints of executing a daytime search warrant. The officers were authorized to seize ten broad categories of records, and those records were present in every drawer of both file cabinets. No item not specified in the warrant was admitted against Mr. Hargus at trial. Under these circumstances the officers did not grossly exceed the warrant in concluding they did not need to examine at the site every piece of paper in both cabinets.

Thus, the Tenth Circuit held that the warrant and resulting searches were reasonable.

In *Davis v. Gracey,* 111 F.3d 1472 (10th Cir. 1997), Anthony Davis operated a large computer bulletin board system. After selling obscene CD-ROMs to an undercover officer, a warrant was obtained to search his business premises. Following his criminal conviction and civil forfeiture of the computer equipment in state court proceedings, Davis, his related businesses, and several users of electronic e-mail brought this action alleging that the seizure of the computer equipment and e-mail and software stored on the system violated several constitutional and statutory provisions. One of the issues on appeal was whether the warrant was overbroad under the Fourth Amendment.

The court stated that

> [t]he Fourth Amendment requires that a search warrant describe the things to be seized with sufficient particularity to prevent a "general, exploratory rummaging in a person's belongings." *Voss v. Bergsgaard,* 774 F.2d 402 (10th Cir. 1985) (quoting *Coolidge v. New Hampshire,* 403 U.S. 443 (1971)). "The particularity requirement ensures that a search is confined in scope to particularly described evidence relating to a specific crime for which there is demonstrated probable cause." *Id.* "The requirement that warrants shall particularly describe the things to be seized makes general searches under them impossible and prevents the seizure of one thing under a warrant describing another. As to what is to be taken, nothing is left to the discretion of the officer executing the warrant." *Marron v. United States,* 275 U.S. 192, 48 S. Ct. 74 (1927).
>
> … "[t]he test applied to the description of the items to be seized is a practical one," *Leary,* 846 F.2d at 600, and the language in warrants is to be read in a "common sense fashion," *In re Search of Kitty's East,* 905 F.2d at 1374. Thus, "[a] description is sufficiently particular when it enables the searcher to reasonably ascertain and identify the things authorized to be seized." *Leary,* 846 F.2d at 600 (quoting *United States v. Wolfenbarger,* 696 F.2d 750 (10th Cir. 1982)) (internal quotation omitted). "As an irreducible minimum, a proper warrant must allow the executing officers to distinguish between items that may and may not be seized." *Id.* at 602. Moreover, "[e]ven a warrant that describes the items to be seized in broad or generic terms may be valid 'when the description is as specific as the circumstances and the nature of the activity under investigation permit.' " *Id.* at 600 (quoting *United States v. Santarelli,* 778 F.2d 609 (11th Cir. 1985)).

The court reviewed the warrant, asking two questions: "did the warrant tell the officers how to separate the items subject to seizure from irrelevant items, and were the objects seized within the category described in the warrant?" Upon answering both of these questions in the affirmative, the court explained that the seized computer equipment fell within the scope of the warrant because the warrant was confined to that equipment which pertained to the distribution or display of pornographic material. The description included only that equipment directly connected to the suspected criminal activity and the criminal activity referenced in the warrant was very narrow, providing a ready guide to determine if a given item was one that

might be the instrument or evidence of the criminal activity. Thus, the court concluded that the warrant was not overbroad.

In *United States v. Majors,* 196 F.3d 1206 (11th Cir. 1999), F.O. Majors and Gareth Majors appealed the admissibility of evidence seized pursuant to a search warrant in light of their convictions for mail fraud, securities fraud, and other related crimes.

Using four corporations, the Majors conspired to defraud investors by selling millions of dollars of worthless securities. In 1996, pursuant to an investigation by the FBI, an FBI agent submitted an affidavit in support of a request for a search warrant to search the premises of one of the corporations, Alliance Fuel Corporation (AFC). A search warrant was issued authorizing the search of the AFC premises for "[b]ooks, [l]edgers, [r]eceipts, [i]nvoices, [b]usiness records, the identification of [f]inancial accounts and any other evidence in violation of 'Title 18 U.S.C. §§ 1341 and 1343.' " As a result of the search, thousands of documents were seized by the government.

After reviewing the record, including the application for search warrant and attached affidavit, the circuit court concluded that the search warrant was not overbroad. Due to the particular nature of a charge of fraud, especially where corporations are used as vehicles of fraud, an application to search the premises for the above described articles described with particularity the items to be seized.

In *United States v. Mathison,* 157 F.3d 541 (8th Cir. 1998), Eugene Mathison appealed the admissibility of evidence seized pursuant to a search warrant authorizing the seizure of all records at Mathison's office pertaining to seventeen distinct businesses and eleven individuals, including Mathison. Mathison and his associates operated fraudulent investment schemes. They were convicted of conspiracy, mail fraud, and money laundering.

The court determined that the search warrant was appropriately specific; it did not, contrary to Mathison's assertion, authorize a general search. In this case, the FBI had considerable information regarding Mathison's criminal activity, including the names of seventeen corporations that were potentially involved in criminal wrongdoing. Fraud, by its nature, entails concealment. The FBI could not be certain that the records of the seventeen corporations about which it had information would contain evidence of Mathison's crimes. It, therefore, sought and received authorization to search

all of Mathison's financial records in addition to the delineated corporate records. Because the search warrant limited the search to all records pertaining to the specified corporations and to certain individuals' financial records, the court found that it was sufficiently particular.

Further, the court found that the trial court properly denied Mathison's motion to suppress certain evidence on the ground that its seizure exceeded the scope of the search warrant. Mathison alleged that the FBI unlawfully seized documents pertaining to a number of companies not specifically named in either the affidavit or the warrant. The trial court declined to suppress that evidence, finding that it fit within the confines of the warrant. The circuit court agreed, noting that the warrant properly authorized the seizure of Mathison's financial records. Because the disputed evidence related to investment groups in which Mathison was listed as an investor, the seizure did not exceed the scope of the warrant.

In *United States v. $92,422.57,* 307 F.3d 137 (3d Cir. 2002), Kim's also argued that the descriptions of the items identified in the warrant were so vague and expansive that the warrant constituted a general warrant in violation of the Fourth Amendment. The court noted that the Fourth Amendment does not impose a cap on the number of items a warrant may seek.

> The Fourth Amendment does not prohibit searches for long lists of documents or other items provided that there is probable cause for each item on the list and that each item is particularly described.
>
> "The particularity requirement 'makes general searches … impossible.' " *United States v. Christine,* 687 F.2d 749, 752 (3d Cir. 1982) *quoting Marron v. United States,* 275 U.S. 192, 196, 48 S. Ct. 74, 72 L. Ed. 231 (1927); *see also, e.g., Stanford v. Texas,* 379 U.S. 476, 480, 85 S. Ct. 506, 13 L. Ed. 2d 431 (1965). A general warrant authorizes "a general, exploratory rummaging in a person's belongings." *Coolidge v. New Hampshire,* 403 U.S. 443, 467, 91 S. Ct. 2022, 29 L. Ed. 2d 564 (1971). In order for a warrant to be invalidated as general, it must "vest the executing officers with unbridled discretion to conduct an exploratory rummaging through [defendant's] papers in search of criminal evidence." *Christine,* 687 F.2d at 753. As we noted in *Christine,* examples of general warrants are those authorizing searches for and seizures of such vague categories of items as " 'smuggled goods,' " " 'obscene materials,' " " 'books, records, pamphlets, cards, receipts, lists,

> memoranda, pictures, recordings and other written instruments concerning the Communist Party of Texas,' " " 'illegally obtained films,' " and " 'stolen property.' " *Id.* (citations omitted).
>
> We have contrasted a "general warrant" with a warrant that is simply overly broad. An overly broad warrant "describe[s] in both specific and inclusive generic terms what is to be seized," but it authorizes the seizure of items as to which there is no probable cause. *Christine,* 687 F.2d at 753-54. An overly broad warrant, however, can be cured by redaction, that is, by "striking from [the] warrant those severable phrases and clauses that are invalid for lack of probable cause or generality and preserving those severable phrases and clauses that satisfy the Fourth Amendment." *Id.* at 754. Evidence seized pursuant to an overly broad warrant need not be suppressed if the good faith exception applies.

The court concluded that the description of the items to be seized under the warrant was not overly broad for purposes of establishing that the stores under Kim's control did not conduct retail food operations that would account for the large amounts of cash they were generating.

> Although the scope of the warrant was certainly extensive, the warrant was not general. The warrant authorized a search for and seizure of the following:
>
> 1) Receipts, invoices, lists of business associates, delivery schedules, ledgers, financial statements, cash receipts, disbursement, and sales journals, and correspondence.
>
> 2) Computers, computer peripherals, related instruction manuals and notes, and software in order to conduct an off-site search for electronic copies of the items listed above.
>
> JA at 179, 181. The warrant thus "describ[ed] in … inclusive generic terms what is to be seized." *Christine,* 687 F.2d at 753. It did not vest the executing officers with "unbridled discretion" to search for and seize whatever they wished. *Id.* It was indubitably broad, but it was not "general."
>
> Moreover, we think that reasonable officers could have easily believed that the warrant was not even overly broad with respect to the categories

> of items to be seized. To be sure, the warrant authorized a search for and the seizure of entire categories of legitimate business records, but it is critical to keep in mind that a principal purpose of the warrant was to prove a negative, *viz.,* that Kim's had ***not*** engaged in legitimate business transactions with the sham groceries from which Kim's had received large cash payments. [Emphasis added by the court.]

In *United States v. Bridges,* 344 F.3d 1010 (9th Cir. 2003), the defendant also argued that the description of the records identified in the warrant under which the government seized the records was overly broad. The court agreed.

> The Fourth Amendment requires search warrants to state with reasonable particularity what items are being targeted for search or, alternatively, what criminal activity is suspected of having been perpetrated. *Marron v. United States,* 275 U.S. 192, 196, 48 S. Ct. 74, 72 L. Ed. 231 (1927). Otherwise, the officers charged with executing the search are left to speculate as to what is the underlying purpose or nature of the search. The executing officers must be able to identify from the face of the warrant, as well as any attached or expressly incorporated documents, what it is that they are being asked to search for and seize from the target property.
>
> The warrant in this case authorized federal officers to search for property that was concealed in a two-story brick building located at 3021 6th Avenue North in Billings. The specific items that the government believed were concealed in ATC's offices were articulated on a separate document entitled Attachment B, which was attached to the warrant and incorporated by reference. Attachment B states in relevant part that:
>
> > Based on the facts as presented in the Affidavit for Search Warrant, your Affiant has probable cause to believe that there exists, within the previously described premises … evidence of crimes that includes but is not limited to:
> >
> > 1. a. Records and documents, or electronically stored information … .
> >
> > b. Documents, contracts, or correspondence … .
> >
> > c. Records relating to clients/victims … of [ATC] … .

* * *

3. a. Computer hardware … .

   b. Computer software … .

   c. Computer-related documentation … .

   d. Computer passwords and other data security devices … .

4. Telephone toll records … .

5. All fax machines … .

6. All telephone answering machine outgoing message cassettes and incoming message cassettes.

7. All records, documents, and photographs establishing the person … owning or leasing 3021 6th Avenue North … .

8. Typewriter ribbons.

9. Phone numbers contained in the memory of an automatic telephone dialer, and phone numbers which can be retrieved from a Caller ID box.

10. Cash.

11. Notary seals … .

12. Postal meter or records of outgoing or incoming mailings/shippings … .

13. Unopened mail … .

Although the list of items and categories of property set forth in Attachment B is detailed, the list is so expansive that its language authorizes the government to seize almost all of ATC's property, papers, and office equipment in Billings. The list is a comprehensive laundry list of sundry goods and inventory that one would readily expect to discover in any

small or medium-sized business in the United States. In fact, other than Attachment B and the warrant's description of the location of ATC's offices, the warrant delineates no clear material limitation or boundary as to its scope.

The wording of this warrant is unquestionably broad in terms of describing what items the federal agents are being asked to seize. In its section entitled "Items to be Seized," the warrant authorizes the seizure of all records relating to clients or victims "including ***but not limited to***" (emphasis added) the ones listed on the warrant. If, however, the scope of the warrant is "not limited to" the specific records listed on the warrant, it is unclear what is its precise scope or what exactly it is that the agents are expected to be looking for during the search.

D. Post-Search Issues

The execution of a search warrant is a very serious matter and manifests that a criminal investigation of the company is underway by the government. At this time, the company should retain outside counsel that is experienced in criminal investigations. It is important to obtain outside legal counsel because the government may question the independence of in-house counsel, given its relationship with corporate management and the perception that they wear two hats: one legal and the other, management. Further, prosecutors may be more candid about their views with outside counsel because of this perception.

1. Obtain Documents from Court

After the search, the warrant, the copy of the return, the inventory, and all other documents are filed with the clerk of court. Counsel should obtain them along with a copy of the affidavit in support of the warrant or a transcript of the agent's statement if made by oral testimony. A copy of the return made by the officers, including the inventory of seized items, should also be obtained from the court. These are sources of information regarding the nature of the government investigation. If the affidavit has been placed under seal to keep the investigation confidential or to protect the identity of the informant, counsel can still try to obtain a copy of the affidavit from the court or prosecutor with any redactions deemed necessary by the prosecutor.

In *In re Search Warrant for 2934 Anderson Morris Road Niles, Ohio 44406,* 48 F. Supp. 2d 1082 (N.D. Ohio 1999), the residents of a house,

searched pursuant to a warrant, sought review of a magistrate's denial of a motion to unseal an affidavit in support of a warrant.

The court noted that generally, a person whose property has been seized pursuant to a search warrant has a right under the Warrant Clause of the Fourth Amendment to inspect and copy the affidavit upon which the warrant was issued. However, this right is not absolute.

The court stated that this matter was still in the preindictment phase, and a question existed as to whether the residents even had a right to review the affidavit upon which the warrant was issued. Courts are split on the issue of whether the Warrant Clause of the Fourth Amendment grants a right of access to sealed affidavits in support of a search warrant prior to indictment.

Upon consideration of the sealed affidavit, the affidavit of the special agent, the motions of the parties, and the evidence in the record, the court denied the motion. The court found that the sensitive nature of the information contained in the affidavit, the compelling government interest in protecting the ongoing investigation, and the privacy interests of those named in the affidavit, all weighed in favor of maintaining the affidavit under seal. Moreover, the court found that no less restrictive means were available as even redactions could not protect the identities of various individuals due to the context in which they were mentioned.

In *In re Search Warrants Issued August 29, 1994,* 889 F. Supp. 296 (S.D. Ohio 1995), the U.S. Customs Service applied for and received a warrant to search the office — located in the owner's residence — of Afshein, Inc. Upon the government's motion, the search warrant and affidavit were placed under seal. The owners of Afshein, Inc. moved to unseal all search warrant documents relating to the searches. The government moved to quash, alleging that its criminal investigation would be compromised.

The issue before the court was whether the documents relied upon to establish probable cause for the issuance of the search warrant must be disclosed to the person whose residence was the subject of the search, after the search was completed. The court concluded that

> the Fourth Amendment right to be free of unreasonable searches and seizures includes the right to examine the affidavit that supports a warrant after the search has been conducted and a return has been filed with

> the Clerk of Court pursuant to Fed. R. Crim. P. 41. It is not, however, an unqualified right. As is true with other constitutional rights it may be overridden when it is shown that precluding access is "essential to preserve higher values and is narrowly tailored to serve that interest." *Press-Enterprise Co. v. Superior Court,* 464 U.S. 501(1984). Thus, the right of access may be denied only where the government shows (1) that a compelling governmental interest requires the materials be kept under seal and (2) there is no less restrictive means, such as redaction, available. Clearly, the fact that there is an ongoing criminal investigation could provide a compelling governmental interest. *Cf. Baltimore Sun,* 886 F.2d at 64. Other examples of compelling governmental interests which might, in an appropriate case, justify the extraordinary act of sealing warrant materials after the underlying search has been conducted include the presence of information in a supporting affidavit gleaned from a court ordered wiretap that has yet to be terminated, or information that could reveal the identity of confidential informants whose lives would be endangered. Sealing may be appropriate under such circumstances if redaction is not feasible.

Thus, the court granted the motion to unseal the search warrant materials, but permitted the government to redact the identity of confidential informants and any investigative procedures still being used in the continuing investigation.

2. Recover Seized Items

Rule 41(g) provides

> Motion to Return Property.
>
> A person aggrieved by an unlawful search and seizure of property or by the deprivation of property may move for the property's return. The motion must be filed in the district where the property was seized. The court must receive evidence on any factual issue necessary to decide the motion. If it grants the motion, the court must return the property to the movant, but may impose reasonable conditions to protect access to the property and its use in later proceedings.

In *J.B. Manning Corp. v. United States,* 86 F.3d 926 (9th Cir. 1996), a corporation and principal whose property was seized by a Customs Service agent filed a timely motion for return of property obtained in an illegal

search and seizure. The search was illegal because the search warrant failed to describe the items subject to seizure with particularity. The issue before the court was whether the good faith exception to the exclusionary rule should apply to Rule 41(g) motions. The court, citing *Kitty's East v. United States,* 905 F.2d 1367 (10th Cir. 1990), stated that, "[u]nder the rule [41(g)] as it now exists, suppression and return of property are separate and distinct inquiries." Since Rule 41(g) allows the government to impose "reasonable conditions" on the return of property "to protect access and use of the property in subsequent proceedings," granting a 41(g) motion does not increase the chance that "a guilty defendant may go free," which was the concern behind the good faith exception. *United States v. Leon,* 468 U.S. 897 (1984). Thus, the court held that the good faith exception does not apply to Rule 41(g) as it was amended in 1989. The court stated:

> If a district court determines that property has been illegally seized, the proper question in deciding the merits of a 41(e) [currently Rule 41(g)] motion is not whether the officers acted in good faith, but whether returning the illegally seized documents would be "reasonable[ ] under all of the circumstances." … If the government's investigatory and prosecutorial interests can be served by retaining copies of the documents, it is unreasonable for the government to refuse to return original documents to the owner.

Accord United States v. A Building Housing a Business Known as Mach. Prods. Co., 139 F.R.D. 111 (W.D. Wis. 1990) (contractor had to show that it would be injured irreparably unless the seized materials were returned but was allowed to copy all the business records at issue).

3. Debrief Employees

Each company employee involved in the search should be interviewed by counsel following the search. The list of individuals would include employees interviewed by the officers, employees monitoring the search, and employees whose records or offices were searched. Particular attention should be paid to the questions posed by the officers and any documents the officers showed to the employees. A memorandum detailing the search should be prepared and marked as attorney-client privilege.

E. Proactive Measures

The corporate response to a search warrant should be a well-thought-out process and should involve clearly defined methods and procedures. Com-

panies should not be in the position of attempting to react to a search of company premises. Corporate procedures may be set in place to minimize the problems encountered in responding to a search warrant for corporate records. The list below is not inclusive; it is meant to suggest some of the steps available to companies and should be considered in the context of the earlier discussion.

1. Company Compliance Program

The company should create and implement a compliance program that is communicated to everyone. This would ensure that all officers, directors, and employees commit to total compliance with all laws, rules, and regulations. Each corporate department should be audited to maintain compliance and a disciplinary system should be put into place to deal with inappropriate activity.

2. Hiring Practices

Reference checks should be made on all potential employees to confirm that there is no bad prior history. Background checks can be done and public court records can be searched.

3. Backup Copies of Records

It is an excellent idea to regularly back up and store off-site all computer disks and tapes. This will enable the company to quickly resume all day-to-day operations in case of any disaster, including seizure of computers and software pursuant to a search warrant.

4. Document Retention Program

It is also important to implement a formal document retention program through which all unnecessary business documents are regularly purged. This will not only enable a company to locate needed documents for business purposes, but also facilitates cooperation with agents or officers executing a warrant.

Although the selective destruction of corporate records, outside the context of a formal records retention program, should be prohibited as a matter of company policy, the destruction of company records in accordance with a formal records retention program, and in the absence of possible litigation or governmental investigation, can reduce the company's potential liability exposure.

5. Standard Operating Procedures

Further, it is necessary to create explicit company guidelines and procedures to follow if a search warrant is served. All employees should be trained in these procedures.

6. Privileged Documents

All hard copies of attorney-client privileged materials and work-product documents should be kept separate from the general corporate files. Further, all these documents should be clearly marked as "Privileged Attorney-Client Communications." Within the organization, only those with a need to know should receive copies of these items. Any extra copies or drafts should be purged. Any databases, files, documents, or data within a computer system should also be marked as privileged and protected by password-only access. The same can be done for any proprietary information.

7. Train Employees

Training all employees how to conduct themselves when confronted by prepared government agents executing a warrant is essential. The company should explain to its employees their legal rights, duties, and obligations before they dispense any information to government agents. Instruction should also encompass contact with officers while not on company premises. Employees should be encouraged to notify corporate counsel in the event they are contacted by officers. Corporate counsel should also advise the employees that it is within their rights to decline to be interviewed by officers unless they are under arrest.

III. Conclusion

Obviously, execution of a search warrant is a clarion call to the company that a criminal investigation has reached a new level and has become a very serious matter. The seizure of corporate records should be monitored closely. At this time, it would be highly prudent to conduct an internal investigation so that a proper defense can be mounted. If the company does not have a compliance program, a system for background checks, a document retention program, or certain standard operating procedures to deal with warrants, now is the time to develop and implement these systems for the future. Through effective planning, the company can minimize the disruption caused by a search of the company premises and be ready to deal with the many issues that such a search raises.

International Protection of Trade Secret Rights*

*James Pooley***

I. Introduction

Trade secret protection outside the United States is something of a mess,

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** *The author specialized in the litigation and trial of intellectual property matters and is a senior partner in the Palo Alto, California, office of Milbank, Tweed, Hadley & McCloy, LLP.*

but it is improving. In one sense, the world scene is similar to that which we face in this country: substantive standards varying among a large number of jurisdictions, each with its own procedural rules as well. But here we benefit greatly from the harmonizing effect of the *Restatement of Unfair Competition* and of the Uniform Trade Secrets Act, even though they have not been adopted in precisely the same way. We also benefit from a common legal tradition, a common language, and the Full Faith and Credit Clause of the U.S. Constitution, all of which tend to mitigate the differences and make interstate transactions and litigation relatively predictable.

Until the negotiation of the North American Free Trade Agreement (NAFTA) treaty and the Trade-Related Aspects of Intellectual Property Rights (TRIPs) agreement resulting from the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) talks, there has been very little successful effort at harmonizing the standards of protection and enforcement for trade secret laws around the world. Here, we will briefly examine the impact of those two treaties, which is potentially enormous, but with the emphasis on "potentially." The wheels of change roll very slowly in matters of international trade, and for a complex set of reasons this has been especially true with regard to intellectual property issues.

While we wait for the day when the countries of the world have agreed on — and implemented — roughly common standards of conduct and enforcement, we will continue to deal with a massively complex and dynamic set of rules (or lack of rules or rules in formation), which must be investigated and assessed in the context of each transaction and each potential dispute. That said, one can make some broad observations that should be useful in establishing the context for some of the information which follows.

Trade secret law is fairly well developed and predictable in the United Kingdom and in most jurisdictions (such as Canada and Australia) that have borrowed from its jurisprudence and that employ a common-law system of largely judge-made law. Enforcement is quite reasonably available in most places, and although discovery rights are not nearly so extensive as in the United States (an issue of some importance for trade secret plaintiffs), some would say that may provide more of an advantage than impediment.

In the civil law systems of most of continental Europe, in which the judge or other judicial officer takes charge of collecting the evidence through a series of hearings, and in which the standards are set primarily through statute and regulation and much less by judicial interpretation, there are rea-

sonably comprehensive rules governing confidential information. Discovery as we know it is virtually nonexistent, but remedies can be swift and effective when the necessary facts are known.

To understand the situation in most of Asia, one needs to appreciate that the countries of that region do not share the Western cultural history of intellectual property. For many Asian people, the very notion of "owning" ideas seems odd. Although the industrial revolution has by force overtaken this philosophical viewpoint, that does not mean it deserves no respect; and, more importantly, we must remember the point when purporting to judge how far and fast the Asian nations have come in accommodating the prevailing Western view. With that background, it can be said that, until the second half of the twentieth century, trade secret protection in Asia was a matter of private business dealings, with the law intervening only in a relatively haphazard and unpredictable way. Beginning in the 1990s, international pressure (primarily from the United States) has wrought major change, as trade secret protection laws have been enacted in most major Asian countries. Enforcement remains a prickly issue, however.

In the developing nations of the world, intellectual property law is often seen as a primary means of continued economic domination by the industrialized countries. The rhetoric has been intense, directed mainly at patent rights and the developing countries' attempts to limit terms of protection and to impose compulsory licensing to domestic firms. In the field of pharmaceuticals, this campaign has been waged in the name of public health and the inability of poor people to afford the "retail" price of proprietary formulations. But in other areas, and broadly in relation to secret technology and know-how, the main theme has been the need to build domestic industries, and the frustration at remaining mired in their dependency on imports from the first world. Thus, what may seem to us as straightforward issues of protecting investment are to many others deeply political matters closely tied to other aspects of international trade and development. The effort at harmonizing intellectual property laws has gone on in this environment.

Despite the challenges, it is encouraging to note that a great deal of progress has been made in recent years, and that the institutional pressure remains strong — in the United States primarily through the work of the U.S. Trade Representative — to follow through on the promise of the TRIPs agreement and bring us to a point where confidentiality laws are reasonably similar in scope and enforceable in reality. In the meantime, the basic

message to those dealing with trade secrets around the globe is this: Do your homework, and be careful about whom you trust.

II. Harmonization

It is perhaps difficult to understand, but until the groundbreaking approach of the NAFTA treaty, intellectual property issues in general, including trade secret laws, took a back seat to "larger" matters of transnational trade in the ongoing commercial spats and negotiations that have characterized modern international relations. Traditionally, trade secret rights outside the United States depended on what country you were in at the moment, often on what government was in charge, and sometimes on who you knew (or were willing to pay) in the government or business establishment. Investment in foreign manufacturing facilities in many cases was retarded by a fear of losing valuable process technology, either because the law did not provide reliable trade secret protection, or indeed because it demanded that secrecy be sacrificed to compulsory licenses and limited terms of protection. Thankfully, the drag that this chaotic and self-defeating situation created for growth in world trade has been recognized. The two most recent multilateral trade treaties entered into by the United States demand fundamental reform designed to bring consistency and reliability to the cross-border protection of intellectual property.

Before moving to the specific treaties, however, we should pause for one interesting and provocative observation. It has been suggested that the United States is itself out of compliance with these treaties because there is no federal civil trade secret statute. In part, for the formalistic reason that the treaties require that the signatories themselves provide the protection, but more so because of the disparate statutes, theories, and interpretations that form our "patchwork" collection of state laws, the United States arguably is now required to enact a broad federal civil statute similar to the Uniform Trade Secrets Act./1/

III. NAFTA

On December 17, 1992, the United States, Mexico, and Canada entered into a regional trading relationship through NAFTA. Directed primarily (and controversially) at eliminating tariff and other barriers to free trade in the North American continent, it also took aim at discontinuities in the level of protection for trade secrets, mainly between Mexico on the one hand and the other two countries on the other.

The first part of the primary relevant section (Article 1711) addresses protection against misappropriation. Trade secrets are defined under NAFTA in terms virtually identical to the Uniform Trade Secrets Act, expressing the three core elements of actual secrecy and actual or potential value, backed by reasonable protection efforts. The concepts of relative secrecy (bounded by ready ascertainability) and secrets consisting of combinations of known elements are both recognized. The signatory countries are required to provide legal protection for qualifying information as against unauthorized acquisition, disclosure, or use "in a manner contrary to honest commercial practices." However, an exception is provided that allows a country to require that secrets be reflected in a document in order to be protectable. This is a feature of Mexico's national law. Moreover, the definition of "contrary to honest commercial practices," as set forth in Article 1721, requires that a party know or be "grossly negligent" in failing to know that the information was misused. Arguably, this is a less demanding standard than the "know or should have known" criterion of U.S. law.

The second aspect addressed by Article 1711 is the duration of trade secret protection. The treaty requires that secrets be granted potentially perpetual protection and more generally proscribes any discriminatory or excessive limitations on the right to license trade secret information.

The third feature relating to trade secrets is a requirement that the signatory nations ensure confidentiality of information provided to government agencies as part of a licensure process. Allowable protection depends on the data having been developed with "considerable effort"; and there are exceptions to secrecy when disclosure "is necessary to protect the public." However, these limitations are reasonable on their face and, presumably, will not be abused in practice. Competitive reliance on information filed with an agency must be prohibited for "a reasonable period," which will "normally" be at least five years.

Regarding enforcement, Article 1716 of NAFTA requires that "judicial authorities" in member countries have the power to order injunctive relief to prevent violation of intellectual property rights. Mexico has amended its Law on Industrial Property to meet this requirement.

IV. GATT TRIPs

Annex C to the GATT of April 15, 1994, which brought to closure the

long-running Uruguay Round of discussions and established the World Trade Organization (WTO), is titled "Trade-Related Aspects of Intellectual Property Rights" and is referred to as TRIPs.

Given the number of signatory nations, and more importantly the number of countries that want to become members of the WTO, the terms of this treaty give us probably the most reliable window on the future of global harmonization of intellectual property rights. Counsel should keep in mind that the transition provisions of the treaty (Article 65) permit varying periods for a member country to come into compliance, depending on whether it is a "developing country" or in the "process of transformation" to a market economy (five years), or a "least-developed country" (ten years). However, the other benefits of becoming a member of the WTO are apparently sufficiently attractive that many developing countries have moved to amend their laws to (apparently) comply.

Article 39, ¶ 2 is the basic section defining trade secrecy. Although it speaks in terms of "undisclosed information," the nature of the rights protected is clearly what we know as trade secrets. As with NAFTA, TRIPs recognizes the fundamental elements of relative secrecy, value, and reasonable steps to maintain secrecy. It also employs the same qualifier of "contrary to honest practices," which is defined in a footnote as meaning "at least practices such as breach of contract, breach of confidence and inducement to breach, and includes the acquisition of undisclosed information by third parties who knew, or were grossly negligent in failing to know, that such practices were involved in the acquisition." Thus, the same concern exists that this may express a lower level of protection (by raising the measure of culpable conduct) than that which is generally supplied under U.S. law. Moreover — and this is not an issue with NAFTA — it expresses the element of "value" without the additional clarifying phrase "actual or potential." This coverage for not-yet-commercialized secrets, or "negative secrets," is a very important aspect of our modern law on trade secrets,/2/ and it would significantly diminish the minimum level of protection required by the treaty if the wording of this section were to be interpreted too narrowly.

Article 39 also contains language, virtually identical to that found in Article 1711 of NAFTA, directed at assuring the confidentiality of information submitted to government agencies. Although there is no separate provision prohibiting national laws that would set an arbitrary duration for secrecy, the same effect seems implied by the language of ¶ 2, which requires

member countries to protect undisclosed information "so long as" it meets the basic requirements of a trade secret.

Article 41 contains the primary provisions directed at judicial enforcement. It requires that member nations provide remedies that are "fair and equitable" and not "unnecessarily complicated or costly, or entail unreasonable time limits or unwarranted delays."

Other basics of due process, such as a written decision based only on the evidence and the availability of appellate review, are mandated. These requirements are explained in Article 42, which guarantees written notice of claims, representation by counsel, and procedures to protect the confidentiality of information in litigation, "unless this would be contrary to existing constitutional requirements." Article 43 requires the availability of subpoenas for evidence and permits summary judgment. Broad judicially imposed injunctive relief, including orders barring importation of goods that "involve the infringement of an intellectual property right,"/3/ is provided by Article 44, so long as the defendant at least had "reasonable grounds to know" of the infringement (curiously, the "gross negligence" standard of Article 39 is not carried over). Paragraph 2 of Article 44 permits a royalty in lieu of injunction in limited circumstances./4/

The right to recover compensatory damages is guaranteed in Article 45, which again is subject only to the limitation that the infringer knew "or had reasonable grounds to know" of the infringement. Awards may (according to national law and the discretion of the judicial authority) include costs, attorneys' fees, and (without regard to the defendant's knowledge of infringement) statutory damages. Article 46 requires that the courts have the power to order seizure and sale of "goods that they have found to be infringing," as well as equipment used in the production thereof, while Article 47 permits member countries to require an infringer to identify others who have been involved in infringing activity. Article 48 covers bonds, and Article 49 addresses administrative procedures. Finally, Article 50 requires that judges be given the power to make provisional orders preventing infringement and preserving evidence.

V. Transaction Strategies

As noted above, the international environment presently is a bit chaotic. Even where a country has introduced what looks like a familiar set of rules

for the protection of confidential information, there is usually a substantial question as to whether those rights can be effectively enforced. In many countries of the world, what we regard as strictly business matters may evoke the strongest of public policy concerns relating to employee rights and political issues, such as national economic dependency. Nevertheless, business life goes on, and the increasingly global scope of commerce requires that most companies give serious thought to how their confidential information can travel overseas and remain intact./5/ This issue comes up in a variety of contexts, including distribution and sales agencies and subsidiaries, direct customer relationships, manufacturing facilities, joint ventures, outsourcing support functions, and research activities.

Important trade secret questions also arise when the company wants to (or is forced to) grant a license for its technology. In some countries, the price of establishing a business may be a requirement to sell a portion (sometimes a controlling portion) to a local citizen or corporation, or to form a partnership in which the relevant technology must be provided under license. That same country, or others in which the company actually wants to license its information, may provide by law that confidentiality agreements (including the nondisclosure provisions of licenses) may last no longer than a set number of years, following which the information may be used and disclosed without compensation. Finally, many countries regulate technology licenses that may have an anticompetitive effect on their markets, such as through contractual territory or use restrictions. These issues should all be examined before entering a given jurisdiction.

VI. Protecting Trade Secrets Abroad

Given the complications and uncertainties involved in cross-border technology transactions, one obvious approach is simply to stay home, but that is usually not a realistic option for a thriving and growing business. Rather than avoid foreign entanglements altogether, a business may want to consider the following suggestions:

— Choose your markets carefully. Stay out of countries that do not appear to have a legal system that enforces confidentiality obligations.

— Choose your licensees and outsourcing vendors carefully. Investigate their reputations, as well as their business relationships that may imperil the security of the company's data. If the information is extremely

important, investigate their principals as well. And, choose your investigators carefully.

— Choose overseas employees (including employees of subsidiaries and affiliates) carefully. Do extensive background checks before hiring local managers, and supervise their work to be sure that they respect the need to keep information confidential.

— Have foreign employees, especially managers, sign written confidentiality agreements. Some jurisdictions may be more willing to consider the issue as a matter of contract, rather than an implied-in-law obligation of confidentiality.

— Require licensees, vendors, and business partners to enter into appropriate confidentiality agreements with their employees. Monitor compliance regularly.

— Provide only the kind and amount of information that is necessary to support the relationship. This is true both for direct employees and contracting firms. Make sure that the people who are responsible for the overseas operation or transaction are sensitive to this issue, and that they track carefully what is made available (as well as what is requested).

— Specify, by contract, that the information can only be disclosed to a certain number of people, or to named persons.

— Specify, by contract, the facilities, computer, and communications security measures that must be taken in the foreign jurisdiction to protect the information.

— Mark all sensitive documents with prominent confidentiality warnings. For especially important documents, individually number copies and prepare them on special paper that cannot be copied.

— Do not reveal extremely sensitive information using the telephone or Internet. Lines are tapped in some countries. Where possible, encrypt electronic communications.

— Have foreign offices “swept” for listening devices. Do not discuss

extremely confidential information in hotel rooms; use an isolated corner of a public place instead.

— Consider separating information into modules. Some companies have deliberately split their overseas manufacturing operations into pieces, each located in a different country, in order to reduce the temptation and the risk. Within any single affiliate or licensee, try to structure the relationship so that no single person has access to all the important data.

— Create a structure in the transaction that gives the business partner an incentive to respect the company's rights. Sometimes this is as simple as requiring each side to create and share confidential data. Individual managers can be provided incentives to maintain security.

— Provide by contract for U.S. law and jurisdiction for dispute resolution. Consider whether to require arbitration of disputes through an international organization.

— Include penalty clauses in contracts, with specific dollar figures, in the event of disclosure or misuse.

If it comes to a dispute, retain local counsel who has a successful record in trade secret matters.

VII. Litigation Strategies

It may seem obvious, but bears emphasis, that the best place for U.S. companies to litigate is generally in the United States. Even in situations in which the relevant activity has gone on in a foreign jurisdiction where most of the witnesses are located, or in which the company's local manager would like to pursue local legal solutions, the better decision is often to take the case to a U.S. court or agency. There are three main reasons. First, this is a familiar jurisdiction with familiar processes and outcomes. Second, remedies here are for the most part reasonably effective: plaintiffs can get discovery (frequently very important in trade secret cases, where many of the facts may be exclusively in the hands of the defendants); injunctions are available; and the case will usually be resolved within a reasonable amount of time. Third, and perhaps most important, what happens in this country probably will matter most to the other side in the dispute, since the United States is the world's biggest single market.

There are occasions when the possibility exists for parallel proceedings in this country and a foreign one, either because an action was started there first, or because there are remedies or strategies that can be pursued uniquely in each venue. However, this approach should be examined very closely — especially if the foreign proceeding has not yet been instituted. The pendency of a lawsuit overseas on a closely related matter may be sufficient reason for a U.S. court to stay part or all of the action here./6/ If the U.S. action is stayed, the trade secret plaintiff will likely lose the ability to get effective discovery.

VIII. Procedural Issues

The threshold issue in most transnational litigation is personal jurisdiction. In many trade secret cases, the dispute arises between entities that, in the process of negotiation, had visited each other's home facilities. If in the process of coming to this country, the defendant executed a nondisclosure agreement, jurisdiction most likely can be asserted here./7/

Closely related to jurisdiction is service of process, which for the most part must be accomplished in accordance with the provisions of the Hague Service Convention./8/ However, service by letters rogatory pursuant to state statutory procedure may be sufficient./9/ And, of course, the preferred method is to serve personally the company's officer who is present in the United States./10/

Discovery has already been mentioned as an important advantage to proceeding in a U.S. court. In order to realize that advantage to the fullest, one has to be able to obtain discovery from foreign nationals. As to the defendant and its overseas affiliates, that may not be too difficult since the domestic court maintains the power to compel compliance with discovery orders against parties over which it exercises personal jurisdiction./11/ This may even apply to ordering discovery methods overseas that are prohibited by the laws of the relevant country./12/

IX. International Trade Commission

One option for litigation against international misappropriation of secrets is to try to seal the border against the entry of offending products. This is accomplished through the International Trade Commission (ITC), under the authority of § 337 of the Tariff Act./13/ The major advantages of an ITC pro-

ceeding are speed (most investigations must be completed within one year)/14/ and enforcement (an exclusion order will be enforced at all ports of entry into the United States by the U.S. Customs and Border Patrol). Moreover, nationwide service of process is available for ITC subpoenas for document and deposition discovery./15/

Jurisdiction exists with the ITC to protect domestic markets against "unfair acts," which include intellectual property infringement in general, and trade secret misappropriation in particular./16/ However, there must be a causal link shown between the misappropriation and the act of importation. Unlike statutory claims for patent, copyright, and trademark infringement, trade secret cases will be considered under the more stringent test of injury to a domestic industry that generally prevailed before the Omnibus Trade Act of 1988./17/

X. Selected Foreign Jurisdictions

In providing a very brief overview of the trade secret laws of foreign jurisdictions, your author takes the risk of getting it wrong, since he is qualified only in the United States, and because there often are important nuances of local practice that are not apparent from the text of a published statute or summary. In addition, foreign laws change, and we are in an especially dynamic period now, given the recent focus on harmonization through the force of multinational treaties.

Therefore, it is critical that the reader, before doing more than getting a general direction or satisfying a casual curiosity, secure advice from a lawyer resident in the relevant country./18/

A. Canada

One unusual aspect of Canadian trade secret law is the existence of dual systems. While Quebec is a civil law jurisdiction with its own Civil Code, the other provinces of Canada base their rules on the common law of England. Nevertheless, in general, trade secret protection is governed by the same basic principles, and is virtually as robust and predictable in its enforcement, as it is in the United States. There is no statutory regulation of trade secret misappropriation in Canada, either as to private liability or under the criminal laws. Moreover, the general theft statute has been held not to apply to "intangible" information.

B. Mexico

Mexico is a civil law jurisdiction, but before it entered into negotiations toward NAFTA, Mexico's laws did not include any provision specifically directed at the protection of trade secrets. Consistent with its obligations under the treaty, Mexico has enacted a reasonably comprehensive statute that employs a broad definition of a trade secret. However, it applies only when the secret information is reflected in some written document or other tangible record. Mexico simultaneously enacted a criminal trade secret theft statute. As a direct result of NAFTA, judicial issuance of preliminary injunctions against intellectual property violations is permitted (this had been allowed, if at all, through the Mexican Institute of Industrial Property).

C. Brazil

As of May 1996, Brazil — a country that had been fairly notorious for its negative views concerning intellectual property in general — enacted comprehensive legislation in the area, titled the "Industrial Property Law."/19/ Article 195 addresses "crimes of unfair competition," defining (in ¶¶ X-XII and XIV) trade secrets in terms similar to the TRIPs requirement, with one major exception. It expressly does not apply to information "which is obvious to a person skilled in the art." This notion, borrowed from the patent law, substantially reduces the basic level of protection by introducing an element of novelty. As a result, an accused misappropriator in Brazil will, in many cases, be able to provide a convincing account of obviousness that is informed primarily by the very information with which he or she was entrusted. If the corporate plaintiff is able to establish misappropriation, however, it should (theoretically) be able to recover damages measured broadly by its own loss or the defendant's gain.

D. Japan

Japan amended its Unfair Competition Prevention Law on June 15, 1991, to include, for the first time, specific provisions directed at trade secret misappropriation. Although Japan had long been one of the world's leading economic powers, it might be argued that its extremely stable employment system, with employees rarely shifting jobs, made the regulation of trade secret loss much less compelling. In any event, the Japanese law is remarkably similar to the Uniform Trade Secrets Act, after which it was modeled. The law is quite comprehensive, providing for injunctive and damage remedies. But there has not been extensive use of the new legislation through court filings. The major difficulty with trade secret protection in Japan seems to be that enforcement is extremely risky, since the Japanese

constitution guarantees that court proceedings will be open to the public. Perhaps, with practical solutions to this apparent dilemma, the statute will be invoked more often.

E. China

China, potentially the largest single market of the twenty-first century, adopted its Anti-Unfair Competition Law effective December 1, 1993. This is the first law in China to address the issue of trade secrets, which is an important area of legal protection there, given the limited nature of patent rights./20/ The law defines trade secrets in terms that appear to meet the TRIPs formulation. Article 10 defines "infringement of a trade secret" as

(1) acquisition from the owner by theft, bribery, coercion, or other improper means;
(2) disclosure or use (or allowing others to use) following an improper acquisition;
(3) disclosure or use (or allowing others to use) in breach of an agreement or duty to maintain secrecy; or
(4) acquisition, use, or disclosure by a third party who knew or should have known of its improper provenance.

Thus, the Chinese legislation seems to cover misappropriation to the same extent as U.S. law. Alleged infringements may be the subject of an action in the People's Court, or can be handled through an administrative authority. Stated remedies include fines, damages (including disgorgement of the infringer's gain), injunctions, and seizures of tainted property.

Although no studies are yet available to confirm the effectiveness of the new law, there has been at least one appellate decision construing the statute expansively and confirming that its penalties apply to individuals as well as to entities./21/ China's commitment is also evidenced by regulations issued in 1995 clarifying the statute, and by an addition to China's Criminal Law (Article 219) that took effect on October 1, 1997, providing for significant prison terms for infringement of trade secret rights.

F. Taiwan

Effective January 19, 1996, Taiwan's new Trade Secrets Act meets the definitional standards of TRIPs. It even goes further, addressing issues of ownership of information developed during employment (presumptively belongs to the employer) and the employee's rights to independent inven-

tions. It also specifies what is known in the United States as a "shop right" of the employer. Joint ownership issues are also considered in the business-to-business context, defining joint venturers' rights and providing something like a shop right to a company hired to help develop a product, unless the contract provides otherwise. The term, territory, and scope of licenses to secret information are to be determined according to the contract. Secrecy in administrative and judicial proceedings (and arbitrations) is assured through provisions imposing confidentiality on participants and permitting closure of the court and relevant public files.

Acts of misappropriation and remedies are defined according to the minimum standards of TRIPs, with one possibly disturbing exception. Article 10 (which specifies unlawful activity) provides for liability for use or disclosure of entrusted information "without due cause." It remains to be seen whether this unusual proviso will become an exception which in practice swallows the rule. There is a statute of limitations, requiring assertion of a claim within two years of knowledge or ten years of the misappropriation.

G. Korea

Like the other leading Asian industrial economies, Korea has enacted a law directed at unfair competition and included provisions directed at trade secret misappropriation. As of December 15, 1992, Korea modified its basic Unfair Competition Prevention Act, defining "trade secrets" as technical or "managerial" information (including production or marketing methods) that meet the familiar criteria of relative secrecy, value, and protection efforts by the owner. With the exception of the "gross negligence" standard that apparently was by then part of the TRIPs discussions, the standards for determining a misappropriation seem equivalent to those in the Uniform Trade Secrets Act.

H. European Union

Trade secret laws in Europe are established and enforced by each separate country, some of which are noted briefly below. However, the issue of potentially anticompetitive use of secret technology — along with other forms of intellectual property — through licensing is a matter of Community-wide concern. Article 85(1) of the Treaty of Rome voids restrictions on competition. Article 83(3) exempts restrictive agreements with certain positive effects. Registration (notification) to the European Commission (EC) is necessary to find out if any given license agreement qualifies. To avoid an avalanche of individual filings (or massive noncompliance), the EC has

issued "block exemptions" that cover most restrictive terms in most kinds of agreements.

Regulations regarding "know-how" (trade secrets) and patent licenses are set out in EU Regulation No. 240/96, and should be reviewed for compliance before entering into any major license transaction.

I. United Kingdom

The United Kingdom can probably lay claim to the most well-developed law with respect to trade secrets; after all, that is where we borrowed the notion. The law, like that in the United States, is primarily derived from the decisions of judges in cases that come before them, most typically on injunction applications. A U.S. lawyer would easily recognize all the concepts that have come to reflect the English law on the nature of protectable confidential information. Remedies available include interlocutory injunctions, "Anton Piller" orders (in effect, civil search warrants), and damages measured primarily by the benefit to the defendant.

J. Germany

Germany, a civil law country, has no statute that uniquely applies to trade secrets as such. However, its general law against unfair competition provides for injunctive relief and damages against a "person who, in the course of business activity for purposes of competition, commits acts contrary to honest business practices." Section 17 of the same law provides for criminal punishment of an employee or apprentice who reveals the secrets of an employer or a third party who engages in intentional misappropriation for personal gain.

K. France

France, also a civil law jurisdiction, distinguishes between a trade secret, called a "secret commercial," and a professional secret, or "secret professional." The latter applies to doctors, lawyers, and others whose communications with their clients necessarily must be protected from disclosure in order for the relationship to function. The former is meant to apply to manufacturing or industrial secrets. However, case decisions have extended legal protection to confidential business information of the type that typically is covered under U.S. law. Under the French Labor Code, an employee who attempts to disclose a trade secret is subject to a fine and imprisonment. The Criminal Code also punishes theft and extortion involving trade secrets. Although there are no civil statutes expressly directed at trade secrets, liability

may be established under laws of more general application. Provisional injunctive relief and damages (usually measured as out-of-pocket or lost profits) are available.

ENDNOTES

/1/ *See* Pace, "The Case for a Federal Trade Secrets Act," 8 *Harv. J.L. & Tech.* 427, 450-54 (1995). The U.S. has enacted a criminal law, the Economic Espionage Act, which applies roughly the same definitions as the Uniform Trade Secrets Act. 35 U.S.C. §§ 1831-1839.

/2/ *See Restatement (Third) of Unfair Competition* § 39.

/3/ The broad wording of this provision is significant to trade secret rights, since the misappropriation may have occurred in the design or manufacture of goods. While the importation of those goods would not itself be an act of misappropriation, the property is recognized as having been tainted by the earlier act.

/4/ This approach is similar to that provided in the Uniform Trade Secrets Act.

/5/ For some companies, there is also the issue of whether they can send their information overseas at all, without permission from the federal government. The subject of export controls is beyond the scope of this article, but should be considered by any company that produces material or products covered under the Export Administration Regulations of the Department of Commerce.

/6/ *See, e.g., Mediterranean Enters., Inc. v. Sangyong,* 708 F.2d 1458 (9th Cir. 1983) (affirming stay of entire action in favor of arbitration of some claims in Korea).

/7/ *See Intek Corp. v. Southwest Pipe & Supply Co.,* 683 F. Supp. 1092, 1098-1100 (N.D. Tex. 1988) (denying motion to quash as to foreign defendant that signed a nondisclosure agreement, but granting as to defendant whose only connection with the United States was to send to the Patent and Trademark Office an assignment of patent application for recordation). *See also BP Chems. Ltd. v. Jiangsu Sopo Corp. (Group) Ltd.,* 285 F.3d 677 (8th Cir. 2002) (Chinese-owned business, through an agent, disclosed plaintiff's secrets to U.S. companies in the course of soliciting manufacture of components for plant in China, which was to use the secret process; although theft occurred overseas, disclosure in United States was separate act of misappropriation, and plaintiff could choose to plead that theory to avoid sovereign immunity defense).

/8/ "Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters," 20 *U.S.T.* 361. Note that it is entirely proper for a foreign defendant to insist on compliance with the Hague Convention requirements for service even when it owns a subsidiary that is a U.S. corporation. *Sheets v. Yamaha Motors Corp., U.S.A.,* 891 F.2d 533, 537-38 (5th Cir. 1990) (reversing Rule 11 sanctions).

/9/ *General Envtl. Science Corp. v. Horsfall,* 753 F. Supp. 664, 672 (N.D. Ohio 1990).

/10/ *Apollo Techs. Corp. v. Centrosphere Indus. Corp.,* 805 F. Supp. 1157, 1189 (D.N.J. 1992).

/11/ *General Envtl. Science Corp. v. Horsfall,* 136 F.R.D. 130 (N.D. Ohio 1991) (so long as the corporate party has practical control over the documents located abroad, it may be ordered to produce them).

/12/ *See Société Nationale Industrielle Aerospatiale v. United States Dist. Court,* 482 U.S. 522 (1987) (French "blocking" statute unsuccessfully asserted as reason for refusal to respond to interrogatories or produce documents).

/13/ 19 U.S.C. § 1337.

/14/ 19 U.S.C. § 1337(b)(1).

/15/ 19 U.S.C. § 1333(b).

/16/ *See In re Certain Apparatus for the Continuous Prod. of Copper Rod,* 206 U.S.P.Q. (BNA) 138, 157-58 (I.T.C. 1979) (refusing, however, under the circumstances of the case, to issue an exclusion order and instead making a "cease-and-desist" order; *see* 19 U.S.C. § 1337(f)).

/17/ *See* Gary Hnath & James Gould, "Litigating Trade Secret Cases at the International Trade Commission," 19 *AIPLA Q.J.* 87 (1991), which provides a comprehensive treatment of the issues.

/18/ One may also find more extensive reviews of the laws of these and other nations in the multivolume looseleaf work, *Worldwide Trade Secrets Law,* Terrence MacLaren (ed.) (Clark Boardman Callaghan 1993) (updated), which contains a collection of country-by-country accounts, each written by a lawyer admitted to practice in the particular jurisdiction. However, events are moving so quickly in this field that lag time in the publication of updates may make some of the material incomplete. Therefore, counsel should still make contact with a local lawyer on any matter of significance.

/19/ "Brazilian Industrial Property Law," No. 9279/96, translation provided by the Rio de Janeiro firm of Dannemann Siemsen Bigler & Ipanema Moreira (1996).

/20/ *See* John Vassiliades, "Investors in China Turn to Trade Secrets," *Intellectual Property World Wide (Law Journal Extra!*), Nov./Dec. 1996. This article also contains a good deal of practical advice for those contemplating trade secret licenses in China. One of these is to identify the subject matter in the contract as "developed and improved technology." Use of this description apparently will take the transaction out from under coverage of another law that limits the duration of a recipient's confidentiality obligations to the term of the contract.

/21/ See Xiaoguang Yang, "Protection of Trade Secrets in China," a paper that was presented on June 24, 1997, in Palo Alto, California, at 3. Mr. Yang is a patent attorney and vice president of the CCPIT Patent and Trademark Law Office in Beijing. The case referred to is *Xiamen Powder Metallurgy v. Xiamen Kaiyuan District Hengzhu Metallic Product Factory,* which was reported from the Supreme People's Court on September 19, 1994.

A Holistic Approach to Corporate Compliance and Dispute Management*

Susan R. Chema and Steven A. Lauer**

I. Introduction

Litigation is a fact of life for every corporation. The management of disputes (including litigation) is one of the most important responsibilities of a corporate law department. Mismanagement of disputes can lead to excessive cost, adverse results (such as negative findings by juries or judges, overly costly settlements, and equitable remedies that impact business operations adversely), and business relationships that are needlessly destroyed.

In-house attorneys recognize the importance of preventing disputes from

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** *Susan R. Chema is the Chief Litigation Counsel for NCR Corporation in Dayton, Ohio, where she has been employed since 1995. Previously, she was an associate with Smith & Schnacke LLP in Dayton, Ohio, served as a U.S. Naval officer in the Judge Advocate General's Corps, and was a litigation attorney in the General Counsel's Office of the U.S. Navy. Steven A. Lauer is Director, Integrity Research, for Integrity Interactive Corporation. Previously, he was a consultant to law departments (for approximately seven years), Deputy Editor and Publisher of* The Metropolitan Corporate Counsel *(for over two years), an in-house attorney (for over thirteen years), and in private practice (for six years). Questions about his article can be addressed to Mr. Lauer at slauer@i2c.com or (973) 207-3741.*

arising. The efforts by law departments to minimize the occurrence or likelihood of disputes — let's call those efforts "preventive" law or counseling — can include educational efforts, matter-specific counseling and product- or service-development contributions.

How can a law department effectively manage disputes so as to minimize adverse results and prevent similar disputes from occurring? The solution is a comprehensive, holistic approach to disputes. Such an approach brings to bear the multiple talents of both in-house and outside counsel and captures lessons learned from actual disputes to train employees and strengthen the business. Well-thought-out processes assure that appropriate tools are brought together to address disputes so as to resolve them in a manner that does not exacerbate the differences between the disputants.

Law departments of any size face the same issues and hurdles in managing disputes and litigation, though they differ, of course, in the internal and external resources that they can apply to the task. On account of its more limited resources, a small law department might need to rely on outside counsel to a greater degree than a department that has more inside attorneys and other support staff and services. A smoother relationship between inside and outside counsel, therefore, may be even more critical for a small law department than for its larger counterpart.

Whatever the law department's size, however, it should approach disputes consistently, applying an integrated approach from start to finish. Each element of a dispute prevention and management regimen should reinforce the other elements, rather than having the incentives or approach of one element undermine the efficacy of any other.

What are the basic components of such a comprehensive, holistic dispute-management protocol? While there are many steps that might be included within that term, the basic elements are

— efforts to make the company more legally aware and compliant in respect of the law-related issues and liability-creating situations that the employees likely encounter in their day-to-day activities;
— a means of consistently and effectively assessing the merits of each dispute (relative to other disputes in which the company is embroiled as well as the instant dispute on its own) early;
— a consistent method by which to select and retain outside counsel;

— an approach to disputes and litigation that treats each one as a project to be managed using relevant planning and budgeting tools;
— deliberate staffing of the company's dispute-management team for each matter;
— corporate attitudes and approaches (what we call the "ethos" of the company) that increase the chances that disputes will be avoided and, if they occur, are addressed appropriately;
— the proper use and application of information related to disputes; and
— well-designed corporate policies that extract information about the company's experience in each dispute so as to allow continuous improvement of its business processes based on experience.

While this may seem a daunting list, it is not as imposing as it may appear.

All the elements of the dispute-management protocol must be similarly "calibrated." If one element is effective only if the company emphasizes settlement rather than "scorched earth" litigation but another element of the protocol does not reward reasonable litigation tactics and instead rewards a "no stone unturned" approach, the inconsistency will be counterproductive (not to mention expensive). The entire protocol must be holistic and designed to have mutually reinforcing processes.

II. Litigation Management before Litigation Exists

The perspective of the company on certain issues will constitute an important part of a dispute-management regime. In certain circumstances, that attitude might enable the company to avoid litigation in the first place, which represents the most effective means of keeping litigation costs down. In order to accomplish that goal, however, it is usually important that the attorneys constitute an integral part of the company's approach to business, and that legal issues are integrated into the activities of the nonlawyers in the company./1/ If you identify and address legal issues early in the business development cycle, you are more likely to avoid problems that might lead to disputes and litigation. Not all companies, however, are equally open to such involvement by the lawyers, inside or out.

Effective training of employees on substantive legal issues can very effectively contribute to the prevention of disputes. Integrity Interactive Corporation offers online compliance training courses on subjects such as antimoney laundering, antiharassment, the proper use of e-mail, and intellectual prop-

erty, as examples. The more the employees understand the ways in which their day-to-day activities can intersect with legal rules, the better prepared they are to avoid such problems. From a dispute-management perspective, the subject of such training should also include company policies and procedures because inconsistent adherence to or application of those policies can lead to disputes with clients, customers, suppliers, and other business partners.

The company can deliver that training — the heart of a corporate compliance program/2/ — in a number of ways. In-person training can be most effective, particularly for the in-depth treatment of complex topics. Indeed, many law departments include that type of training in the services that they provide their in-house clients. In-person, face-to-face training, however, is very resource-intensive. When in-house attorneys are among the presenters of such training, the burden on the law department can be significant, especially if many employees in geographically dispersed locations require training.

Alternative training-delivery mechanisms exist. Computer-based training represents a much more cost-effective means of achieving consistent, trackable compliance training./3/ Such training can be delivered over the Internet, a corporate intranet, or by compact disc. Each method entails some administrative challenges and each offers some advantages. A combination of methods might best suit a particular company's situation. Each method may have particular strengths and weaknesses that you should consider when designing the compliance training for your organization./4/

An example of a training tool that is an integral component of a holistic dispute resolution process is the use of a "lessons learned/best practices" process. When legal disputes are resolved at NCR Corporation, for example, the law department attempts to capture the lessons learned from, or best practices associated with, each matter. This practice offers a mechanism for providing regular legal training to clients in the context of actual issues that the company faces today, and it is directed to those best positioned to learn from the case and to help the company avoid similar disputes in the future.

To summarize, a good training and compliance program comprises an important element of, or a perfect complement to, an effective dispute-management program. By ensuring greater compliance with both government-issued laws and regulations (the typical focus of a compliance program) and the

company's own policies and procedures, you should increase your chances of preventing disputes from arising or from rising to the level of litigation. If, despite that program, your efforts fail to prevent them from reaching a formal stage, however, a good training and compliance program should provide you with valuable ammunition in your litigation-related efforts./5/

III. Litigation Management Once Litigation Exists

Once a case against the company is filed, you need to manage that dispute as efficiently and as effectively as you can in order to reach the best resolution possible. This aspect of dispute management calls for the application of the project management techniques that we referred to above.

The early and periodic assessment of disputes is necessary in order for the company to deal with each one appropriately. You cannot treat a "bet the company" antitrust inquiry from a government agency as you would a routine "slip and fall" case because the risks that they present are so different. Conversely, to treat every dispute as if it were a torpedo aimed directly at the company's main engine room would lead to excessive cost. Even putting aside those extreme examples, obviously not every dispute deserves the same response. Adjusting the response to the dispute, however, requires an early understanding of the significance of the matter. That significance can be measured in terms of possible adverse consequences if it were to go to a jury or in terms of the amount of effort needed to resolve it.

At NCR Corporation, the law department prepares litigation risk assessments for lawsuits and disputes at the commencement of each matter. These risk assessments serve a number of purposes: they identify the general level of exposure associated with the case, they facilitate attorney-client communications, they identify factual issues the client may help address, and they assist in evaluating the return the company achieved in exchange for the fees spent to resolve the matter.

Determining whether outside counsel are needed to represent the company's interests in a particular dispute is one of the first decisions that in-house counsel must make when a dispute arises or appears imminent./6/ If in-house counsel has determined to retain outside counsel to represent the company, he or she must turn to the selection of appropriate counsel — the next major decision. This may also be the most important decision that in-house counsel must make in respect of the dispute, since the choice of counsel can

have a significant impact on the likely outcome as well as the cost of that outcome./7/ There are a variety of methods by which to make that choice, each method having its own strengths and weaknesses./8/ The appropriateness of each method depends on the situation, so it is important to understand the strengths and weaknesses of those selection tools prior to selecting from among them.

A holistic dispute-management process will capture the results of past disputes to assist in the selection of outside counsel for new matters. For example, NCR's law department tracks outside counsel performance in selected areas, such as accuracy of budgeting and return on investment. Return on investment is derived by applying a ratio that compares the variation between the expected value of the case and the actual outcome with the amount spent to achieve that outcome. Armed with this information, the law department is well positioned to select the best performing lawyers to handle new cases and to identify outside counsel that are not achieving comparatively strong results. Before retaining a new counsel that has not previously represented the company, NCR's law department seeks to ensure that the prospective new counsel understands the company's requirements and is likely to meet them. This process provides a principled and effective structure for selecting, and maximizing the use of, the best performing outside counsel.

Once you have selected outside counsel, the retention letter is your first opportunity to provide outside counsel a comprehensive picture of the company's expectations *vis-à-vis* that representation. Through such a letter, you can lay the groundwork for a smooth, successful, client/counsel relationship. Moreover, in order to prepare a good retention letter, a law department needs to think through the work that it plans to assign to outside counsel as well as the ways in which inside and outside counsel will jointly represent the company in the course of that work. Some of the subjects that it should address in the letter are

(1) the scope of the representation;
(2) expectations regarding budgeting and assistance in the risk assessment process;
(3) the basis by which the fee will be calculated;
(4) the company's policy regarding conflicts of interest on the part of outside counsel;
(5) the extent of outside counsel's responsibility; and
(6) the client's and the firm's respective rights to terminate the relationship.

The department should convey to outside counsel very early in the representation the company's attitude toward disputes (*e.g.,* does it take a "not one cent in blood money" approach, or does it want counsel to assess every dispute's potential for settlement before plunging too far into the merits and details of the case), either in the retention letter or in guidance that it provides counsel at about that same time.

The difficulty of controlling the cost of litigation underscores the importance of creating an environment that is very conducive to efficiency and cost control. An effective way to do this is to apply some project management techniques to the task. Foremost among those techniques are budgeting and planning. Those two disciplines can provide the information and means to exert control of a project (and litigation is a project, make no mistake). You must balance cost and thoroughness in managing litigation./9/

Staffing for litigation, as for any sizeable project, should be deliberate, not undisciplined. Having the appropriate law firm involved in your case is an important first step, but making sure that the appropriate individuals are handling the work is an often-overlooked part of the solution./10/ The larger and more involved the case, the more critically you must review the makeup of the team to assure that it includes the correct mix of talent and experience. Try to achieve consistency in staffing because turnover leads to greater cost and greater risk. When considering the roles of various individuals and organizations in managing litigation and representing the interests of the company, do not forget to integrate the business unit personnel into the team./11/

The existence of a dispute (whether or not it ripens into litigation) often means that the business could learn a lesson. Unfortunately, few companies have a programmatic method of extracting those lessons from their litigation or other disputes. From a total quality management perspective, however, a company should identify those lessons and incorporate them into improved business procedures so as to avoid repetitive errors. A systematic approach to doing so on each dispute, such as conducting a "post mortem," can provide very valuable benefits, as discussed above./12/

In order to manage disputes, you need information. You need information about each dispute as well as about all of them. A database that includes information about the entire range of disputes to which the company is a party is critical, particularly in order to identify trends or common issues that might

otherwise escape notice. In constructing and implementing a database, however, take into account privilege issues so as not to create a valuable "road map" for other parties.

Law departments often use a great deal of legal research on important issues that arise in litigation and other matters. All too often, however, the substance of that research (which in some instances represents a considerable investment) is lost to future use once it enters corporate files. The capability of identifying the existence of useful research previously completed and paid for, and being able to retrieve that research from those files in a timely fashion, can be a very valuable asset.

Information that is unavailable to those who would be its immediate users does not qualify as useful information. For that reason, it is important to make information directly available to the "frontline" workers, whether they are outside or inside counsel. There are electronic tools available now for that purpose that did not exist just a few years ago./13/

A business executive is rumored to have remarked (perhaps apocryphally) that lawyers are the only group that can take an unlimited budget and exceed it. If that is the view of corporate management about legal budgets generally, it is even truer of litigation budgets and, within the context of litigation, of discovery efforts. Developing a consistent, centralized approach to discovery can save money and increase the chances of success considerably. Discovery can also be the cause of considerable adverse consequences, such as sanctions, if improperly done. Major corporations have been subjects of severe penalties for discovery lapses.

Think about adopting a more strategic approach to discovery. Especially for firms that face multiple lawsuits that raise similar issues or relate to similar information, approaching discovery on a multimatter basis offers cost savings as well as potential improvements in results. The possibility of inconsistent production of documents, including privileged documents, constitutes a real concern when the production of those documents is managed only on a case-by-case basis by multiple law firms that handle those discrete cases for the same company. By assuming more control of the document production process, a law department might achieve lower costs for that process (less duplication of the same documents, fewer reviews of the same information for privilege and other issues, etc.) and less chance for embarrassing mistakes (or worse, such as charges of spoliation).

Each law department should expend effort to develop corporate policies in respect of some issues that, while not central to litigation management, are closely enough related as to have potential impact (positive and negative) on the costs or results of litigation. Among these are the bases on which the law department reports to management about its management of disputes, the scope of authority of the lawyers (inside and outside) in respect of strategic and tactical decisions, the division of responsibility for the legal service and associated tasks between inside and outside counsel, policies *vis-à-vis* early dispute resolution and alternative dispute resolution, and evaluation of outside counsel./14/

Another, often-forgotten exercise consists of the metrics by which a law department measures its progress in litigation./15/ The metrics should serve several purposes. First, they should dovetail with the reporting that the law department provides to senior management of the company. Second, they should provide the department an effective means to compare its results from year to year in order to identify trends in the company's dispute experience as well as the effectiveness of the department's efforts. Third, the metrics should correlate well with the expectations that the department has expressed to outside counsel *vis-à-vis* their performance for the company so as to enable the law department to provide them effective and useful evaluations and reviews.

IV. Summary

In-house counsel should view all disputes, whether or not they have ripened into litigation, as stages along a continuum in the parties' relationship. Do not forget to consider whether an ongoing business-to-business relationship constitutes a desirable and possible result despite the dispute or litigation. In any event, treat disputes as "litigation to be" and design your procedures to address them in that fashion. To the degree that you create a holistic approach to disputes, the company likely will be better off and better prepared to emerge with minimal damage to its business and its reputation.

What does all this mean? Dispute management encompasses more than litigation management. It even extends to an earlier point in time, prior to the existence of disputes, because dispute prevention is, in fact, the most effective form of dispute management. Compliance, including effective compliance training, represents a core element of such a program.

ENDNOTES

/1/ Dembiec, "Manage Your Case before It Starts," 35 *House Counsel* (Winter 1999).

/2/ "Training Is an Important Element of Any Ethics and Compliance Program." LaJoie & Lauer, "Business Ethics and Compliance — Establishing an Effective Program," Vol. 34 No. 3 *Law. Brief,* Feb. 15, 2004, at 2. This is consistent with the views of government officials. The Office of the Inspector General of the federal Department of Health and Human Services, for example, has indicated in guidance documents that "[a] critical element of an effective compliance program is a system of effective organization-wide training on compliance standards and procedures. In addition, there should be specific training on identified risk areas, such as claims development and submission, and marketing practices." See page 8 of "Corporate Responsibility and Corporate Compliance: A Resource for Health Care Boards of Directors," which is posted at <http://oig.hhs.gov/fraud/docs/complianceguidance/040203CorpRespRsceGuide.pdf>.

/3/ Trackability of compliance training will serve a valuable role in light of the accountability of senior management and members of the board of directors for the effectiveness of a company's compliance program under the new standards established by the U.S. Sentencing Commission. See, for example, § 8B2.1(b)(2)(A) of the Sentencing Guidelines for Organizational Defendants (approved Apr. 8, 2004): "The organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program." Data generated by an Internet-based training system can provide metrics that enable the members of the company's governing authority to be knowledgeable about the status of the compliance-training program and, thereby, exercise their oversight responsibilities.

/4/ The federal Occupational Safety and Health Administration believes that computer-based training cannot convey to employees necessary information about safety appliances as well as in-person training and hands-on exercises. See, for example, <www.osha.gov/pls/oshaweb/owadisp.show_document?p_table=INTERPRETATIONS&p_id=21635>.

/5/ The relationship between a firm's compliance program and its litigation-risk profile highlights the need to broaden your perspective when analyzing staffing and other issues related to those two efforts, such as reporting relationships. While the entire range of issues that you should address is broad, your time devoted to exploring them will be well spent. *See* Lauer, "Think Strategically — Plan!" Vol. 19 No. 4 *Corp. Couns. Q.,* Oct. 2003, at 56.

/6/ Lauer, "The Evaluation of Cases Is a Critical Element of Litigation Management," *In-House Practice & Management* (Altman Weil), Jan. 1999, at 9.

/7/ *See* Lauer, "What Is the Most Important Task of In-House Counsel?" Vol. 19 No. 2 *Corp. Couns. Q.,* Apr. 2003, at 73.

/8/ Lauer & Stock, "Make Your Selection of Counsel More Than a Beauty Contest," *Canadian Corp. Couns. Prac. Manual* (Dec. 1998), § 3.3.1.

/9/ *See* Lauer, "Litigation Planning and Budgeting — The Use of Task-Based Budgeting to Manage Litigation," *Law Dep't Mgmt. Adviser,* May 1, 2002, at 8.

/10/ Whether you subscribe to the approach that you "hire the lawyer" rather than the law firm or you select the firm first, you at least must take into account both when making your counsel selection.

/11/ *See* Lauer, "In-House Counsel, Executive Must Play Strong Role: To Win in Litigation, All Players Must Take the Field," Vol. 2 No. 8 *U.S. Bus. Litig.,* Mar. 1997, at 16.

/12/ A "post mortem" can constitute an important element of a total compliance program, which should include remedial steps by which to prevent a recurrence of the noncompliant event or act. The dispute-management "post mortem," therefore, offers an opportunity to combine the compliance and dispute-management regimes. Inasmuch as the Sentencing Commission's new changes to the Sentencing Guidelines require that an organization conduct periodic evaluations of its compliance program for that program to be effective, "post mortems" will also serve a very valuable purpose in that context as well.

/13/ Lauer, "Improving the Client/Firm Relationship with Technology," *Law Dep't Mgmt. Adviser,* Dec. 1, 1999, at 13.

/14/ *See* Lauer, "What Business Can Teach Law," *Legal Times,* Sept. 22, 1997, at 25; and Lauer, "What Is The Most Important Task of In-House Counsel?" Vol. 19 No. 2 *Corp. Couns. Q.,* Apr. 2003, at 73.

/15/ *See* Lauer, "Measuring the Value of Metrics," Vol. 16 No. 3 *Corp. Couns. Q.,* July 2000, at 50.

Request for Production of Documents Can Be a Technology Trap*

Donald A. Wochna**

Traditionally, litigators obtain relevant documents from their opponents by issuing a Request for Production of Documents. Although the Rules of Civil Procedure mandate the disclosure of relevant, nonprivileged documents,/1/ it is a rare case in which an opponent copies all relevant documents and provides them in response to the first request. Usually, counsel must make several phone calls, write letters, monitor the partial responses provided, and constantly work to obtain as complete a production of documents as possible.

The use of computers to create, process, and store data has placed additional burdens on attorneys. Attorneys now must understand some basic computer concepts in order to determine whether they are receiving a proper production of documents. For example, most attorneys know that "deleting" a document does not remove the document from the computer's hard drive. The document remains stored on the computer, but is merely rendered "invisible" to the operating system. Because deleted documents are invisible to a computer's operating system, a party cannot produce deleted documents in response to a request for production of documents. In the past, therefore, deleted documents have usually been ignored and left behind — notwithstanding the fact that they were discoverable.

Deleted documents are not the only data that can be rendered invisible to a computer's operating system, and thereby left out of a standard production response. It is very common to have documents created on a computer using

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** *Donald A. Wochna is co-founder of Vestige, Ltd., a provider of computer forensic and electronic discovery services to the legal community, located in Medina, Ohio.*

a program that, at the time of the document request, can no longer read the documents. Accounting programs, for example, are updated each year. Some updates are not "legacy," meaning that the updated program cannot read and interpret old files. In some cases, the program used to create relevant files has been removed from the computer, and the computer simply cannot open or read those files. All this data is invisible to the operating system, insofar as this data will not be retrieved when searching the system for documents responsive to a document request.

Data with an inaccurate file extension is also "invisible" to the operating system. Simply changing the extension associated with a file (for example, changing ".doc" to ".jpg") will render the contents of the ".doc" file unintelligible to the operating system. This technique is a favorite among users trying to hide data. In some cases, these users also save the file (with inaccurate extension) in a folder used by the operating system, where one would normally never look for documents and data. These materials will not be produced in response to a document request.

Information that was never "saved" as a file by a user is also invisible to the operating system. Many attorneys are surprised to learn that a computer's operating system automatically saves data by writing it to the hard drive without any input from the computer's user. Almost all users, however, have seen this feature work, such as when a user recovers from a transient power loss that occurred while creating a brief or memorandum. When power is restored and the computer is rebooted, the operating system will automatically ask whether the user wishes to open the document that was being created when the power failed. This retrieved document will be available, even though the user had not saved the work. The retrieved document was created by the operating system automatically saving the work. If the user elects to ignore this retrieved document, the document remains on the hard drive, but is thereafter ignored by the operating system.

A computer's operating system also renders invisible large amounts of data used by the operating system to perform functions. For example, when printing documents, the operating system copies the data into a "spool file" — a file that the system will use to print, and afterwards ignore. After printing the documents, a copy of the document will remain in the spool file. Similarly, the operating system creates (and subsequently ignores) thousands of temporary, cache, buffer files, and other types of data used by the system to perform various functions. These are generally referred to as "artifacts" and can

be analyzed to determine the manner in which a computer was used. For example, operating system artifacts can prove that a user improperly copied customer lists to a floppy drive prior to leaving a company. Artifacts could also prove that a user had removed a hard drive from a system at a time when the user knew of pending litigation.

None of the data discussed above will be produced in response to a request for production of documents. While it is all discoverable, it is simply left behind on the hard drives of the relevant computers.

How important is the data? Experienced litigators know that the way in which an opponent has used its computer systems often provides a road map that proves essential elements of tortious conduct. Discovering the substance of deleted documents, instant messages, e-mails, etc., often provides a treasure trove of statements that support or contradict essential legal theories or strategies in a case.

Although attorneys agree that it would be very desirable to discover this data, most litigators have never tried to do so. This was because, until very recently, case law relating to production of documents did not seem to easily apply to data created, processed, and stored on computers. There was no set of procedures and protocols that an attorney could follow similar to the procedures related to requesting production of documents. Additionally, it appeared to many attorneys that it was unrealistic to request access to an opponent's computers because to do so would be disruptive, burdensome, overbroad, costly, and violative of privilege. Attorneys did not want to incur substantial research, time, and effort in motion practice to compel access where such motions did not seem likely to be granted. Most attorneys agreed that if they could economically obtain all the data related to a case (visible and invisible to the computer), without spending significant time and effort in motion practice, and without getting lost in the technical world of "computer-speak," they would pursue the production of all such data.

Within the last two years, federal and state courts have recognized technology and protocol that permit discovery of all relevant data, including the data rendered invisible to a computer's operating system. Attorneys can now obtain all relevant data in one simple, economical process that is nondisruptive, properly limited to relevant data, and protective of privilege. Fortunately, the process is very similar to that used by attorneys to request production of documents.

The process begins with either

(1) substituting for a traditional request for production of documents, a request to produce tangible things: to wit, all hard drives on which is resident data relevant to the claims or defenses in the case; or
(2) serving a traditional request for production of documents drafted to define documents as any medium upon which intelligence or information is recorded or from which intelligence or information can be recorded, retrieved, or perceived, with or without the use of detection devices, including detection devices other than the operating system and programs installed on any of the defendant's computers.

Note that the definition of "document" focuses upon the substance that carries the data. Paper, for example, is a medium on which data — intelligence or information — is recorded, and from which the data can be perceived by reading. Similarly, a hard drive in a computer is a medium on which is recorded data in the form of polarized, magnetic particles that can be perceived (*i.e.,* understood) using a computer as a detection device. This definition includes data that cannot be recognized using the producing party's computers. Courts have recognized, however, these data can be perceived using programs and software tools available to a computer forensic expert.

Using specialized forensic software tools, a forensic expert first makes a "clone" of those computers used by a party to create, process, store, archive, or otherwise manipulate data related to a particular case. These are the "relevant computers" in a case, and identifying them at the onset of litigation is the common objective of all parties and their attorneys. At the moment when a party knows or should know that litigation is anticipated, that party has a duty to preserve electronic evidence and prevent its spoliation. Continuing to use computers on which resides visible and invisible data that is relevant to a matter overwrites the data and causes spoliation. Thus, in order to prevent the spoliation of evidence, the parties must identify the relevant computers and thereafter take action to preserve the evidence on the relevant computers. Preventing spoliation can be accomplished by refraining from using relevant computers or by creating a forensic image of each of these computers. Because it is rarely acceptable to refrain from using relevant computers, litigants most often resort to forensic imaging.

A forensic image contains all the data — visible and invisible — residing on the relevant computers' hard drives. Once a forensic image of each

relevant hard drive is created, the computer can be returned to service because all the data have been "frozen" on the forensic image. The forensic image is an electronic "snapshot" of each of the relevant computers.

Making a forensic image requires a computer forensic expert to be granted access to the subject computer's hard drive for four to six hours. Access can be provided on-site, at a lawyer's office, at home, or at any location convenient for the producing party. To avoid disruption, access is usually granted at night, over a weekend, or during nonbusiness hours. The forensic expert will attach to the subject computer a "write-blocking" device which prevents any data from being written to or changed on the subject drive, while an exact, bit by bit image is copied onto a drive supplied by the forensic expert. If several relevant computers are involved in a matter, they can all be imaged simultaneously, so that making a forensic image of many computers can be accomplished in less than eight hours. The producing party and its counsel can observe the creation of the forensic image.

The last step in creating a forensic image is to verify the image. Verification is the process that embeds into the image a "digital DNA marker," termed an "MD5 Hash Value." This value can be used to prove that the forensic image has not been altered in any fashion whatsoever from the time of its creation.

After forensic images are made of each of the relevant computers, these clones are then simultaneously connected to a forensic lab computer so they can be electronically searched. Electronic searching is conducted by the forensic expert using powerful searching software that identifies and extracts only relevant data. No "fishing expedition" is conducted by randomly opening files or folders hoping to stumble across something relevant. Because relevant data are identified electronically, no person will ever view any data that are not related to the litigation.

Once the relevant information has been extracted, it can be compiled, parsed, and arranged so that the data intelligently reflect the issues in a case. At this point, the relevant data are usually placed into a report that can be read using a word processor. The report will contain exact copies of all relevant data, including all deleted e-mails, letters, memoranda, instant messages, etc. The report is then presented to counsel for the producing party so that counsel can redact the data for privileged matter. After redacting the data and creating any applicable privilege logs or reports as required by the court, the producing party provides the data to the requesting party.

The requesting party will receive all relevant data, including all data hidden, deleted, or otherwise rendered invisible to the computers of the producing party. The requesting party will receive, therefore, all the documents that would have been produced in the traditional manner, plus all documents and data that could not have been copied from the computers of the producing party.

This process is very quick. Imaging is usually accomplished in a matter of hours. Using software to electronically search and extract relevant data is completed within seven working days, including about twenty-five to thirty man-hours to analyze, parse, and compile the search results./2/ The initial report can be delivered electronically to counsel for the producing party, and is usually redacted in ten days. In almost all cases, litigators can have all the relevant facts within three to four weeks from the date of access to the computers.

The process is very economical. The process usually results in reducing the time spent on discovery disputes, while costing about 10 percent of the total legal fees incurred in a case.

ENDNOTES

/1/ This assumes counsel has defined the term document properly.
/2/ This estimate is applicable to cases in which the computers are being searched to extract data. It is more complicated and, therefore, takes more time for cases in which artifacts must be analyzed to determine the manner in which the computer was used.

Recent Developments Relating to the Attorney-Client Privilege

*William A. Hancock**

I. The Self-Evaluative Privilege

It has become fairly common for large corporations to undertake self-evaluative investigations into various aspects of their operations, such as the occurrence of accidents and the degree of compliance with federal law. When persons seek access to this investigative information in discovery, companies often argue that disclosure of the information would result in less candid self-evaluation in the future. Federal courts have exercised their discretion and refused to compel disclosure of the information in instances where the following factors are present:

— the confidential materials are of a self-investigative and self-evaluative nature;
— confidentiality is essential to the evaluative and investigative process; and
— the process serves a strong public interest that outweighs the discovering party's need for the documents.

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* *William A. Hancock is Editor and Publisher at Business Laws, Inc. and a member of the Ohio and California Bars.*

This protection has been given a variety of names by the courts and commentators including the "privilege of self-critical analysis," the "self-evaluative report privilege," the "self-critical subjective analysis privilege," and the like.

The self-evaluative privilege differs from the attorney-client privilege in that it does not depend on whether the internal investigation was conducted by a lawyer, nor on whether legal advice was sought or rendered as part of the internal review. It also differs from the work-product doctrine in that its application does not require that the investigation be done in anticipation of litigation. The privilege resembles the executive privilege, which protects confidentiality in order to preserve administrative integrity and encourage cooperation in government investigations.

One conclusion that can be drawn from the cases decided thus far is that ***the privilege is, at best, a qualified one.*** Qualified privileges may be overcome by a showing of sufficient need by the party seeking disclosure. Thus, ***courts will balance the litigant's need for the materials in a particular case against the public's interest in preserving the free flow of communication.*** In terms of sheer number of cases, it has to be said that while the majority of cases acknowledge the theoretical existence of the self-evaluative privilege, most usually come down on the side of requiring disclosure of the material. That has led most counselors to advise that it would be very risky to rely on the privilege, but, where appropriate, the privilege should at least be claimed. Following are two cases, one of which actually does hold that the privilege is applicable, so it would be a very good one for corporate counsel to have available.

In *In re Currency Conversion Fee Antitrust Litigation,* No. M21-95, 2003 WL 22389169 (S.D.N.Y. Oct. 21, 2003), the defendants asserted that material outlining certain problems with the defendants' currency conversion rates were self-critical in character and were, thus, exempt from production. The court, however, determined that the material was not protected.

> First USA relies solely on the self-critical analysis privilege, claiming that Item 2.2 is the product of "a voluntary, self-critical analysis of First USA's pricing practices." (First USA Opp. at 17.) The self-critical analysis privilege recognizes that in very limited circumstances, "an intrusion into the self-evaluative analysis of an institution would have an adverse effect on the [evaluative] process, with a net detriment to a cognizable

> public interest." *Trezza v. The Hartford, Inc.,* No. 98 Civ. 2205 (MBM) (KNF), 1999 WL 511673, at *1 (S.D.N.Y. July 20, 1999) (quotation omitted). First USA's argument, however, is unavailing.
>
> In the first instance, this court notes that the availability of the self-critical analysis privilege is an open question in this circuit. *Tortorici v. Goord,* 216 F.R.D. 256, 258-59 (S.D.N.Y. 2003); *see also Wimer v. Sealand Serv., Inc.,* No. 96 Civ. 8730 (KMW) (MHD), 1997 WL 375661, at *1 (S.D.N.Y. July 3, 1997) (the self-critical analysis privilege "has led a checkered existence in the federal courts") (collecting cases).
>
> This court need not reach this issue, however, because even assuming the availability of the privilege, it would not apply to Item 2.2 of Control No. 269A. Item 2.2 was not produced pursuant to any type of review that serves a "cognizable public interest" sufficient for the application of this privilege. *See, e.g., In re Salomon Inc. Sec. Litig.,* Nos. 91 Civ. 5442, 5471 (RPP), 1992 WL 350762, at *4 (S.D.N.Y. Nov. 13, 1992) ("[M]anagement control studies and internal audit reports are not the type of studies or reports whose flow would be curtailed if discovery is allowed.").

In *Robbins v. Provena Saint Joseph Medical Center,* No. 03C1371, 2004 WL 502327 (N.D. Ill. Mar. 9, 2004), the plaintiff sought to obtain complaints and related documents submitted or prepared in connection with the defendant's intracompany procedures. The defendant asserted that the materials sought by the plaintiff were protected from discovery by the self-critical analysis privilege. The court agreed.

> The purpose of the Self-Critical Analysis Privilege is to "protect from disclosure documents containing candid and potentially damaging self-criticism." Donald P. Vondergraft, Jr., Legal Development, "The Privilege of Self-Critical Analysis: A Survey of the Law," 60 *Alb. L. Rev.* 171, 175-76 (1996). The privilege is granted on the premise that disclosure of documents reflecting candid self-examination will deter or suppress socially useful investigation and evaluations. *Sheppard v. Consol. Edison Co.,* 893 F. Supp. 6, 7 (E.D.N.Y. 1995). Thus, "courts generally acknowledge that determining whether the privilege applies requires the court to balance the public interest in protecting candid corporate self-assessments against the private interest of the litigant in obtaining all relevant documents through discovery." *Morgan* [*v. Union Pac.*

> *R.R. Co.*], 182 F.R.D. 264 [N.D. Ill. 1998]. In determining whether the privilege applies, I must look at whether the party asserting the privilege establishes that: (1) the information resulted from a critical self-analysis taken by the party seeking protections; (2) the public has a strong interest in preserving the free flow of the type of information sought; (3) the information is of the type of information whose flow would be curtailed if discovery were allowed; and (4) the documents were prepared with the expectation that they would be kept confidential. *Id.* at 264.
>
> Here, I find that the ADOs [Assignment Despite Objections] and related information satisfy the four-prong standard for protection under the Self-Critical Analysis Privilege. First, Robbins' own characterization of the ADOs demonstrates that they are self-generated for the purpose of critical analysis. Moreover, the ADOs are utilized by a Patient Care Committee, which is made up of INA nurses and members of management of the Medical Center, to identify opportunities to improve patient care. Second, the public has a strong interest in preserving the free flow of such information because it can result in improved patient care. Third, the ability of litigants to use the forms against the Medical Center is a legitimate basis for the Medical Center to stop utilizing them. Finally, the documents are maintained in a confidential manner in that they are only distributed to employees of the Medical Center who have a need to know the information for purposes of improving patient care. Accordingly, the ADOs and related documents fit precisely within the definition of information protected by the privilege. [Footnote omitted.]

The court also noted that disclosure of the information was precluded under state statute.

> In addition to the common-law privilege, the Medical Center claims that the Illinois Medical Studies Act (the Act) also protects ADOs and related information from disclosure. The Act states:
>
> > [A]ll information, interviews, reports, statements, memoranda, recommendations … or other data of … health care delivery entities or facilities … used in the course of internal quality control or of medical study for the purpose of reducing morbidity or mortality, or for improving patient care … shall be privileged, strictly confidential and shall be used only for medical research, increasing organ and tissue donation, the evaluation and improvement of quality care, or

> granting, limiting or revoking staff privileges. Such information, records, reports, statements, notes, memoranda or other data shall not be admissible as evidence nor discoverable in action of any kind in any court.

735 ILCS 5/8-2101 *et seq.* The purpose of the Act is to ensure that members of the medical profession will engage in self-evaluation in the interest of advancing the quality of health care. *Doe v. Illinois Masonic Med. Ctr.,* 696 N.E.2d 707, 709 (Ill. App. Ct. 1998). In this case, the Act is applicable to the ADOs and related documents for the same reasons that the common-law Self-Critical Analysis Privilege applies. The ADOs constitute confidential information that is self-generated and used for the purpose of evaluating and improving patient care. Robbins contends that the Medical Studies Act does not apply because the Act only protects patient records, but I see no such limitation in the Act.

II. Crime-Fraud Exception

The crime-fraud exception to the attorney-client privilege is an evidentiary rule by which a court will permit the disclosure of otherwise privileged attorney-client communications where there is proof that the communications were intended to further a ***future*** or ***ongoing*** crime or fraud. The theory is that such communications do not enhance or further the policies underlying the attorney-client privilege.

The attorney-client privilege is based, in part, on the theory that society has an interest in protecting the confidences of a client who seeks advice about contemplated acts so that he or she can conform his or her conduct to the requirements of the law. In addition, given the nature of our adversary system, a client has a legitimate interest in securing informed representation without fear of compelled disclosure. On the other hand, society has no interest in facilitating the commission of crimes or frauds. The crime-fraud exception presumes that, by stripping improper communications of their privileged character, clients will not be so quick to run to counsel for unlawful purposes. If they choose to do so, the law will not protect them.

The policy of encouraging clients to confide fully in their legal advisers under a cloak of confidentiality goes against the general evidentiary policy of encouraging full disclosure of all the evidence in a case so that the truth may prevail. Since both policies are designed to advance justice, the

application of the privilege in a particular case often involves a balancing of the conflicting policies of full disclosure versus client confidentiality. When a crime-fraud situation exists, the scales tip in favor of the evidentiary/disclosure policy because the privilege policy is not being served.

A. Application to In-House Counsel

In *United States v. Cohn,* 303 F. Supp. 2d 672 (D. Md. 2003), the defendant and Four Star Financial Services, LLC were charged with mail and wire fraud for participating in the operation of a telemarketing scheme. The government requested that it be permitted to produce testimony and obtain documents from one of Four Star's in-house attorneys. The defendants objected to the government's request, asserting the attorney-client privilege. The court, however, determined that any attorney-client privilege held by the defendants with regard to the in-house attorney as vitiated by the crime-fraud exception.

The defendants responded that the court's determination would eliminate the availability of the attorney-client privilege between any company charged with a crime and the company's in-house counsel. The court disagreed.

> The crime-fraud exception does not apply because Pompei was in-house counsel, it applies because the evidence reveals that she was actively employed to advance Four Star's fraudulent telemarketing operations. To be sure, Pompei's contribution to the fraudulent scheme at Four Star is different from instances in which a lawyer furthered a criminal or fraudulent scheme through a specific act. *Cf. In Re Grand Jury Proceedings,* 102 F.3d. 748, 751-752 (4th Cir. 1996) (defendant provided counsel with fraudulent information regarding the date that a loan was issued and counsel then referenced the date in subsequent documents). Here, Pompei was not commissioned to perpetuate a discrete facet of the fraudulent scheme; rather, through her complete, though primarily unknowing, involvement in the telemarketing program, she furthered the fraudulent operation as a whole. As in-house counsel, Pompei worked under the direction and supervision of Four Star's General Counsel, Cohn, who was shown by the evidence, as the government proffered, to be in control of nearly every component of the telemarketing programs. Cohn, wearing the mantle of executive vice president and general counsel, made final decisions about hiring and firing employees, he contributed to the creation of the telemarketing scripts and fulfillment packages, and he made the important decisions about the credit card programs. As

subordinate attorneys, Pompei and Ozimek supported him in running the program. For example, Pompei reviewed telemarketing scripts, drafted and edited contracts, responded to legal inquiries and contributed to overall operation of the telemarketing program. These duties contributed substantially to Four Star's fraudulent telemarketing operation.

Thus, application of the crime-fraud exception here does not, as Four Star contends, signify that the exception applies whenever a company with in-house counsel is charged with a crime. Rather, the exception applies in situations such as this, where the legal services of in-house counsel are put to active, albeit unknowing, use in perpetrating a criminal scheme.

B. Ethical Wall

While not deciding the quantum of proof necessary to establish a *prima facie* case for the application of the crime-fraud exception, the U.S. Supreme Court in *United States v. Zolin,* 491 U.S. 554 (1989), addressed one of the inherent difficulties in applying the exception — the type of evidence that may be used to establish the *prima facie* case. How does one determine the privileged status of attorney-client communications without first examining the communications to see if the exception applies — thereby violating the privilege? The common answer to this question is the use of *in camera* review — a method that courts employ as a means of sidestepping the difficult and time-consuming problems of proof. In *Zolin,* the Court affirmed the use of *in camera* review to determine whether allegedly privileged communications fall within the crime-fraud exception.

In isolated incidents, courts have also employed a screening mechanism, referred to as an ethical wall, to review documents as an alternative to *in camera* review. The practice, however, is not well established.

In *United States v. Kaplan,* No. 02CR883, 2003 WL 22880914 (S.D.N.Y. Dec. 5, 2003), the government, as part of the investigation of an insurance fraud scheme involving staged automobile accidents, seized files and paperwork from the defendant's law office pursuant to a search warrant. The defendant sought to suppress information obtained from the client files seized by the government, asserting attorney-client privilege. The government replied that the files contained material that was not privileged under the crime-fraud exception. The affidavit in support of the warrant detailed procedures under which privileged materials that were not in furtherance of the fraud

would be screened, prior to review by the prosecution team, by an "ethical wall" attorney, an attorney in the U.S. Attorney's office who was not working on the prosecution of the case. The defendant objected to the government's arrangement and argued that the documents should be viewed *in camera* in accordance with *Zolin*.

The court noted that *Zolin* and subsequent cases make clear that *in camera* review is a discretionary alternative to establishing the crime-fraud exception with independent evidence. The court, therefore, rejected the defendant's position on the grounds that sufficient independent evidence had been presented by the government to support a finding of probable cause to believe that many of the defendant's files fell within the crime-fraud exception, making *in camera* review unnecessary in this case.

In addition, the court addressed the government's use of the ethical wall procedures to review for privileged documents.

> However, while it is apparent from a review of independent evidence available to this court that the crime-fraud exception applies to files in categories one through four, it is also apparent that the procedures used by the government in this case were of little use in protecting any privileged materials seized by the government. It appears that the FBI case agent was given access to review materials from seized files even before it was determined whether or not the crime-fraud exception applied. From the government's submissions, it also appears the FBI case agent — and not any member of the "Ethical Wall Team" of Assistant United States Attorneys — made a determination that materials were not privileged because the crime-fraud exception applied, based on his review of file lists with cooperating witnesses. For a law enforcement agent involved with the prosecution and investigation of the case to have made determinations about whether or not materials are privileged conflicts with the procedures the government affirmed to Magistrate Judge Bloom would be used in executing the search warrant, raises serious concerns about the admissibility of information gained in the investigation of leads developed as a result of review of materials that ultimately are determined to be privileged, and eviscerates any claim that an "ethical wall team" within the government effectively screens the prosecution team from privileged materials.
>
> Although the government cites five "recent publicly filed cases" in this

> district wherein an "ethical wall" has been employed, none of these cases resulted in opinions addressing the propriety of the use of ethical walls. Moreover, it is not clear that judges in the cases were even aware of the use of an ethical wall, since a review of court records does not show the practice was ever challenged by the defendants. Certainly this opinion should be counted among those disapproving the government's use of an ethical wall team to "protect" the attorney-client and work-product privileges or to determine whether the crime-fraud exception applies, where potentially privileged materials are turned over to the trial team and case agents before any challenge to those determinations can be raised by a defendant and determined by a court. [Footnotes omitted.]

C. In Furtherance of Crime or Fraud

The courts agree that the establishment of a *prima facie* case does not automatically open the communications to discovery; the party seeking discovery must show a connection or relationship between the crime-fraud and the attorney-client communications.

In *Blumenthal v. Kimber Manufacturing, Inc.,* 826 A.2d 1088 (Conn. 2003), the plaintiff filed an action against the defendant claiming that the defendant was engaged in an illegal boycott. The plaintiff sought production of an e-mail transmission sent to the defendant's attorney and two of the company's executives by one of the company's employees. The defendant asserted that the e-mail was a privileged communication. The plaintiff, however, argued that the privilege was not available under the crime-fraud exception.

The court denied the plaintiff's claim on grounds that the plaintiff had failed to demonstrate that the communication sought in discovery was made in furtherance of the unlawful act.

> Our analysis as to the "in furtherance" requirement is informed largely by our reasoning in part I of this opinion. As we previously stated, the trial court reasonably could have found that the e-mail concerned matters involving the agreement by a major firearms manufacturer seeking to avoid litigation, and how that agreement, along with the litigation that gave rise to it, similarly might affect the respondents. Moreover, the e-mail reveals nothing that suggests an intent to break the law. Indeed, we agree with the trial court's determination that the critical statements at issue are "not words of advocacy, but, rather, statements of fact or im-

> pression." Furthermore, to the extent that the e-mail refers to any action, it is the actions of others, and not of the respondents; it neither advocates that Kimber take any action of its own, nor that others take a particular action. The evidence does not support a conclusion that the respondents sent the e-mail with the intent to further a fraud or crime. Rather, as the trial court reasonably concluded, it was intended to keep Goldman [attorney] informed so that he could provide them with sound legal advice. Accordingly, the injury that would inure to the relationship of Kimber and its attorneys by disclosure of the e-mail is greater than the benefit that would be gained by its disclosure to the petitioner. *State v. Cascone,* 195 Conn. 183, 189, 487 A.2d 186 (1985).
>
> Therefore, we conclude that the trial court properly concluded that the e-mail is not subject to disclosure under the crime-fraud exception to the attorney-client privilege.

In *In re Public Defender Service,* 831 A.2d 890 (D.C. 2003), Public Defender Service (PDS) refused to produce documents in response to a grand jury subpoena. The documents consisted of the recanted testimony of a witness purportedly obtained by one of PDS's clients by coercion. PDS asserted that the documents were protected by the attorney-client privilege. The government argued that the crime-fraud exception applied to remove the privilege.

The court noted that there is disagreement over whether the crime-fraud exception requires that the crime or fraud ultimately be completed. The court adopted the position that completion of the crime or fraud is not necessary.

> We are not persuaded by the view that the crime-fraud exception requires that the intended crime or fraud be completed. The exception should be construed so as to effectuate and be "consistent with the purposes of the privilege." *Swidler & Berlin,* 524 U.S. at 409-10. Those purposes do not include concealing abuses of the attorney-client relationship to further the commission of a crime or fraud. Such abuses may occur whether or not the crime or fraud is brought to fruition. We adhere to the view that the exception applies so long as the attorney-client communications "further a crime, fraud or other misconduct." *White,* 281 U.S. App. D.C. at 43, 887 F.2d at 271.

The court next considered the showing necessary to demonstrate that the communication was made in furtherance of the crime or fraud.

What, then, is the content of the "furtherance" element of the crime-fraud exception? PDS suggests that the government must show a "further culpable act" occurring after the attorney-client communication. The government, on the other hand, urges that "[a] communication between client and attorney can be 'in furtherance of' the client's criminal conduct even if the attorney does nothing after the communication to assist the client's commission of a crime, and even though the communication turns out not to help (and perhaps even to hinder) the client's completion of a crime." *In re Grand Jury Proceedings (Corporation),* 87 F.3d at 382. The critical factor, the government contends, is simply "the client's intent to further a crime or fraud" when he communicates with his attorney. *In re BankAmerica Corp. Sec. Litig.,* 270 F.3d at 642.

We are not prepared to adopt either party's proposal precisely as stated. To begin with, we have considerable reservations about the government's position. We see little evidence that courts have applied the crime-fraud exception where attorneys successfully nullified their clients' bad intentions. As we have observed, counseling clients to obey the law lies at the core of an attorney's role in our legal system. Many clients will approach their lawyers with a genuine desire to conform their conduct with the law, but it would be pollyannaish not to recognize that some clients will not. Some clients inevitably will advance fraudulent or otherwise illegal proposals to their lawyers — the establishment of an illegal tax shelter, the evasion of a regulatory requirement, the withholding of evidence, the false embellishment of the client's testimony, and so on. Under the government's theory, all of these instances would fall immediately within the crime-fraud exception, regardless of whether the client abandoned his illegal proposal after receiving the advice of counsel. We do not believe the "precise focus" of the exception reaches so far. *White,* 281 U.S. App. D.C. at 43, 887 F.2d at 271. When an attorney dissuades or prevents his client from engaging in illegal conduct, the attorney-client relationship has not been abused; rather, the relationship has served the administration of justice by promoting legal conduct. *See In re Grand Jury Investigation (School),* 772 N.E.2d 9, 21 (Mass. 2002). Whatever the client's initial intentions, the attorney-client communication in such a case did not further the commission of a crime or fraud; it furthered obedience to the law. To withhold the privilege from such communications would be a mistake, for it effectively "would penalize a client for doing what the privilege is designed to encourage — consulting a lawyer for the purpose of achieving law compliance." *Restatement*

(Third) of the Law Governing Lawyers § 82 cmt. c; *accord, In re Sealed Case (Company),* 323 U.S. App. D.C. at 236, 107 F.3d at 49.

PDS's suggestion — that a "further culpable act" is necessary for the crime-fraud exception to apply — responds to our concern, but we are not satisfied with PDS's phrasing. "Culpable" may be taken to imply that the furthering act has to be fraudulent or criminal in and of itself, which we think is not required; the exception should operate, for example, where the attorney is duped into unwittingly facilitating the client's unlawful scheme. In addition, a strict "further culpable act" requirement might exclude certain special cases in which, we think, the attorney-client privilege is appropriately forfeited *ab initio* because the communication itself advances a crime or fraud — as where the attorney agrees to help the client carry out his illegal scheme instead of rejecting it outright. *See United States v. Gordon-Nikkar,* 518 F.2d 972, 975 (5th Cir. 1975). In this respect, we prefer the *Restatement* formulation that the crime-fraud exception is applicable where a client "consults a lawyer for the purpose, later accomplished, of obtaining assistance to engage in a crime or fraud." *Restatement (Third) of the Law Governing Lawyers* § 82 (a). Under this formulation, the privilege is lost once the client obtains from his lawyer the assistance he seeks to commit a crime or fraud. But the privilege is not lost where the lawyer refuses such assistance and the criminal or fraudulent plan is abandoned or stopped in its tracks.

We conclude that it is not enough for the proponent of the crime-fraud exception to demonstrate probable cause to believe only that the client consulted a lawyer for the purpose of obtaining assistance to engage in a crime or fraud. The proponent must present evidence that the consultation furthered the client's improper purpose. The burden is not a heavy one. The government does not have to show that the intended crime or fraud was accomplished, only that the lawyer's advice or other services were misused. Typically that can be shown by evidence of some activity following the improper consultation, on the part of either the client or the lawyer, to advance the intended crime or fraud.

The court concluded that the government had failed to present sufficient evidence to carry its burden of proof with regard to the exception.

In the present case, the facts in the government's proffer demonstrated probable cause to believe that Client knew Witness had been coerced

into making false statements for Client's benefit at his upcoming murder trial and that Client or someone acting on his behalf had conveyed those statements to Attorney. One can fairly infer that if Client communicated with Attorney about Witness's statements, it was probably for the purpose of obtaining Attorney's assistance in perpetrating a fraud.

The government did not show probable cause to believe that Client's communication with Attorney furthered his improper purpose, however. To the contrary, Client was stymied; Attorney did not cooperate in Client's plan and instead renounced it. The government proffered nothing to show that Client or Attorney did anything to advance Client's fraudulent plan after they conferred. Attorney's conversation with Witness cannot be characterized as such an act, nor does the government attempt to do so. On its face the purpose of the interview was to fulfill defense counsel's duty to investigate the alleged intimidation of a key government witness against his client. *See Wiggins v. Smith,* 123 S. Ct. 2527, 2536-37 (2003) (finding ineffective assistance of counsel where defense counsel failed to conduct "the requisite, diligent investigation"); *Williams v. Taylor,* 529 U.S. 362, 395 (2000) (same); *see also ABA Standards for Criminal Justice, The Defense Function* § 4.1(a) (3d ed. 1993) ("Defense counsel should … explore all avenues leading to facts relevant to the merits of the case."). The necessity of this investigation is underscored by the government's announced intention to introduce evidence of the intimidation at Client's murder trial to demonstrate his consciousness of guilt. *See Crutchfield v. United States,* 779 A.2d 307, 323 (D.C. 2001). Our holding might be different if Attorney had expressed an intent to use Witness's statement to impeach him; then one could infer that Client's communications with Attorney furthered his planned fraud. The facts in the proffer do not permit any such inference, however.

D. What Constitutes "Fraud" for This Purpose?

The case of *Vardon Golf Co. v. Karsten Manufacturing Corp.,* No. 99C 2785, 2003 WL 1720066 (N.D. Ill. Mar. 28, 2003), involved many attorney-client privilege issues including the crime-fraud exception. Part of the dispute between the parties involved a patent infringement suit. It was alleged, and appeared to be accepted, that Vardon engaged in inequitable conduct in the patent office by failing to disclose certain prior art in connection with a patent application for a golf club head. Karsten wanted access to some documents which were at least arguably covered by the attorney-client privilege, and claimed that Vardon's inequitable conduct amounted to "fraud on the

patent office" which meant that the documents in question were not protected by the attorney-client privilege because of the crime-fraud exception.

The court basically held that this was not the case — inequitable conduct in front of the patent office is not enough to qualify as the "fraud" in the crime-fraud exception to the attorney-client privilege. Liberally paraphrased, with citations omitted, the court's analysis is instructive.

> The crime-fraud exception applies where the party attempting to circumvent the privilege can meet the following test: (1) a *prima facie* showing of fraud, and (2) the communications in question are in furtherance of the misconduct … . This analysis requires an exhibition of a valid relationship between the work product sought and the *prima facie* fraud. Here, Karsten asserts that the jury's finding that Allen (who was Vardon's sole shareholder) engaged in inequitable conduct before the Patent Office establishes a *prima facie* showing of fraud. Inequitable conduct, however, is distinguishable as a lesser offense than common-law fraud, and includes types of conduct less serious than knowing and willful fraud. … This court cannot make a finding of *prima facie* fraud based solely on the jury's finding of inequitable conduct.
>
> Karsten also alleges that Allen is currently involved in litigation misconduct and argues that this establishes a *prima facie* showing of fraud to satisfy the crime-fraud exception. Some courts have held that a knowing pursuit of baseless litigation is sufficient to show the fraud element of the crime-fraud exception test. The first prong is satisfied, however, only where the party seeking to circumvent the privilege can show that the very act of litigating was fraudulently being pursued despite little or no legal or factual basis.

The court held that simply was not the case here.

Covenants Not to Compete in Employment Contracts (Ulmer & Berne Presentation)

William A. Hancock*

On August 12, 2004, lawyers for Ulmer & Berne LLP (Cleveland, Ohio) made a presentation to our local corporate counsel group in which they discussed, among other things, covenants not to compete in employment contracts. One of the occasions for the discussion was a fairly recent decision of the Ohio Supreme Court (*Lake Land Employment Group of Akron, LLC v. Columber,* 804 N.E.2d 27 (Ohio 2004)), in which the Ohio Supreme Court clarified that, in Ohio, continued employment was sufficient consideration for a covenant not to compete. The case was a clear one. Columber signed a noncompete agreement with Lake Land well into his tenure there, and there was apparently nothing whatsoever that could serve as "additional consideration." Columber left Lake Land and started his own business in the same territory doing the same thing as Lake Land.

The lower courts sided with Columber, but also certified the question to the Ohio Supreme Court because of a split in the Ohio lower courts. The question certified was, "Is subsequent employment alone sufficient consideration to support a covenant-not-to-compete agreement with an at-will employee entered into after employment has already begun?" The court said, "We con-

* *William A. Hancock is Editor and Publisher at Business Laws, Inc. and a member of the Ohio and California Bars.*

clude that forbearance on the part of an at-will employer from discharging an at-will employee serves as consideration to support a noncompetition agreement."

The court did note that jurisdictions throughout the country are split on the issue, and provided an ALR annotation which collects the cases. "Annotation, Sufficiency of Consideration for Employee's Covenant Not to Compete, Entered into after Inception of Employment," 51 *A.L.R.3d* 825 (1973).

Also, one should note that there were two dissents (out of seven justices), one of which made an interesting point.

> The majority must acknowledge that the execution of a noncompetion agreement for which forbearance from discharge is the consideration alters the at-will nature of the employment relationship. Any promise of continued employment removes the employment from the realm of an at-will relationship. For some undefined time, the employer must continue to employ the signer of the agreement. How long a period is enough? The absence of a specified term for the forbearance from discharge will leave courts to determine what is reasonable.

The Ulmer & Berne lawyer speaking on this issue talked about this latter concept in terms of good faith, fairness, and reasonableness. He said, for example, that if a company knew it was going to fire someone, and knew that it did not have a noncompete agreement with the person, and then had the employee sign such an agreement and fired the person a week later, that would probably not hold up. In general, virtually every presentation having anything to do with employment law makes the general point — legal niceties aside, the end result usually turns principally on fairness and with heavy emphasis on the fairness and reasonableness of whatever was done at the point of termination.

I. What about Reasonableness?

That remains an issue. To be enforceable, covenants not to compete must be "reasonable" in terms of their time duration, the territory in which they apply, and what they cover. This agreement prohibited competition within fifty miles, for three years, and covered activity which was competitive with Lake Land. The lower courts did not address this because they disposed of the issue on the consideration grounds. The Supreme Court sent the case back

to focus on the reasonableness of the covenant. One issue we suspect will be discussed is the so-called blue pencil doctrine. Suppose the lower court finds that the fifty miles is OK and the scope being "competitive with Lake Land" is OK, but three years is too long? Will it make a determination of an appropriate time and enforce it for that period or hold the whole clause is unenforceable because it is too broad on the time duration issue?

All in all, we have a great deal of litigation, a long passage of time (Columber left Lake Land in 2001), and undoubtedly much legal costs on both sides. How should corporate counsel go about advising the company/client on whether this kind of litigation is worthwhile? The Ulmer & Berne lawyer conducted a survey of the audience, and as one might suspect, there were differences of opinion. Following is a rundown.

One response was what one might call the "grapevine principle." This holds that employees will talk and, if the company does not enforce these noncompete clauses, no one will pay any attention to them. Therefore, they have to be enforced "on principle."

> ***Comment:*** There is some legal authority for the proposition that a pattern of failure to enforce noncompetition clauses amounts to a waiver and makes enforcement of such clauses later more difficult. Therefore, a simple "pick and choose" approach has some risk. The Ulmer & Berne lawyer suggested that it would be useful to get "some relief" in most cases even if it was not legal relief. For example, if the company wrote a letter to the second employer (or the employee himself in cases such as *Lake Land*) reminding everyone about the noncompete clause and getting some type of acknowledgment that those involved would not do anything to violate it, that would probably be sufficient to avoid waiver.

Most in the audience (including your editor) did not subscribe to the "enforce the covenants on principle" approach but, rather, would prefer a weighing approach. The benefits to be obtained from enforcement would be balanced against the cost. Unfortunately, in today's legal climate, the cost is likely to be in the range of $50,000 to $100,000 and, if things get out of control to the extent they did in the *Lake Land* case, the costs would be even higher. Therefore, one would need to balance that figure (or whatever other estimate seemed appropriate in the situation) against the following:

1. What are the actual damages which might be sustained?

— Are there specific customers or clients the defecting employee would be likely to take?

— Are there specific trade secrets which the employee is likely to divulge, and which cannot be protected by the more easily enforceable nondisclosure agreements?

2. Where is the defecting employee going? Is it to your principal competitor that you meet in the marketplace frequently or a company more on the sidelines or margins?

3. What is the relevant law? Ulmer & Berne reports that Ohio law is fairly favorable to employers on matters of this type, but corporate counsel may have to face judges or juries in other jurisdictions. That has to be factored into the analysis.

4. Are there any other bad facts involved in the potential enforceability of the noncompete?

— Is the employee in the group of those protected by discrimination laws?

— Is the employee a "whistleblower"?

— Is the covenant clearly "reasonable" in terms of scope, geography, and time, or is that a question?

— Did the employee quit or was the employee fired? If fired, were there clear grounds for the dismissal, or is the company relying entirely on the employment-at-will concept?

5. What is the company market share in the market in which you are concerned about competition? At some point, a very high market share makes enforcement of noncompete agreements more risky.

6. Is this situation one where the principal motivation of the company is that they are upset with or angry with the individual? Emotions can sometimes be involved in these matters — sometimes much more so than appropriate.

II. The Desirability of Advance Planning

Has the company developed a strategy or plan for this type of thing? These advance plans are very helpful — in fact, without them the practicalities of the matter may preclude effective relief. The advance plans might include

- identification and advance discussion with counsel who will handle the matter for the company/client;
- drafts of the actual documents which need to be filed in order to get a preliminary injunction (as a practical matter, without a preliminary injunction it may be difficult to get any effective relief, and it may be difficult to justify the legal costs involved);
- timing is of the essence in these matters (at least where the potential harm may be significant) (management and the human resource function should know this and be sure to get corporate counsel involved at the earliest possible point); and
- identification of the relevant law and choice of law or forum in which the documents should be filed (at least preliminary decisions — these matters can always be changed but one should not be starting out with a blank slate).

III. Paying for the Noncompetition Clause

The enforceability of noncompetition clauses is generally at least somewhat problematic. First, there are the legal issues outlined above. Whether the clause is reasonable in terms of duration, geography, or scope is rarely something that can be determined in advance with certainty. In addition, the decision as to whether the restriction is reasonable is always going to be made against the backdrop of the equities, and perceived equities, of the situation. One of the traditional ways of increasing the equities on the company side of the scale is to pay the executive for the time (or a portion of the time) of the noncompetition period. This does not entirely deal with the problem of the employee earning a living because taking the employee out of circulation for a period of time may adversely affect that employee's marketability after the term of the restriction period. In fact, in certain technical jobs, it may be a very significant reduction. Nevertheless, it is a useful technique, and corporate counsel often try to get to the realities of the situation by asking management how much they are willing to pay for the noncompete clause. If they respond that they are not willing to pay anything, counsel may be on notice that the actual harm that may be caused by the employee joining a

competitor is likely to be limited, and it may be more effective to deal with this more directly by, for example, restrictions against soliciting certain customers, etc. On the other hand, if management is willing to continue the employee's salary for a certain period after the termination of employment, that tends to show a genuine concern with possible harm from competition and significantly bolsters the company's arguments about the reasonableness of the restriction.

IV. The "Garden Leave" Practices in the United Kingdom

This concept appears to be more widespread in the United Kingdom (U.K.), and even has a name — "garden leave." The idea is that the employee is paid to "work in the garden" for a certain period rather than join a competitor. For an illustration of how these agreements are drafted, we refer interested corporate counsel to the S-1/A filing of Phase Forward Inc., Exhibit 10.9, dated April 20, 2004. (This company provides integrated enterprise-level software products.) The agreement is a "Senior Executive's Service Agreement" and contains ¶ 4.4 called Garden Leave. It is part of the notice provision which generally provides that either party can terminate the agreement by giving the other twelve months' notice. It then goes on to provide in this garden leave section that the company may, if it desires, substitute this garden leave for the twelve-month notice period. That would mean that the company could discharge the executive immediately and prevent any competition for twelve months so long as it continued the executive's salary. A slightly edited and paraphrased version is reproduced below.

> 4.4 Garden Leave
>
> [T]he company may, once notice of termination has been given by either side require the Executive to cease performing his job for such period of the notice period as the Company shall in its absolute discretion determine. During such period of garden leave:
>
> — the Company shall continue to pay the Executive's salary and shall provide all benefits to which he is entitled under this Agreement;
> — … the Company shall be under no obligation to provide any work for the Executive and shall be entitled to appoint any other person or persons to perform the Executive's Duties under this Agreement whether on a temporary or a permanent basis;
> — the Company may forbid the Executive to enter any Company premises or to contact any employees of the Company without its prior consent;

— the Executive shall, at the request of the Board, immediately deliver to the Company all or any property in his possession or control which belongs to the Company or which relates to the business of the company … ;
— the Executive shall, at the written request of the Board, immediately resign (without claim for compensation) from all and any directorships and other offices which he may hold … and transfer without payment as the Company may direct any shares of the company in accordance with the company's articles of association … ; and
— for the avoidance of doubt the Executive shall continue to be bound by all the Executive's obligations under this Agreement insofar as they are compatible with the Executive being on garden leave including, without limit, the Executive's duty of good faith and the Executive's (responsibilities not to be employed in any other business).

[*Editor's Note:* For another U.K. employment contract containing the same basic concept, but not using the words "garden leave" and having a fairly short notice period of one month, see the Freescale Semiconductor Inc. S-1/A, Exhibit 10.17, filed June 1, 2004.**]**

V. Other Illustrative Restrictive Covenants

Following are some randomly selected restrictive covenants from employment contracts recently filed with the SEC's EDGAR database. In each case, the company and location of the document is noted so interested readers can get the whole contract if desired.

1. Freescale Semiconductor Inc., Form S-1/A, Exhibit 10.16, filed June 1, 2004 (semiconductors)

(d) No Competition Solicitation of Business. During the Restricted Period, the Executive shall not, either directly or indirectly, compete with the business of the Company by (i) becoming an officer, agent, employee, partner or director of any other corporation, partnership or other entity, or otherwise render services to or assist or hold an interest (except as a less than 3-percent shareholder of a publicly traded corporation or as a less than 5-percent shareholder of a corporation that is not publicly traded) in any Competitive Business (as defined below), or (ii) soliciting, servicing, or accepting the busi-

ness of (A) any active customer of any member of the Affiliated Group, or (B) any person or entity who is or was at any time during the previous twelve months a customer of any member of the Affiliated Group, provided that such business is competitive with any significant business of any member of the Affiliated Group. "Competitive Business" shall mean any person or entity (including any joint venture, partnership, firm, corporation, or limited liability company) that engages in any principal or significant business of the Company or any of its subsidiaries as of the Date of Termination (or any material or significant business being actively pursued as of the Date of Termination that the Company or any of its subsidiaries enter during the Restricted Period).

2. Dollar Financial Corp., Form S-1, Exhibit 10.26, filed March 12, 2004 (financial services to "under-banked" consumers)

11. Covenant Not to Compete. In consideration of the compensation and other benefits to be paid to Executive pursuant to this Agreement, Executive agrees that he will not, without prior written consent of the board of directors of Holdings, for a period the greater of: (i) two (2) years following the termination of Executive's employment with Employer for any reason whatsoever or (ii) one (1) year beyond any payment or repurchase made pursuant to this Agreement by Employer (or to such lesser extent and for such lesser period as may be deemed enforceable by a court of competent jurisdiction, it being the intention of the parties that this paragraph 11 shall be so enforced):

a. directly or indirectly engage in the United States, Canada or any other country in which the Employer now or hereafter conducts business, in any business in direct competition with the business conducted by Employer at the time of termination or any business that Employer has a bona fide plan to commence or enter into, either as an officer, director, employee, independent contractor or as a 2% or greater owner, partner, or stockholder in a publicly traded entity;

b. directly or indirectly cause or request a curtailment or cancellation of any significant business relationship that Employer has with a current or prospective vendor, business partner, supplier or other service or goods provider that would have a material adverse impact on the business of Employer;

c. directly or indirectly induce or attempt to influence any employee of Employer to terminate his or her employment with Employer; or

d. In addition to and without limiting the foregoing, upon the termination of the Executive's employment by the Employer for any reason, whether before or after the expiration of the Term, Executive shall not at any time directly or indirectly disclose, use, transfer or sell to any person, firm or other entity any trade, technical or technological secrets, any details of organization or business affairs, or any confidential or proprietary information of Employer. For the purposes of this paragraph 11, the term Employer shall be deemed to include Employer and all of its subsidiaries.

3. Creative Host Services Inc., Form SC to T, Exhibit 99.D.7, filed February 26, 2004 (food concessions at airports)

8. Covenant Not To Compete

(a) For a period of twelve (12) months following the Employee's last day of employment by the Company, Employee shall not, directly or indirectly, without the written consent of the Company, knowingly solicit, entice, or persuade any other employee of the Company, or any employee of an affiliate of the Company, to leave the services of the Company or such affiliate for any reason.

(b) Employee will not for a period of twelve (12) months following Employee's last day of employment by the Company: (i) directly or indirectly engage in "Competitive Activity" (as defined below) within the "Territory" (as defined below), or (ii) directly or indirectly engage in "Competitive Activity" (as defined below) with any business that was a customer of the Company or a potential customer of the Company during the period including twelve (12) months prior to the time this Agreement expires or is otherwise terminated up through and including the time this Agreement expires or is otherwise terminated, or (iii) enter into any relationship whatsoever, alone or in a partnership, or as an officer, director, employee, stockholder (beneficially owning the stock or options to acquire stock totaling more than five percent (5%) of the outstanding shares) of any corporation, or acquire or agree to acquire a significant present or future equity or other proprietorship interests, whether as a stockholder, partner, proprietor, or otherwise, with any enterprise, business or division thereof, which is engaged in "Competitive Activity," hereby defined as the provision of contract food or vending services in Airports like that engaged in by the Company or any parent, subsidiary or affiliate company, during the term of this Agreement. "Territory" means the geographic area over which Employee had management and/or financial responsibility at the time this Agreement expires or is otherwise terminated; provided, how-

ever, that in the case of an employee whose duties and responsibilities relate to accounts nation-wide, "Territory" shall mean the states in which said accounts are located.

(c) The Employee acknowledges that the restrictions placed upon the Employee by this Section 8 are reasonable, given the nature of Employee's position, and that there is sufficient consideration promised Employee pursuant to this Agreement to support these restrictions. The Employee further acknowledges that under the law of North Carolina, which governs this agreement, the above non-competition provision is enforceable, as it, inter alia: (1) is in writing, (2) is part of a contract of employment, (3) is based on valuable consideration, (4) is reasonably necessary for the protection of the Company's legitimate business interest, and (5) is reasonable as to time and territory.

(d) The restrictions of this Section 8 shall survive Employee's last day of employment by the Company and shall be in addition to any restrictions imposed upon the Employee by statute or at common law.

4. Cabela's Inc., Form S-1, Exhibit 10.1, filed March 23, 2004 (direct marketer of camping and sporting goods)

6.3 Nonsolicitation/Noncompetition.

a. Acknowledgments. Executive acknowledges that Company has expended and will continue to expend considerable time, effort and resources to develop and market its products and services, that the relationships between Company and its employees, customers, prospective customers, vendors and suppliers are valuable assets of Company and key to its success, and the employees of Company establish close professional relationships with other employees, customers, vendors and suppliers and franchisees of Company in the course of their employment with Company, all of which constitute goodwill of Company. Executive further acknowledges that, because the Confidential Information could not practically be disregarded, providing similar services to a client or competitor of Company immediately following the termination of Executive's employment with Company would inherently and inevitably result in the use of Company trade secrets by Executive even if Executive were to use Executive's best efforts to avoid using such trade secrets.

b. Scope. In recognition of the foregoing and in order to prevent the im-

proper use of Confidential Information and the resulting unfair competition and misappropriation of Company's goodwill and other proprietary interests, Executive agrees that while Executive is employed by Company and for a period of 12 months after the date of the termination of Executive's employment with Company for any reason whatsoever, whether voluntary or involuntary, Executive will not, directly or indirectly:

(1) Solicit the sale of products or services from, or place, accept or aid in the replacement of products or services of, any customer of Company with whom Executive did business and had personal contact within 12 months prior to termination of Executive's employment with Company of the type or character provided by Company to such customer during Executive's employment.

(2) Encourage any vendor, business partner (as defined by Company), supplier, or customer, or franchisee of Company to curtail, sever, or alter its relationship or business with Company; or

(3) Employ, solicit for employment, or advise or recommend to any person that such person solicit for employment or employ, any individual who is, has agreed to be, or within 12 months of such employment or solicitation has been, employed by Company.

(4) Executive further acknowledges and agrees that the terms of this Section 6 shall be applicable to Executive regardless of whether Executive engages in any such competing business activity as an individual or as a sole proprietor, stockholder, partner, officer, director, employee, agent, consultant or independent contractor of any other entity.

c. Reasonable Restriction. In signing this Agreement, Executive is fully aware of the restrictions that this Agreement places upon Executive's future employment with someone other than Company. However, Executive understands and agrees that Executive's continued employment by Company, Executive's privileged position with Company, and Executive's access to Confidential Information of Company makes such restrictions both necessary and reasonable. Executive acknowledges and agrees that the restrictions hereby imposed constitute reasonable protections of the legitimate business interests of Company and that they will not unduly restrict Executive's opportunity to earn a reasonable living following termination of Executive's employment with Company.

6.4 Enforcement. For purposes of this Section 6, the term Company shall include Company and all of its subsidiaries. Each of Company's subsidiaries shall be an intended third party beneficiary of this Agreement and shall have the right to enforce the provisions hereof against Executive individually or collectively with any one or more of the other subsidiaries.

6.5 Equitable Relief. Executive acknowledges and agrees that, by reason of the sensitive nature of the Confidential Information and Intellectual Property of Company referred to in this Agreement, in addition to recovery of damages and any other legal relief to which Company may be entitled in the event of Executive's violation of this Agreement, Company shall also be entitled to equitable relief, including such injunctive relief as may be necessary to protect the interests of Company in such Confidential Information and Intellectual Property and as may be necessary to specifically enforce Executive's obligations hereunder.

Environmental Updates and Brownfields Redevelopment

*Mara J. Holland**

On November 17, 2004, Mara J. Holland, Associate Editor, Business Laws, Inc., attended a seminar by the Cleveland Bar Association <www.clevelandbar.org> titled, "Environmental Updates and Brownfields Redevelopment." The following is a report of the seminar. The speakers are entitled to full credit for the substance of this report, but it has not been reviewed by any of the speakers. Business Laws, Inc., therefore, assumes complete responsibility for it.

I. Water Update

Raymond Rea, Assistant Director of Law, City of Cleveland Department of Law; James L. Koewler, Jr., The Koewler Law Firm

A. Storm Water Regulatory Update

In March 2003, the EPA's Phase II MS4 storm water rule went into effect.

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* *Mara J. Holland is an associate editor at Business Laws, Inc. and a member of the Ohio, Florida, and Illinois Bars.*

A municipal separate storm sewer system (MS4) is defined as a conveyance, or system of conveyances (including roads, catch basins, curbs, gutters, ditches, man-made channels, or storm drains) owned or operated by a public body, designed or used for collecting storm water, and not part of a publicly owned treatment works. The Phase II rule requires National Pollutant Discharge Elimination System (NPDES) permits for MS4s serving populations of less than 100,000, "urban" areas as defined by the U.S. Census Bureau, and designated municipalities with a population of 10,000 or more with a density of 1,000/square mile.

Permit applications were due March 10, 2003, for general permits. Along with the permit, MS4s must submit a storm water management plan describing how the MS4 will implement the program. This must include a description of Best Management Practices (BMPs) addressing six minimum control measures; must include reductions to the maximum extent practicable; establish measurable goals; specifically identify those responsible for BMP implementation; and provide for annual reports to the permitting authority. The six minimum control measures identified in the permit involve

(1) public education and outreach;
(2) public participation/involvement;
(3) illicit discharge detection and elimination;
(4) construction site runoff control;
(5) post-construction runoff control; and
(6) pollution prevention and good housekeeping.

Various municipalities are now in the process of developing construction ordinances to comply with the storm water rule. Model ordinances are being urged, including those by certain regions such as the Northeast Ohio Area Coordinating Agency (NOACA), the federally designated Metropolitan Planning Organization for five counties of Northeast Ohio, which include Greater Cleveland and the Lorain area, whose chief functions are to perform long- and short-range transportation planning, transportation-related air quality planning, and area-wide water quality management planning. The NOACA model ordinance, for example, addresses construction site runoff, riparian and wetland setbacks, and post-construction water quality runoff. The construction site runoff model ordinance would be applicable to sites outside of the MS4 service areas; may include sites that are less than one acre; would involve a two-permit process, one involving footers, basements, and slabs, and a second that would be issued after BMPs are installed and

inspected. The riparian and wetland setback model ordinance sets for the watercourse by drainage area and wetlands by category. The post-construction water quality model ordinance states that post-construction plans would include recorded easements of no less than twenty-five feet wide; maintenance obligations; inspection schedules; written annual inspection reports; performance bonds for construction of BMPs; and a separate surety for continued maintenance obligation of two years.

The Phase II rules have been challenged in the courts. In *Environmental Defense Center, Inc. v. EPA,* 319 F.3d 398 (9th Cir. 2003), *cert. denied, Texas Coalition on Stormwater v. EPA,* No. 03-1125 (June 7, 2004), which consolidated three Phase II cases from the Fifth, Ninth, and District of Columbia Circuits, the court addressed twenty-two constitutional, statutory, and procedural challenges to the rule. Ultimately, the court rejected all of the challenges with exception to the argument that the Phase II rule improperly failed to provide review of Notice of Intents (NDIS) and for public participation in NPDES permitting process. The court stated that the failure to require review of NDIS, which are the functional equivalents of permits under the Phase II General Permit option, and its failure to make NDIS available to the public or subject to public hearings contravene the express requirements of the Clean Water Act (CWA). Another case to watch, which is currently pending in the courts, is *Wisconsin Building Ass'n v. EPA,* a Seventh Circuit case, where the public participation in the permitting process is also at issue before the court.

B. Wetlands Update

About four years ago, the U.S. Supreme Court issued its opinion in *Solid Waste Agency of Northern Cook County v. Army Corps of Engineers (SWANCC),* 531 U.S. 159 (2001), in which it held that the migratory bird rule was insufficient to create jurisdiction over a wetland (in this case an abandoned gravel pit being used by migratory birds) that was not connected to or adjacent to a waterway that is navigable. The issue now that everyone is trying to figure out is the limits of the jurisdiction of the Corps of Engineers (Corps) in this area. The Court in *SWANCC* was careful to state that its decision only applied to the migratory bird rule, and the Court specifically did not invalidate the jurisdiction of the Corps over waters that are not actually navigable.

Following *SWANCC,* the Corps and EPA issued a memoranda stating that jurisdictional decisions regarding isolated waters would be made on a case-by-case basis. However, rather than clarifying, this memo served to create

even more confusion in this area. In addition, in 2003, the EPA and the Corps issued an advance notice of proposed rulemaking (ANPR) seeking input as to a uniform post-*SWANCC* definition of "waters of the United States." This ANPR was eventually withdrawn after it was met with considerable criticism. Thus, the case-by-case determination remains in effect.

A few states, Ohio being one of them, have promulgated wetlands regulations to fill the gap left by *SWANCC.* The Ohio EPA requires a general or individual permit for discharges in "isolated wetlands." Those projects in isolated wetlands that are larger than .5 acre require an isolated wetland individual permit, and the level of scrutiny in the review depends upon the size and category. Projects in Category 1 wetlands that are smaller than .5 acre fall under a general permit. Projects in Category 1 wetlands that are larger than .5 acre or Category 2 wetlands that are larger than .5 acre but not larger than 3 acres receive Level 2 (slightly higher) review, and larger Category 2 or any Category 3 wetlands receive Level 3 review. Ohio enacted its Isolated Wetlands law in 2001 in direct response to *SWANCC.* Ohio's law specifically regulates those wetlands not subject to the CWA. As the speaker noted, Ohio's rule provides that the isolated waters determination is now a question of "who is in charge" rather than "is anyone in charge."

The speaker observed that a footnote in the Justice Scalia opinion essentially invites future cases that assert that waters that are not actually navigable are not subject to federal jurisdiction. He asserts that the Court may eventually be addressing, and could possibly be receptive to, the argument that, if the water is not actually navigable, then it is not subject to federal jurisdiction. The composition of the Court may eventually determine the outcome of such an issue.

With respect to the storm water requirements, the speaker noted that many communities are requiring riparian setbacks as part of storm water management requirements and developers may question whether these regulations usurp federal authority in this area. In addition, the EPA has required buffer zones along wetlands and streams that remain after construction is complete and the speaker noted that there is an issue of whether the setbacks could also satisfy the EPA buffer zone requirements.

In addition, with respect to wetlands mitigation, the speaker noted that the storm water rules tend to require greater storm water retention capacity, and there is an issue as to whether storm water ponds can be used to satisfy

mitigation requirements. However, applicants will need to show that the ponds are not contaminated.

II. Air Update

Steve Bordenkircher, Squire Sanders and Dempsey L.L.P.; Anthony Rospert, Thompson Hine LLP

A. New Source Review Developments

The goals of the New Source Review (NSR) program are to protect attainment areas, permit growth in the nonattainment areas, and phase out grandfathered sources. The NSR rules are applicable to major sources and major modifications at major sources. The Prevention of Significant Deterioration (PSD) rules, 40 C.F.R. § 52.21 *et seq.,* apply to attainment areas for criteria pollutants — major sources (defined as those > 250 tons per year (TPY) and > 100 TPY for certain categories) — and require best available control technology, preconstruction modeling, and potentially monitoring and impact analysis. The Nonattainment NSR, 50 C.F.R. § 52.24 *et seq.,* contains strict requirements that apply to nonattainment areas, major sources (defined as those at 25-100 TPY depending upon the quality of the ambient air), and major modification (net increase over specified limits). This program requires controls reflecting lowest achievable emission rate, preconstruction monitoring and modeling; and emission offsets (reduction greater than new sources).

NSR issues are important as NSR requirements can frustrate project timing, with delays of two years or more not uncommon; require added capital and operating costs; and possibly stop a project where offsets are not available.

The speaker discussed what he termed "NSR traps for the unwary." One trap involves the actual definition of a source, including what emissions units must be aggregated, whether they must be contiguous, and whether unrelated support facilities must be counted, *i.e.,* in the case where a facility is separately owned, the joint venture situation, etc.). Another trap is how to measure "net increases" of emissions.

As the speaker noted, other issues include whether maintenance of an old source that brings it back to its original capacity would trigger NSR requirements (NSR reform, discussed below, addresses this); whether a series of small independent projects must be aggregated as a major modification; and if NSR is triggered by a physical change to one unit that simply eliminates production bottleneck.

The NSR rule changes, published on October 27, 2003, involve six major areas:

(1) routine replacement reform;
(2) determining baseline emissions;
(3) actual-to-projected actual emissions methodology;
(4) Plantwide Applicability Limits (PALs);
(5) a clean unit exemption; and
(6) pollution control project exclusion.

The routine replacement reform is perhaps the most controversial of the six, and has resulted in considerable litigation. This part of the reform provides that NSR requirements are not triggered if the routine replacement involves functionally equivalent replacement components, does not increase capacity, and does not cost more than 20 percent of the capital cost of the entire unit. The District of Columbia Circuit Court on December 24, 2003, stayed the effectiveness of the equipment replacement provision. On August 9, 2004, the EPA and the Department of Justice filed the government's brief in the lawsuits brought by states, local governments, industry, and environmental groups to challenge the EPA's rule.

PALs set forth an alternate approach for determining major NSR applicability. A "PAL" is defined as a facility-wide annual emissions limit under which any change can be made without triggering NSR for a specific pollutant. The Clean Unit Test provides that a clean unit can be modified without triggering NSR if the change does not cause the unit to exceed its permitted allowable emissions and the change does not compromise the basis for a BACT/LAER determination. The pollution control project exclusion provides that an air pollution control project can avoid major NSR, even though the new controls result in an increase in other emissions, provided that a two-part test is met. That test includes an environmentally beneficial test that shows that the benefits outweigh the emissions increase, and an air quality test that shows that a project will not cause or contribute to National Ambient Air Quality Standards (NAAQS), a PSD increment, or an air-quality-related value problem.

B. Clean Air Act Regulations of 2004

The Clean Air Interstate Rule (CAIR), originally proposed in 2004 as the Interstate Air Quality Rule, addresses power plant emissions of sulfur dioxide (SO_2) and nitrogen oxides (NO_X). Its goal is to reduce NO_X emissions by 70

percent and SO_2 by 65 percent. The rule impacts twenty-nine states and the District of Columbia. The CAIR rule was proposed as a regulatory response due to the inability of the Bush Administration to have Congress pass its Clear Skies legislation.

According to the EPA, the reductions called for in CAIR would result in fewer cities and counties being out of compliance with the new eight-hour ozone and new 2.5 particulate matter (PM) standard. According to the EPA, CAIR would bring twenty-eight additional counties into compliance with the new PM standard and eight additional counties would attain the new ozone standard.

CAIR incorporates a cap-and-trade program and, according to the EPA, benefits of such a program include control of emissions to desired levels under a fixed cap that is not compromised by future growth; high compliance rates; lower cost of compliance for individual sources and the regulated community as a whole; incentives for early emission reductions; promotion of innovative compliance options and air pollution control technology; flexibility for the regulated community; direct legal accountability; coordinated programs to conserve administrative resources; and transparent, complete, and accurate reading of emissions.

The EPA has estimated that CAIR will require the utility industry to make at least $50 billion in investments in order to comply. A single-year capital expenditure for new control hardware could run as high as $23 billion; operating costs are expected to add about $1.75 billion annually to existing operating costs, and the price of electricity would likely jump 25 percent in 2010 and an additional 10 percent in 2105. However, the EPA maintains that CAIR would produce $82.4 billion in annual health benefits, with 18,000 fewer nonfatal heart attacks, 1.7 million fewer absences from work and school, and 13,000 premature deaths; would result in 1.4 billion in annual visibility improvements in Southeastern national parks and forests; and would reduce acid deposition, or acid rain, by up to 45 percent in some areas and virtually eliminate chronic acidity in the Adirondack Mountains.

C. NAAQS Regulations of 2004

The CAA requires the EPA to set national standards for controlling ambient air concentration of certain emissions. The NAAQS for ozone and PM, issued in 1997, establish a new eight-hour ozone standard (0.08 ppm averaged over eight hours) and a standard of 2.5 for PM. The rules have

withstood legal challenge. In April 2004, the EPA issued its final designations, which determined that 474 counties are nonattainment areas. The designations have resulted in lawsuits including Ohio which in June 2004 filed suit in the District of Columbia Circuit Court questioning the EPA's methodology in placing thirty-three of its counties in nonattainment.

Pitfalls to nonattainment include measures known as transportation conformity that requires planning to ensure that road construction and projects do not affect the ability of the area to conform to the eight-hour standard; heightened NSR permitting requirements, including stricter standards for existing sources, new or modified sources (including LAER); enhanced ambient air monitoring requirements; and effects on the nonregulated community such as programs to reduce emissions from cars, fuels, and consumer products.

Many counties in nonattainment recognize the economic impact as it is unlikely businesses will want to locate to a nonattainment area and be subject to NSR standards requiring stringent controls.

The new standards are likely to have significant economic impact. For example, Ohio Governor George Voinovich has predicted that the ozone standard alone will cost a family $263 a year, and increase electric bills between 2.3 and 17.4 percent.

III. Small Business Liability Relief & Brownfields Revitalization Act

Debora S. Lasch, Cowden, Humphrey, Nagorney & Lovett Co., L.P.A.

The Comprehensive Environmental Response, Compensation, and Liability Act's (CERCLA's) innocent landowner defense provides that a party may have a defense to CERCLA liability if it can show that it did not know of the contamination prior to purchasing the property, that it did not do so on the basis of the condition of the property, and no amount of investigation would have discovered the contamination. Very few parties have ever qualified for the defense. Thus, in 2002, President Bush signed the Small Business Liability Relief and Brownfields Revitalization Act (the Act). This Act, among other things, provides a new defense for prospective purchasers of contaminated property, which is an alternative to prospective purchaser agreements that have traditionally taken enormous efforts to obtain from the EPA. Importantly, the bona fide prospective purchaser defense provides that a party

need not be innocent to receive liability protection under CERCLA. The purchaser may even purchase the property with knowledge of the contamination after performing all appropriate inquiries, provided the purchaser meets certain requirements set forth in the Act. These include the following:

— the landowner must have acquired the property after all disposal activities;
— the landowner must provide all legally required notices with respect to the discovery or release of any hazardous substance;
— the landowner must exercise all appropriate care by taking reasonable steps to stop any releases on the property and prevent future releases (which probably means remediation);
— the landowner must provide full cooperation and assistance with respect to response actions;
— the landowner must comply with all land use restrictions;
— the landowner must not impede the effectiveness or integrity of any institutional controls;
— the landowner must comply with any CERCLA request for information or administrative subpoena; and
— the landowner must not be potentially liable or affiliated with any such party who is potentially liable for response costs.

For property purchased after May 31, 1997, the Act established the American Society for Testing and Materials (ASTM) Standard Practice E 1527, "Standard Practice for Environmental Site Assessment: Phase I Environmental Site Assessment Process" (as the 1997 or 2000 versions), as the interim standard for conducting "all appropriate inquiry."

On August 26, 2004, the EPA published in the *Federal Register* a draft rule setting forth what will be required for "all appropriate inquiry" for property purchased after January 11, 2002, the effective date of the Act:

— the results of an inquiry by an environmental professional (one of the more contentious criteria);
— interviews with past and present owners and operators;
— reviews of historical sources including chain of title documents, aerial photographs, building department records, etc.;
— searches for recorded environmental cleanup liens;
— reviews of federal, state, and local government records, including underground storage tank reports, hazardous waste generation reports, etc.;

— visual inspections of the facility and adjoining properties (in the past some environmental professionals have actually evaluated facilities without even conducting a visual inspection; now they must do so);
— the specialized knowledge or experience on the part of the defendants, *i.e.,* whether they should have known of the contamination;
— the relationship of the purchase price to the value of the property if not contaminated;
— commonly known or reasonably ascertainable information about the property; and
— the degree of obviousness of the presence or likely presence of contamination on the property and the ability to detect it via appropriate investigation.

As the speaker noted, one of the more contentious aspects of the draft rule has involved the definition of "environmental professional," including the appropriate educational qualifications. The speaker suggested that it will now be appropriate for a Phase I audit, for example, to include specific information as to the educational background of the consultant conducting the inquiry. Thus, reports should now include the names of the consultants and should not just include the name of the consulting firm.

In addition, the draft standard provides that consultants must actually visit the site as, incredibly, some have even prepared Phase I reports without actually visiting sites.

IV. Reviewing Environmental Assessments

Julianne Kurdila, Chief Assistant Director of Law, City of Cleveland Department of Law

Environmental assessments are conducted for a variety of reasons. Of course, real estate transfers often require assessments in order to provide a snapshot for the purchaser. An assessment may be conducted in order to qualify for CERCLA's bona fide purchaser defense. An assessment may also be done pursuant to a state voluntary action program, such as Ohio's, whereby parties can undertake remediation at a site and receive assurances from the state that it will take no further action at the site.

Most assessments are conducted pursuant to ASTM standards. These include the ASTM 1528-97 Transaction Screen, whose purpose is to flag any

recognized environmental conditions (RECs) in order to qualify for CERCLA's innocent landowner defense. For the most part, the transaction screen is not used very much any more and most parties opt for the Phase I Environmental Site Assessment, ASTM E 1527-00. A Phase I is a thorough site assessment of commercial property used to satisfy the innocent landowner defense.

Assessments may also be conducted pursuant to state programs, including, for example, Ohio's Voluntary Action Program, OAC Rule 3745-300-06. This requires more hoops than the ASTM process, noted the speaker, such as the requirement that a certified professional conduct the assessment.

The purpose of the Phase II Environmental Site Assessments, ASTM E 1903, is to conduct sampling of and analyze RECs. These assessments characterize the rate and extent of contamination so that a remedial action plan and costs can be developed. States may also have standards for conducting Phase II assessments, including Ohio, which has the Voluntary Action Program (VAP) Phase II, OAC Rule 3745-300-07.

In selecting the consultant, it is important to consider the experience of the firm and its individual consultants, the internal project manager, and the need for a certified professional if conducting the assessment pursuant to a state VAP type program, such as Ohio's.

The speaker identified some "red flags" that may be present in Phase I reports. These include information with regard to access to the buildings and the property. For example, it should be determined whether the consultant was provided with limited access, if he or she only had access to the main buildings and not outbuildings, if there was snow on the properties obscuring views, etc. Another red flag might involve gaps in the report including Sanborns, aerials, and site history. If the site is not properly identified on maps, that might be another red flag. If the consultant has not been able to interview parties, or if the individuals interviewed were disgruntled employees, be wary of the statements made in the report.

If the report addresses prior reports, it should state that. In addition, a consultant should not rely too much on prior reports, and the report should reflect the consultant's own due diligence.

Note that, if the report is over 180 days old, it should be updated. In addi-

tion, if it is over two years old, most banks require a completely new assessment, not just an update. The ASTM is silent as to this.

Be wary of a report that does not clearly define RECs or if the identified areas of contamination are not clearly defined. If there are areas of stockpiles, the report should state the exact location. Look for consistency of descriptions in reports, including that it consistently describes buildings (*i.e.,* building number 4, 5, etc.) throughout the report in order to avoid confusion.

Also be wary of a Phase I report that recommends a Phase II assessment simply because a building is 100 years old as that is not enough evidence of an REC. Note that firms may be looking for business and consider whether different firms should conduct the Phase I and II assessments.

Be suspect of a report that does not include a thorough records review, or where the consultant has not requested adequate records including those of local fire departments, etc.

Finally, be wary of a report that gives legal advice or specifically identifies areas that are not regulated as consultants cannot make such judgments.

The speaker also identified some red flags in Phase II reports. First, make sure the report addresses each REC/IA that is listed in the Phase I report; verify that the consultant has analyzed the right chemicals of concern in each REC/IA and that the consultant is not screening for every chemical, just those that are necessary based upon the history of the use of the site; and determine the rate and extent of contamination, and do not go beyond that for the cleanup.

Finally, with respect to both Phase I and II reports, look for typographical errors. One speaker noted that she read a report where she could tell that the consultant had cut and pasted material from other reports and made numerous spelling errors, which says a lot about the quality of the report and the firm conducting it.

Copyright Myths*

*Norbert F. Kugele***

I. Introduction

In today's world, making copies, even in electronic or digital form, has

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** *Norbert F. Kugele is a partner with Warner Norcross & Judd LLP, specializing in computer, Internet, and e-commerce law; HIPAA compliance; intellectual property litigation, including trademark and copyright infringement; and commercial litigation. He may be reached in the Grand Rapids office at (616) 752-2481. Warner Norcross & Judd is a full-service law firm with offices in Grand Rapids, Holland, Detroit, and Muskegon, Michigan.*

never been easier. And while most people are aware that there are copyright laws, they may mistakenly believe that such laws either do not apply to electronic media, or that their copying is somehow a "fair use."

While there is a fair use exception under the Copyright Act, many people do not understand its scope and limitations. In fact, many of the myths discussed below result from this misunderstanding about the fair use exception. The fair use exception allows limited copying for certain purposes, such as criticism, comment, news reporting, teaching, scholarship, or research. The purpose of the fair use exception is to balance the exclusive rights of copyright against our First Amendment free speech rights so that we can engage in a dialogue about ideas and issues as they are expressed in other people's works. Here are some common misconceptions that people have about copyrights and the fair use exception, and why they are wrong.

II. Copyright Myth #1: "It Doesn't Matter If I Copy Something, as Long as I Don't Make Any Money from It."

Certainly, if Mary copies a CD of Jane's music and sells it, Jane is entitled to recover Mary's profits. The copyright law, however, does not stop there. Even if Mary copies Jane's CD and simply gives it to a friend, it is still a copyright infringement, and Jane could recover from Mary the profits that Jane would have earned had Mary's friend gone out and bought her own copy of Jane's CD. Alternatively, instead of seeking actual damages, Jane could seek statutory damages, which at the court's discretion could be anywhere from $750 to $150,000, depending on the circumstances and whether Mary's infringement was willful or not.

III. Copyright Myth #2: "It's Okay to Copy Something If It's Posted on the Internet."

If John, a photographer, posts his photographs on the Internet, then Mary is certainly entitled to go to John's Web site and download the photographs so that she can view them. Since the photographs can only be viewed by downloading them from the Internet, John has impliedly given his permission for this. If Mary, however, proceeds to post these photographs on her own Web site, or to print the photographs and distribute them, she is infringing upon John's copyrights.

IV. Copyright Myth #3: "It's Okay to Copy Something, as Long as It's Just a Part of the Work and Not the Whole Thing."

Mary is very fond of one of Jane's songs, and decides to quote a famous line from the song on her Web site. Because she limits herself to using only one of the fifty lines of lyrics, Mary believes that her use is a fair use. A court, however, might conclude that she is infringing. While its true that *de minimis* copying (copying a small amount) is not copyright infringement, there are no rules as to what constitutes a *de minimis* amount. The court will certainly consider the amount that was copied and its proportion to the entire work. The court, however, will also look at other factors, such as the purpose and character of the use (including whether the use is for commercial purposes or for nonprofit educational purposes, etc.), the nature of the copyrighted work, and the effect of the use upon the potential market for or value of the copyrighted work.

V. Copyright Myth #4: "It's Okay to Copy Something If It's Being Used for Educational Purposes."

Stacy, a school teacher, has a new computer at home that came with a spreadsheet program. Stacy decides that this program would be helpful at school, so Stacy brings the program disk to school and loads it on her classroom computer. Stacy uses the program to help her teach math to her students. Although Stacy believes that this is a fair use of the software, a court of law might not even get to the fair use analysis because the use of the software will be controlled by the software's license agreement. Even if Stacy deletes the software from her computer at home before bringing it into school, the software license most likely only allows Stacy to use the software on her new computer. At the very least, Stacy has violated the terms of her license agreement.

VI. Copyright Myth #5: "If It Doesn't Have a Copyright Notice, I Can Copy It."

Mary's church is handing out a leaflet about a fund-raising campaign. The leaflet contains a poem written by Faith, one of the congregation's members. Seeing that there is no copyright notice for the poem, Mary decides to create a poster featuring the poem, and sells it on her Web site. It turns out that Faith has registered a copyright on the poem, and Mary's poster infringes on

the copyright. At one time, failure to put a copyright notice on a work took it out of the protection of copyright and into the public domain. The law, however, has changed, and a copyright notice is no longer a requirement. While Mary may be able to argue that she is an innocent infringer and, thus, not liable for Faith's damages, a court could still order Mary to pay Faith any profits that Mary made on the poster and prevent Mary from selling any more of the infringing posters.

VII. Copyright Myth #6: "It's Alright for Me to Copy Something from Another Work, as Long as I Give Fair Credit to the Other Author."

Mike, a college student, is studying modern literature. Mike takes some of his favorite passages from various works and puts them on his Web site. Because he does not want anyone to think that he is trying to pass these off as his own, he is careful to give full attribution to the original authors. Unfortunately for Mike, attribution — while important for academic and intellectual integrity — is not a defense to an infringement claim. A court of law would likely find that Mike is infringing upon the works of these various writers.

Is Your Company Being "Gatored"?*

Thomas C. Morrison**

I. Introduction

Companies in the consumer product or service business have come to rely on the Internet as an important means of communicating and doing business with their customers. Such companies spend millions of dollars designing, maintaining, and upgrading their Web sites. One study reported that com-

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** *Thomas C. Morrison is with Patterson, Belknap, Webb & Tyler LLP, New York, New York.*

panies with $500 million or more in sales spend an average of $3.9 million per year on Web site design and maintenance. In many industries, such as travel and entertainment, an enormous portion of overall sales are made via the Internet. In the rental car industry, for example, the Internet accounts for as much as 50 percent of some companies' total rentals.

II. The Problem

Imagine, then, the chagrin of a company that learns that, when consumers log onto the company's Web site, a pop-up ad for a competitor — or for a company in a related line of business — suddenly appears on the consumer's screen. This is precisely what our client Hertz discovered in early 2003. Car rental customers who visited Hertz's Web site were suddenly being exposed to ads for Avis, Alamo, Dollar, and Thrifty. In addition, they encountered ads for companies offering a variety of travel services (such as Expedia, Orbitz, Hotwire, Cheap Tickets, and Priceline.com), as well as ads by several major airlines (none of whom were travel partners with Hertz). Finally, and most remarkably, Hertz customers were suddenly seeing ads for companies totally removed from the travel business, such as florists and consumer finance companies.

III. The Culprits

Where were these ads coming from? It did not take Hertz long to discover that the ads were being triggered by an aggressive young Internet company called Gator Corporation (the company has since changed its name to Claria Corporation). Like numerous other companies that own well-known trademarks and operate frequently visited Web sites, Hertz found that it was being "Gatored."

Gator's method of operation was ingenious. First, it designed a series of consumer-friendly software programs such as EWALLET, PRECISION TIME, and DATE MANAGER. For example, EWALLET allows the user to store personal information commonly used in online transactions, such as name and address, passwords, user identification number, and credit card numbers. Gator gives these programs to consumers for free. But when consumers sign up for one of the programs, they agree (electronically) to a contract with Gator. Under the terms of the contract, the consumer agrees to permit Gator to install an additional software program on the user's computer.

This additional software — labeled by Gator as OFFERCOMPANION, but referred to in the trade as "spyware" — allows Gator to monitor the user's Internet activity. Specifically, OFFERCOMPANION is programmed to detect the consumer's visit to popular Web sites such as <www.hertz.com>.

The second component of Gator's scheme involves the solicitation of advertisers that are interested in having their ads appear on popular Web sites. Gator will sign a contract with an advertiser whereby it promises to deliver the company's ads to consumers who have chosen to visit the Web site of one or more of the company's competitors. Gator's marketing message is, of course, focused on the number of consumers who have installed Gator's software and to whom Gator can "deliver" the advertiser's pop-up ad. At the time of our lawsuit, Gator boasted that over 35 million people actively used its OFFERCOMPANION software. The success of Gator's program can be measured by the "click-through" rate, *i.e.,* the percentage of users who, when confronted with a pop-up ad, actually click through to the Web site of the pop-up advertiser. At the time of the lawsuit, Gator claimed that, with respect to the travel industry, the average click-through rate for pop-up ads was 10 percent. Individual advertising campaigns were said to yield click-through rates that were as high as 24 percent (travel), 26 percent (credit cards), 29 percent (automotive), and 48 percent (household products).

Gator has one significant competitor: WhenU.com, Inc. Like Gator, WhenU offers consumers a variety of free software programs; those programs are then bundled with a spyware program known as SAVENOW. Testimony in one of the WhenU lawsuits disclosed that approximately 25 million people are active SAVENOW users. Ironically, while over 100 million people have at one time downloaded the SAVENOW software, 75 million of them have uninstalled it.

IV. The Illegality of the Gator and WhenU Programs

In the various lawsuits that have been filed against Gator and WhenU, the plaintiffs have raised a variety of claims, including trademark infringement, trademark dilution, copyright infringement, contributory copyright infringement, cybersquatting, and a variety of state law claims, such as tortious interference, trespass to chattels, and unjust enrichment. While we pled many of these claims in our complaint for Hertz, the most significant claim — and the claim upon which we believe the case will ultimately be decided — is trademark infringement.

Gator's entire scheme is founded upon the unauthorized use, in its OFFERCOMPANION software, of the trademarks of the companies whose Web sites are targeted for pop-up ads. In order to enable a competitor's ad to appear when Hertz's Web site is being accessed by a consumer, Gator has embedded the Hertz Web site address <www.hertz.com> in its OFFERCOMPANION software. When the user types that address on his or her computer, the address is recognized by OFFERCOMPANION, which, in turn, triggers the appropriate pop-up ad to appear. This is plainly an unauthorized "use in commerce" of Hertz's trademark. Moreover, it is precisely the fame and goodwill of the Hertz name that makes Hertz's Web site an attractive target for the unauthorized display of pop-up ads. Of course, trademark infringement only occurs where the unauthorized use of a party's mark causes a likelihood of confusion. Here, there are two types of confusion that are likely to occur. First, survey evidence in our case demonstrates that, despite the existence of Gator's "contracts" with its software customers, and despite the presence of "disclaimers" that generally accompany the pop-up ads, an enormous percentage of Gator's customers are

(1) unaware of their contract with Gator;
(2) unaware that Gator is responsible for delivering the pop-up ads; and
(3) believe that the ads are sponsored by, or appear by permission of, the Web site owner.

But even if the customer recognizes that the pop-up ad is not likely to be sponsored by the Web site owner, Gator would still be guilty of having generated a second type of confusion, so-called initial interest confusion. Initial interest confusion arises where the defendant has used the plaintiff's trademark to attract the attention of consumers, even though, by the time a given transaction is completed, the consumer is well aware that the transaction is not with the owner of the trademark. The doctrine has most frequently been applied to trade dress cases involving "look alike" store brands that capture consumers' attention by their resemblance to national brands, even though the consumer recognizes — by the time of purchase — that the product is merely a store brand version of the national brand. In the Internet world, this doctrine has been widely applied to prohibit a defendant's use of a competitor's trademark in a metatag to divert consumers to a Web site other than that of the trademark owner. This doctrine was first applied by the Ninth Circuit in *Brookfield Communications, Inc. v. West Coast Entertainment Corp.,* 174 F.3d 1036 (9th Cir. 1999). Subsequently, courts in the First,

Second, Fourth, Fifth, Sixth, and Seventh Circuits have adopted the *Brookfield* decision for metatag cases. Under these decisions, a Hertz competitor, such as Alamo, could not use "hertz" as a metatag and thereby attract consumers to its Web site.

V. The Lawsuits

Several lawsuits have been filed against Gator and WhenU and several decisions have thus far been handed down. However, no case has proceeded to trial and no decision has been reviewed by an appellate court. The results to date are as follows.

A. *Washington Post Co. v. Gator Corp.,* No. Civ. 02-909-A (E.D. Va. June 25, 2002)

In the first case against either defendant, a coalition of the nation's leading publishers obtained a preliminary injunction against Gator. Unfortunately, Chief Judge Hilton issued neither an opinion nor findings of fact or conclusions of law, so the case has no significant precedential value. The case was settled on the eve of trial and the terms of the settlement remain confidential.

B. *In re Gator Corp. Software Trademark & Copyright Litigation,* 259 F. Supp. 2d 1378 (J.P.M.L. 2003)

In addition to Hertz, ten other parties sued Gator in various districts around the country. The other plaintiffs included L.L. Bean, Six Continents Hotels, Inter-Continental Hotels, and United Parcel Service. These cases have been consolidated for pretrial proceedings before Judge J. Owen Forrester of the Northern District of Georgia. The parties are currently engaged in discovery; following the disposition of summary judgment motions, the cases will likely be remanded to the various transferor courts for trial.

C. *U-Haul International, Inc. v. WhenU.com, Inc.,* 279 F. Supp. 2d 723 (E.D. Va. 2003)

Like the *Washington Post* case, this case was filed in the Eastern District of Virginia. Following protracted discovery, U-Haul asked the court to rule on the pending motions for summary judgment rather than holding a trial. The court obliged. It denied U-Haul's motion for summary judgment and granted WhenU's motion for summary judgment as to the copyright and trademark claims. The court's dismissal of the trademark claim, although unfortunate, can readily be overcome in future cases. First, the court relied

heavily on the alleged "consent" of WhenU's customers to the installation of the SAVENOW software. This "consent" can be largely disproved through the use of empirical evidence, such as consumer surveys and the thousands of consumer protests received by Gator and WhenU. Second, the court did not even address the metatag cases that form the foundation of the trademark claim. Following the decision, U-Haul decided that it did not want to expend further time and money on the case and dropped its appeal.

D. *Wells Fargo & Co. v. WhenU.com, Inc.,* 293 F. Supp. 2d 734 (E.D. Mich. 2003)

In November 2003, Judge Nancy Edmunds of the Eastern District of Michigan issued a sixty-six-page decision denying a motion by plaintiffs Wells Fargo and Quicken Loans for a preliminary injunction. Unlike the opinion in the *U-Haul* case, this was a thorough opinion that carefully analyzed the evidence and the law. The court's rejection of the copyright claim (that pop-up ads constitute an unauthorized "derivative work") was not surprising. However, the court's rejection of the trademark claim was surprising. Crediting an argument that has been advanced by both Gator and WhenU, Judge Edmunds held that WhenU's use of plaintiffs' trademarks in their SAVENOW software was not a "use in commerce" within the meaning of the Lanham Act. In addition, Judge Edmunds rejected two confusion surveys offered by plaintiffs. That part of the decision is understandable as the surveys did not even involve the trademarks at issue in the case. This case is proceeding with discovery and, thus, a final decision on the merits is a long way off.

E. *1-800 Contacts, Inc. v. WhenU.com, Inc.,* No. 02-Civ.-8043 (S.D.N.Y. Dec. 22, 2003)

Three days before Christmas 2003, Judge Deborah Batts of the Southern District of New York gave the plaintiffs in all the cases a wonderful Christmas present. In an eighty-eight-page opinion, Judge Batts entered a preliminary injunction against WhenU, enjoining it from

(1) using the 1-800 CONTACTS mark in its SAVENOW software; and
(2) causing pop-up ads to appear when a user has chosen to visit plaintiff's Web site.

Judge Batts based her ruling on the theory that Hertz and the other Gator plaintiffs are advancing — WhenU's inclusion of plaintiff's trademark in its

SAVENOW software constitutes an unauthorized use of that mark in commerce and is likely to cause initial interest confusion under the rationale of the metatag cases. Although the survey evidence offered by 1-800 Contacts was largely discredited — it was the same survey evidence that had been offered and rejected in the *Wells Fargo* case — a well-designed Internet survey can readily supply quantitative evidence of confusion. WhenU appealed the decision to the Second Circuit. Because of the obvious importance of this case to the *Gator* litigation, our firm recently filed an *amicus* brief on behalf of Hertz and the other Gator plaintiffs urging that Judge Batts's decision be affirmed.

VI. The Prognosis

The Second Circuit will have an enormous opportunity to influence the outcome of this issue when it rules on WhenU's appeal. Likewise, the cases against Gator will likely play an important role in resolving this issue. Ultimately, we believe that the trademark claim will prove successful.

What Gator and WhenU are doing is the essence of trademark infringement. They are capitalizing on the reputation and goodwill of famous trademarks, as well as the investment by trademark owners in their Web sites, in order to promote their own products. The Gator and WhenU schemes may involve the brave new world of e-commerce, but their method is an old-fashioned misappropriation of the fame and goodwill of trademark owners.

Limited Liability Companies as Vehicles for Joint Ventures

*William A. Hancock**

I. Introduction

The limited liability company — commonly called an LLC — is a fairly new business form which combines elements of the corporation and partnership. It is useful for a number of purposes, a very important one for corporate counsel being a vehicle for joint ventures. In fact, our research shows that it is probably the preferred vehicle. We have collected a number of illustrations from the SEC's EDGAR database and provide their EDGAR locations at the conclusion of this discussion.

This article will discuss some of the key issues corporate counsel may want to address at the early discussion stages of any joint venture, with emphasis on the questions one would want to ask if an LLC was probably going to be

* *William A. Hancock is Editor and Publisher at Business Laws, Inc. and a member of the Ohio and California Bars.*

the chosen entity. The discussion was created, in part, from examining the LLC joint venture forms listed at the end of the article.

II. Legal Overview

LLCs are creatures of state law, so the details of the law governing them vary among the states. However, there are many common elements to these state laws. In addition, those wanting to form and use an LLC can use any state law they choose. In fact, the majority of LLCs seem to be formed under the state law of Delaware.

The legal document by which an LLC is established under state law is generally called a "Certificate of Formation" or "Articles of Organization." These are very simple documents. Here is an illustration:

> Certificate of Formation of [name of the LLC]
>
> 1. The name of the limited liability company is [In general, the statutes require that the name include the words "Limited Liability Company" or the abbreviation "LLC," and there is also a requirement that the name not be confusingly similar to other companies. Other than those requirements, however, the LLC can have any name the members want.].
>
> 2. The address of its registered office in the State of Delaware is Corporation Trust Center, 1209 Orange Street, in the City of Wilmington, County of New Castle. The name of its registered agent at such address is The Corporation Trust Company. [The Corporation Trust Company is one of a number of businesses that offer their services to other companies to form an LLC and act as the agent for service of process in Delaware — or any other state if desired.]
>
> Signature [Generally only one signature is required and that does not have to be the principal member — a lawyer or accountant can form the LLC.]

Since LLCs are so easy to form, some corporate counsel and law firms have decided that they should form one and have it ready when the need arises. Generally it is formed under Delaware law — using a Certificate of

Formation similar to the one above — and has one member (often the lawyer filing it) with the idea that, when the need arises, the name can be changed and the lawyer can transfer the membership interests as appropriate, but there will be no delays in actually having the entity available.

This Certificate of Formation is a public document. The main governing document of an LLC is generally called an Operating Agreement, and it is a private document written by the members to establish the basic operating rules of the business. It can be either long or short. The Operating Agreement can cover just about all the possibilities which may arise in the operation of the LLC including the frequency of meetings, the rights and obligations of the members, and what happens on dissolution. Most counselors highly recommend that the documents cover most of these operational details. However, if they do not, the state laws will generally provide a set of default rules which will be applicable.

III. The Liability Situation

The key business and legal benefit of an LLC is the same as for a regular corporation. That is, the shareholders in the case of a regular corporation or the members in the case of an LLC are not personally liable for the debts and obligations of the business. Instead, their liability is "limited" to whatever capital they have chosen to contribute to the business. Of course, there are limits. There has to be a reasonable amount of capital contributed, and the members have to respect the fact that the LLC is a separate business entity. Similar principles apply to any corporation.

One might contrast that with a partnership, where the law provides that each partner is responsible for all the business obligations of the partnership.

A. The Tax Situation

In a regular corporation, the corporation is a separate tax-paying entity and will have to pay a tax on all of its profits. Further, when those profits are distributed to the shareholders, there will be an additional tax because that distribution will be income to them. This is the normal "double taxation" which applies to all regular corporations. However, a partnership is not a separate tax-paying entity. A partnership does not pay any tax on its income, but instead simply passes the income through to the partners. Thus, if two companies join together as a 50-50 partnership and the partnership earned

$1 million of income, each member would simply have $500,000 of income, and there would be only one tax on that amount. The same principle applies to losses. Suppose the venture lost $1 million. If it was a corporation, the loss would belong to the corporation, but since the corporation was new, it may not have any other income against which the loss could be used. In a partnership on the other hand, each partner would be entitled to a loss of $500,000 which could be used to offset other income from other sources.

B. Will It Really Work?

The tax laws contain elaborate rules and regulations on how different types of entities should be taxed. Basically, they provide that "reality governs," and if a business entity is "really" a corporation, it will be taxed that way. The trouble is that these rules were ambiguous, and it was difficult to tell whether the IRS would say that the LLC should be taxed as a partnership on the one hand, or whether it should be taxed as a corporation on the other hand. This caused many to be very reluctant to use the LLC. However, beginning in 1997, the IRS adopted some new regulations commonly called the "check the box" regulations. These regulations provided that, when the LLC filed its tax documents, it would simply "check the box" as to whether it wanted to be taxed as a partnership or a corporation. The IRS promised to respect this election, and it appears that they have. That removed substantially all of the doubt about how the LLC would be taxed, and the use of this very helpful business entity greatly increased.

The limited liability issue was also subject to some question. These were new business entities, and it was hard to tell the extent to which the courts would respect them. While these issues are subject to state law, as a generality, it is safe to say that most courts are respecting the limited liability aspects of LLCs to the same extent as corporations.

C. What about a Limited Partnership or an "S" Corporation?

Virtually all states have statutes allowing the formation of a "limited partnership" in which the liability of the "limited partners" is limited to their investment — just like a corporation. In addition, the tax laws authorize an "S" Corporation in which the corporation itself does not pay taxes, but, instead, just passes the income or losses through to the shareholders just like a partnership. Thus, to some extent, there are options to the use of the LLC. However, there are often many technicalities and limitations to these other options which are not present with the LLC. For example, in a limited part-

nership, the limited partners cannot participate in the management of the venture. In an "S" Corporation, there can only be certain types of shareholders, and there can only be a certain number of them. None of these restrictions applies to an LLC.

IV. How Is an LLC Governed?

While state laws will provide a mechanism for governing the LLC if the parties do not, the law also allows the parties to establish their own way of governing the LLC. It can be like a partnership. This is the "member managed" LLC in which each of the members has the right to participate in the management of the business essentially to the same extent they would if it were a partnership. It can be a manager managed business much like a corporation. The members elect a board of managers, and the board of managers then manages the business, often by recruiting others who serve as officers of the business. Further, there are no restrictions on the variations or options for management of the business. Essentially, it can be managed any way the members want — provided they spell it out in the operating agreement.

What are the major issues to think about when using an LLC for a joint venture? Our analysis of the LLC operating agreements listed at the end of this article indicate that corporate counsel may be well advised to raise the following twelve questions with management at the very early stages of consideration of the venture.

1. Exactly what is the business purpose?

The formal documents may say that the LLC is authorized to conduct any lawful business, but the operating agreement should go on to provide some parameters as to exactly for what the LLC is intended to be used. The language can be fairly general and flexible, but the basic intention of the parties should be identified. This is important as it forms the basis for other decisions that will have to be made, such as those listed below. This question may also relate to the dissolution or termination of the LLC. Is it contemplated that the LLC will terminate when it achieves a certain business purpose? If so, what are the details involved?

2. How will the profits/losses be allocated? How are contributions of assets to be valued?

One of the benefits of an LLC is that the parties can agree on how the

profits or losses will be allocated, and that determination does not have to be based on the capital accounts or percentage ownership of the members. Of course, it is often based on percentage ownership, so that raises a question of valuation if one member contributes cash or assets which are easily valued and the other member contributes intellectual property or assets which are not as easily valued.

3. Who can make which decisions?

Most of the operating agreements for these LLCs divide business decisions into at least two classes. The first class is what might be called routine day-to-day business decisions. There may be a board of managers which is authorized to make these decisions, or there may even be a designation of one person to act as the manager to make them. The rights of the members are basically protected by their right to remove the manager(s) if the members do not like the way they are doing things.

Then, however, there is a list of other more important or fundamental things which require some other method of approval. Perhaps it might be a "super-majority" or perhaps these decisions might even require unanimous approval. What should those "super-majority" items include? They can include whatever the members want, but the following are often put on that list. Corporate counsel can provide a useful function by raising this issue and asking what the businesspeople feel are fundamental decisions which should be handled in a separate way. Often the businesspeople will routinely think of some of these — they may not think of some of the other items unless counsel provides a listing of options from other LLC operating agreements:

— admitting new members;
— calls for additional capital contributions;
— issuance of any debt instruments over a certain amount (perhaps including the issuance of any securities);
— any acquisition or disposition of assets over a certain amount;
— leases over a certain amount;
— investments in any other business entity;
— the making of any loans or the sale of any equity interests;
— payment of bonuses or compensation over certain agreed-upon amounts;
— decisions relating to litigation or any other business disputes;
— appointment or removal of the company accountants or auditors; and/or the approval of the company financial statements;

— entering into any contract with any member (often dealt with separately as described below);
— annual budget or business plan, the approval of which requires some type of super-majority;
— entering into any contract involving more than a certain amount;
— hiring any people where the salary is over a certain amount; and
— any guaranty of any other entity.

4. To what extent can the members deal with the LLC?

Often the LLC is not intended to be a complete self-contained business operation. In fact, it may have few employees and none of the traditional staff functions such as purchasing, accounting, law, insurance, human resources, etc. It may not even have its own building or space but instead would be using space provided by one of the members. This presents a potential conflict of interest situation. For example, assume there are two members, A and B, and each has a 50 percent interest in the LLC. Member A, however, will be providing the office space, and also some of the staff functions noted above. The interest of Member A will be to charge as high a price for the space and these services as possible, and the interest of Member B will be to get the space and services at the lowest price. How are these tensions to be resolved? Some possibilities are as follows:

— Treat transactions between the LLC and the members as a super-majority item so that each member has to approve them.

— Include provisions in the operating agreement that any services provided to the LLC by any of the members will be on an "arm's-length" or "most favored customer" basis with, perhaps, some mechanisms for checking up on this from time to time.

— Have a separate procedure or perhaps separate parties to approve any member LLC transactions (*e.g.,* the independent accountants have to sign off on the arrangement).

— Establish an allocation of which services are to be provided by which members and indicate that these services are to be provided at no charge to the LLC.

Another point which should be considered is the degree to which anyone involved with the LLC can have other responsibilities. Many LLC operating

agreements provide that its executive officers are not required to devote their entire energy to the LLC and may, in fact, have jobs or investments in competitors.

5. To what extent are the members bound to act through the LLC only? (*I.e.,* what are the noncompetition issues?)

If the members form a business entity to engage in a certain type of business, it is only logical to assume that they will use the business entity for that purpose, to the exclusion of taking such business opportunities for themselves. The details of that, however, are often more difficult to work out. The agreement must also pass muster under the antitrust laws.

6. What if one of the members wants out of the arrangement but the other member wants to continue?

Some type of buy-out arrangements may be appropriate for the LLC — in much the same way that two people forming a corporation or partnership would at least want to think about what would happen if one of them wanted to exit the business. Sometimes this can be a right of first refusal, perhaps a "put" right, or a combination "put and call" situation where either party can request the other to buy them out at a certain price, and the other party then gets the option to either accept that request or turn it around and require the requesting party to buy the other party's interest at the same price.

7. What about confidentiality and/or the protection of intellectual property?

Often the LLC will be using intellectual property of one or perhaps both of the members. This intellectual property may be contributed to the LLC as it may be of the type that the contributing member would not want to use it except for the LLC operation. In other cases, the LLC may simply have a license to use that intellectual property — perhaps an exclusive license. The contributing party may have an interest in protecting that intellectual property or, perhaps, continuing to use that intellectual property itself in other types of businesses. Similarly, both members of the LLC may have access to confidential or proprietary information of the other member. What type of restrictions or controls are appropriate?

8. Should there be some formal alternative dispute resolution procedures?

Many LLCs that are used for a joint venture purpose do contain some type of procedure which the parties can use to resolve disputes. These alternative

dispute resolution (ADR) procedures are often similar to those which may be found in other business relationships. They may include

— good faith negotiation for some period of time;
— an "escalation" provision whereby each side brings in more senior executives to resolve a dispute;
— mediation; and
— arbitration.

Any or all of these techniques can be used alone or in combination. It is possible to use all of them in sequence — a technique which is becoming increasingly popular.

In addition to a generalized procedure for resolving disputes, many LLC operating agreements anticipate differences of opinion on certain key items and provide for decision making using various committees. For example, one might anticipate differences of opinion on when and where (in which countries) to apply for patents. There may be an intellectual property committee which would be responsible for making the initial determination, and only if they could not reach a decision would the matter be escalated up the chain of command. Similarly we see many committees in pharmaceutical LLCs such as a research committee which makes decisions regarding which research to focus on, and a commercialization committee which makes decisions relating to how a promising product might be commercialized.

9. How does one deal with the complexities of the tax law relating to partnerships?

The provisions of the Internal Revenue Code dealing with the taxation of partnerships are among the most complex in the law. Similarly, in some LLC operating agreements, the provisions dealing with the capital accounts of the parties and exactly what gets passed through to whom and when are extensive and complex. While the LLC is not a tax-paying entity, it does have to file returns and other documents and elections with the IRS. The general approach to taking care of this is to designate a "tax member" to assume this responsibility — subject to approvals and the rights of the other member(s). This is a considerable administrative burden, and the parties are well advised to think about exactly how it will be handled and paid for. Generally, it will require assistance from the LLC's accountants and auditors, and an agreement on who these will be is also helpful.

10. Are there any "change of control" issues which should be addressed?

In today's world of constant mergers, acquisitions, and divestitures, many legal documents should address the possibility of a change of control of the other party. Suppose, for example, that the LLC has two members, both in the pharmaceutical industry but not competitors. The purpose of the LLC is to develop and market a product which would be new to both members. Then, however, one of the members is acquired by a direct competitor of the other member. What should happen? What if there is confidential information involved to which the direct competitor will now have access? There are no right or wrong answers to questions such as this, but it may be helpful to think about them in advance and have some procedures or techniques to deal with them in the operating agreement.

11. Financing the LLC

It will be the rare LLC where the members make an initial contribution sufficient to operate the business on a going-forward basis. Additional capital contributions may be called for, or the parties may agree that, if the LLC needs additional capital, it will borrow it. In some cases, additional capital contributions are a sensitive issue with one of the members being unable or unwilling to simply come up with more cash whenever the LLC needs it. Early discussion of how to handle this is important.

12. To what extent should the details of management of the LLC be spelled out?

Our research shows a very wide range of options. At the one extreme, there is very little in the way of stated requirements for meetings either in terms of what they might be called for or their frequency. Requirements for notice and quorum are either cryptic or nonexistent (if nonexistent, the state law will probably fill in the blanks). At the other extreme, we see operating agreements which require meetings to be held at a certain frequence and spelling out in great detail exactly how that should be done, who should be present, what should be decided, the records and minutes which should be kept, etc. It may be useful for corporate counsel to provide some illustrations to management and obtain their views as to the level of detail which may be appropriate for the operating agreement.

As a matter of governance, most LLC operating agreements do allow telephonic meetings and approval of actions by unanimous written consent without a meeting.

Another variation is the number and composition of committees. To some extent this interacts with the ADR issue mentioned above.

V. Summary and Conclusion

Limited liability companies can be very attractive vehicles for many purposes, including joint ventures between companies that want to join together in some business operation. They are simple and complex at the same time. They are simple to form, and good, illustrative, operating agreements can be found simply by looking at what other companies have done. Much of this is public information as it has been filed by other companies with their reports to the SEC. On the other hand, the ease of formation of an LLC and the relative simplicity of the basic principles should not be allowed to mask the fact that it is a very important legal relationship and many important legal, accounting, and tax issues are present.

VI. Summaries of Operating Agreements

Following are some selected LLC operating agreements where the LLC was used as a joint venture vehicle.

LLC Operating Agreement for Energetic Systems Inc., LLC

EDGAR Filing: American Pacific Corp. 10-K, Exhibit 10.13, filed December 18, 2003
Date of Agreement: October 5, 2002
Length: Approximately 15,447 words

This is an LLC under Nevada law formed to by two companies to acquire the assets of a third company which relate to explosives. The operating agreement contains what amounts to an "optional" system for making additional capital contributions. Each of the members has the right to make them to keep its proportional interest but does not have the obligation to do so. The other members then have the right to make up what is needed, or the LLC can borrow as required. This LLC operating agreement would be very helpful to any corporate counsel where management appeared to want something fairly simple and as informal as practical. It would also be helpful if management had certain named individuals on whom it was basically going to rely for the day-to-day management of the LLC.

Limited Liability Company Agreement between Cargill Inc. and CHS Inc.

EDGAR Filing: CHS Inc. 10-K, Exhibit 10.4, filed November 25, 2002

Date of Agreement: August 26, 2002
Length: Approximately 25,254 words (including exhibits)

This LLC was formed by the parties to buy and export grain. The parties agree that they will engage in this business exclusively through the LLC. There is a Form Services Agreement which has some interesting features, including a provision acknowledging antitrust risks and providing that anyone participating will have appropriate antitrust training. The agreement is governed by Delaware law. This is one of the longest operating agreements in our collection — the definitions alone are over nine pages. One of those definitions is "Business Purpose," and the LLC is authorized to do anything in furtherance of that "Business Purpose." It is defined to mean "to engage in the business of buying, trading, selling, handling and transporting for export and exporting Feedgrains and Oilseeds from the Pacific Northwest, United States, through the Tacoma Facility, and through the Seattle Facility pursuant to a put-through agreement with the operator of the Seattle Facility, to Pacific Basin destinations … ." This Operating Agreement would be helpful to any corporate counsel wanting a very long form to use as a checklist and for illustrations of many different provisions.

Operating Agreement of Techstar, LLC
EDGAR Filing: Starcraft Inc. 10-Q, Exhibit 10.1, filed May 8, 2003
Date of Agreement: January 1, 1999
Length: Approximately 18,012 words

This is an LLC formed by Starcraft and a company called Wheel to Wheel, Inc. to engage in what the parties call "Second Stage Manufacturing" for original equipment makers — including, particularly, General Motors in this case. The LLC was formed under Indiana law. There is an exclusivity feature where the members agree that all of the business of the type contemplated for the LLC will be done through the LLC only — not individually by any of the members. If the LLC should elect not to pursue any given opportunity, the members would be free to do so. There is an express authorization for the LLC to borrow from the members if necessary. The members have set forth very detailed tax and capital account provisions which would highlight the need for many LLCs to have extensive tax and accounting advice at the earliest stages.

Operating Agreement of Stratus Technology Services, LLC
EDGAR Filing: Stratus Services Group Inc. 10-K, Exhibit 10.14, filed December 24, 2003

Date of Agreement: December 18, 2002
Length: Approximately 12,566 words

This is a joint venture between Stratus Services Group which is basically a staffing company, and Fusion Business Services, LLC which is a technology project management firm. The purpose is to help both companies consolidate their technology services business into a single entity. The LLC was formed under New Jersey law. Useful features include provisions on a "cross purchase" agreement, and the designation of one of the members as the "managing member" along with a listing of certain aspects of authority of the managing member.

Operating Agreement for Cincinnati Bell Wireless, LLC

EDGAR Filing: Cincinnati Bell Inc. 10-K, Exhibit 10.I-4, filed March 24, 2004
Date of Agreement: Original Operating Agreement was dated 1998, and there was an amendment dated October 16, 2003
Length: Approximately 26,808 words for the original agreement

This is essentially a joint venture between Cincinnati Bell and ATT Wireless PCS Inc. Cincinnati Bell owns 80.1 percent and ATT the remainder. The function of the LLC is to provide a regional wireless network for the greater Cincinnati area. The agreement contains both many good business provisions relating to the respective rights and obligations of the parties, and also many technical requirements relating to the network itself so that it interconnects properly.

Licensed To _____
License No. _____
Date _____

HANDLING GOVERNMENT SEARCH WARRANTS

What Is the Problem?

In today's environment, government authorities at both the state and federal level are making increasing use of search warrants to investigate what they believe may be corporate crimes. These government agents will probably be carrying guns and will arrive unannounced. They may or may not allow the employees at the site time to obtain legal counsel to deal with the search. It is, therefore, necessary for companies to prepare in advance for this eventuality by making sure appropriate people at each facility understand their rights and obligations in search warrant cases.

What Are the Risks?

The risk of trying to prevent government agents from executing a search warrant is that such action can be criminal in and of itself. In other words, those who try this approach may be guilty of a separate crime, and such conduct may also be attributed to the company which could also be guilty of a separate crime. On the other hand, if company people do not understand their rights — including those granted by the U.S. Constitution — they may cooperate too much with government agents, thus prejudicing the legitimate rights of the company and its employees when accused of criminal conduct. Since company people are not accustomed to dealing with gun-toting federal agents, this is a traumatic event where just about anything could happen — we want to prevent panic and possible unfortunate actions by those involved.

What Are the Basic Rules I Need to Know?

If the government feels that a company may have violated a law, it can proceed in essentially two ways. The first and most typical way might be called the cooperative mode. It will issue a sub-

poena to the company for either documents or testimony, work through the company lawyers, and allow any individual corporate employee who desires to have legal counsel present during any question and answer sessions the government may want. The second approach is what might be called the "gangbusters" approach of simply barging into the company premises unannounced and presenting a search warrant which will allow the agent to search and seize materials described in that warrant. The idea is that this surprise element is necessary to prevent the company or its people from destroying incriminating evidence. Because of the surprise nature of this approach, it may or may not be possible to obtain legal advice in a timely fashion. Therefore, at least some company employees at all locations should have a basic knowledge of their rights and obligations in a search warrant situation.

The U.S. Constitution guarantees all citizens — including corporations as well as their employees — certain rights when the government thinks they may have committed a crime. One of those rights is that the government is not allowed to enter private property and search for evidence or seize items without a search warrant. The government is required to go to some legal authority — often a magistrate or a court — and make a reasonable showing why this rather drastic approach is called for. Two basic rules are brought into play:

1. The government has to be fairly specific about what it wants to search for and the premises it wants to search. The government cannot simply allege that the company or certain individuals have committed a crime. Instead, it has to be fairly specific about what crime may have been committed, and what evidence or type of evidence the government thinks it may find and want to seize to prove that crime.

2. The second rule is that, if the government stumbles over any of the legal requirements imposed by law and the Constitution, the search warrant may be invalid, and any evidence that the agents may seize pursuant to that invalid warrant will not be admissible in court.

Those two basic rules are the foundation for preparation for the possibility of a search warrant. First, you want to see what the warrant says to be sure that it is specific enough to be enforceable and that the agents only do what is allowed by the warrant. Second, you want to document everything that happens so that, if the warrant should be deficient, you can get any evidence seized by the government officers thrown out of court.

There are a host of technical bases the government has to touch in getting a warrant and executing it. Criminal defense lawyers and prosecution lawyers often spend much effort discussing and debating these issues, and it is not necessary to make company employees into defense lawyers for themselves or for the company. However, employees responsible for a facility should have the presence of mind to get the general feel of what is going on and see that at least the basics are covered. That is the purpose of this **FRONTLINE COMPLIANCE** exercise.

1. Ask for a Lawyer

The first line of defense should be the company's lawyers — either outside counsel or lawyers from the company legal department. Therefore, the first thing anyone presented with a search warrant should do is ask that its execution be delayed until the company lawyer can be consulted or, hopefully, brought to the location. That approach, however, may or may not be workable. The agents executing a search warrant do not have any obligation to wait for you to summon the company lawyers. Even if you are lucky enough to have a cooperative agent who will allow you some time to consult with the company lawyers, you may or may not be able to locate the lawyer and/or get the lawyer to the facility within whatever time frame the agent establishes. Therefore, we are using this **FRONTLINE COMPLIANCE** exercise to arm company employees with the basic knowledge of their rights and responsibilities.

You should note that another of the rights granted to you and the company by the U.S. Constitution is the right to effective representation by counsel. This is provided for by the Sixth Amendment, and if you do ask the agent in charge (AIC) to allow you time to get a lawyer and the AIC refuses to do so, you should note that by saying something to the effect that, if the government proceeds with the execution of the warrant, it will be depriving you and the company of the right to legal counsel as guaranteed by the Constitution. That argument may or may not prove beneficial in subsequent legal proceedings, but it is helpful to preserve it so that the lawyers will have it available for whatever it may be worth later on.

2. The Importance of Waiver

At this point, we want to highlight the importance of waiver. While the U.S. Constitution grants you and the company many rights, it is almost universally possible to waive them. Thus, while you and the company are generally entitled to be represented by legal counsel, you can easily waive this right. That is why it is so important to actually make the objections and statements we describe in this **FRONTLINE COMPLIANCE** exercise even if they are not granted by the AIC. All of your rights relating to the search warrant itself (including the right to insist that there be one) can also be waived. The government knows this and may ask you to consent to the search. You should not do this. Note that it is equally important to be able to show a court at a later time that you did not waive the right you want to assert. Thus, it is not only important to make the objection noted above, but it is important to note that you have done so either through making the request in writing or having other witnesses available and documenting, as soon as practical, exactly what you did and said.

3. The Attorney-Client Privilege

In general, documents which represent communications to or from a lawyer for the purpose of getting legal advice are privileged and cannot be obtained by the government either through a subpoena or in a search warrant. If a lawyer is present during the search, you can depend on the lawyer to make sure the privilege is invoked and not waived. However, if a lawyer is not present, those handling the search will simply have to be alert to the fact that some searches may involve privileged documents, and it is important that the privilege not be waived. For example, suppose a facility has an office which a lawyer uses when he or she visits periodically. The person in charge of the search should not allow the search to go into that office without objection, and if the agents decide to go in anyway and continue their search, the company representative should carefully document the fact that an objection was made, overruled by the agents, and then as carefully and thoroughly as possible document exactly what, if anything, the agents took from that office.

4. What about Search Warrants Dealing with Computers?

This is a difficult area. The company representative should understand, however, that the government holds all the cards. If push comes to shove, the government can probably seize the entire computer. This is one of the big reasons to try to establish a businesslike, cooperative attitude with the agents involved. Negotiation is called for, and there is little legal or practical incentive for the agents to do anything other than what they intended to do when they arrived. If that happens to be to seize the computers, that may be what happens. However, there are many other options available to the agents if you can negotiate them. That can often be facilitated by having a person with computer knowledge present.

For example, the government manual on search warrants dealing with computers offers these choices:

— search the computer and print out a hard copy of particular files at that time (this is generally the least desirable thing, as the printout does not contain all relevant information such as the time of creation of the document, whether it has been changed, etc.);

— search the computer, and make an electronic copy of particular files at that time;
— create a duplicate electronic copy of the entire storage device on-site, and then later recreate a working copy of the storage device off-site for review; and
— seize the equipment, remove it from the premises, and review its contents off-site.

Obviously, that latter approach would be extremely disruptive and possibly disastrous to the company, and while you cannot physically prevent the agents from doing that if they choose, you can and should raise as much objection as possible and document that objection.

5. If You Have to Go It Alone

If you have to go it alone during a search warrant execution, the basic approach should be to be as cooperative as possible without waiving any of the company's rights or volunteering anything not required by the search warrant. One of the most important things you can do is plan and think a little in advance so that a traumatic event such as this does not cause any more disruption and anxiety than necessary. Another thing which is helpful is to keep in mind some very basic rights, which include the following:

1. You are entitled to meet and have the name of the AIC. You can ask this person for identification. If nothing else, this slows things down a little allowing you and others to gather their wits.

2. You are entitled to see and examine the search warrant. The things to look at include

   — the name of the company — it has to be correct or at least basically correct (you do not want to try to base an objection on some minor error, but it is important that you verify that the search warrant was issued to your company and not some other company with a similar name);
   — the location which is to be searched (this has to be specific, and you are entitled to limit the search to the location specified in the search warrant; *e.g.,* if your company has two buildings and the search warrant is directed to building one, a search of the second building is not allowed by that warrant);
   — the specific things which are to be searched for (if the search warrant says that the items to be searched for are paper documents, that does not include computers or computer hard drives); and
   — the reason for the search — in other words, what law is the government alleging that you violated.

3. You are entitled to an inventory of anything seized. Should the agents want to seize anything such as files or documents, you are entitled to a detailed listing of exactly what was taken.

4. You are entitled to a prompt execution of any search warrant. This is generally ten days, so if the warrant was issued more than ten days before the agents arrive, you are entitled to object to that. Again we remind everyone of the importance of the concept of waiver. Even if the agents refuse to abandon a search pursuant to a stale warrant, it is important that you note your objection.

5. You are entitled to know who is searching your premises. You are entitled to know not only the name of the AIC, but also the names and identities of others, as the law has certain requirements in terms of who can and cannot participate in the execution of a search warrant. If the searching party includes people who are not authorized, you want to know that and create a record so that the lawyers can raise this objection later.

6. You are entitled to manage the search operation and monitor what is going on. In other words, while you cannot stop the agents from going anyplace authorized by the warrant, you are entitled to follow them and take notes about what they say and do. Theoretically, you would be entitled to employ photographic or video equipment, but this is generally not recommended, at least as a general practice. You may want a photo of everyone who is a part of the search party so their identities and qualifications can be verified at a later date, but this is probably appropriate only if all the people involved do not give you a business card or produce appropriate identification.

7. A search warrant does not allow interviews or interrogation of you or the company people. No such conversations or interchanges should take place during a search warrant execution. Instead, if the agents want to interview or interrogate people, they should be asked to do so pursuant to normal procedures which typically allow representation by legal counsel if the affected employees desire.

What Are the Main Things I Should or Should Not Do?

It would be helpful if the employee in charge of any location (or that employee's deputy, as one must remember that these are surprise events where the government has great latitude in deciding how to proceed) had a checklist of things to do should this unfortunate event occur. That checklist would have to be created specifically for each location, as one of the key things on it would be the identification of the company lawyers to call. In general, however, the following would appear appropriate:

1. Understand the company chain of command and who may be available for help and how to reach them.

2. Initially, try to establish a reasonably cooperative and businesslike environment with the AIC, and slow things down so that they proceed in a logical fashion where you have the opportunity to take the steps and do the things described in this exercise. Remember that the law in this area is very subjective — and generally favors the government. If the agents want to act in an arbitrary and high-handed manner, they will probably be able to get away with that (of course, you can and should complain and make a record of that). Negotiation and businesslike cooperation should be the watchwords — not obstruction or acrimony.

3. Remember that records are going to be very important. Early on, make sure there are people and equipment available to keep records of what is happening, who is saying what, etc. Try to never get into a situation where you do not have at least one other person to witness what you are doing or saying. Tape recorders, cameras, etc., should be used only with the advance approval of the company, and if they are used, that must be apparent to everyone — no secret tape recording or surreptitious photography. The old-fashioned clipboard with paper and pen has many advantages in this situation.

4. Verify the identities and credentials of everyone in the search party to the extent you can.

5. Examine the warrant, and be sure you understand that

   — it is actually directed to your company and not to some other company with a similar name;
   — it was issued within ten days;
   — it describes specifically what the agents are searching for;

— it describes specifically what premises are to be covered by the search; and
— it specifies what criminal activity the government thinks justifies the search warrant.

6. Never waive any of your rights or those of the company — even if you are not sure about those rights. Employees dealing with a search warrant situation should always stick up for their reasonable rights, but should ***never*** physically interfere with the search. Therefore, your only downside risk to asserting a right which your legal counsel later says was really not available is that you happened to be wrong about a technical legal point. You have not made matters any worse.

7. You should probably excuse any company employees who are not essential or who are not actually named in the warrant for the remainder of the day. If they are not around, the agents will not be able to ask them questions.

8. Keep an ongoing record of exactly what the agents do, including especially the identification of anything they want to seize. You are entitled to an inventory of this but, as a practical matter, it is your responsibility to make sure this inventory is actually created and that it is complete and accurate. Make it as detailed and specific as possible. If the agents want originals (which they probably will), try to get their permission to make copies for yourself.

9. Make sure your conversations with the agents (and those of anyone else who may be involved) are limited to the search warrant itself, not the underlying facts of whatever the government thinks happened. For example, a question from the agents about where the files which contain a certain contract are located should be answered truthfully and directly, but that answer should be limited to the location of the documents, and there should be no discussion about what the contract says or means or the background of the transaction.

10. Make sure you report to the appropriate lawyers or others in the company as much as you can possibly remember about everything that happened.

11. Do not consent to the search. You may be asked to do this. This is not a good thing to do, however, as it jeopardizes all of the possible objections the company may have on the basis of deficiencies in the warrant or its execution.

In a Nutshell

The arrival of government agents with a search warrant means that the government thinks there has been a serious criminal violation and has been able to convince a court or magistrate of that fact. It is a very serious thing, and one which should be handled by the company lawyers, if possible. However, as a practical matter, that may not be possible, so others in the company should be aware of their basic rights and responsibilities in dealing with a search warrant. A knowledge of your basic rights, advance planning, some common sense, and failure to panic should help make a bad situation at least manageable.

COMPLIANCE QUIZ

1. The Constitution of the United States guarantees all citizens (including corporations) the right to be free from unreasonable searches and seizures. In general, this means that government agents can search our company facilities only pursuant to valid search warrant, and only to the extent provided in that search warrant.

   TRUE ***FALSE***

2. If government agents come to our location with a warrant, I am entitled to see the warrant and make sure the government agents do only what is expressly allowed.

   TRUE ***FALSE***

3. If the government agents want to do something which is not allowed by the warrant, I am entitled to physically restrain them from doing that.

   TRUE ***FALSE***

4. If a government agent presents a warrant to search a particular place — say the fourteenth floor of a building — and during that search the government agent decides that some incriminating material may be on the fifteenth floor, the agent can continue on to the fifteenth floor so long as the agent has a reasonable belief that is necessary.

   TRUE ***FALSE***

5. If a government agent wants me to answer questions during the execution of a search warrant, I am required to do that.

   TRUE ***FALSE***

6. If a government agent presents a warrant to search the company files for a specific matter, and I have personal files in my office, the warrant does not extend to my personal files.

   TRUE ***FALSE***

7. A government agent wanting to search company property will generally call a short while before arrival to allow employees time to call their lawyer.

   TRUE ***FALSE***

8. A government agent executing a search warrant for paper documents has the implied right to extend that search to computers and computer documents. A government agent executing a search warrant for computers and computer-related material has the implied right to extend that search to paper files.

   TRUE ***FALSE***

9. A government agent who, in my good faith opinion, is exceeding his or her authority as described in the warrant can nevertheless not be physically stopped from doing that.

   TRUE ***FALSE***

10. If a government agent arrives unannounced to execute a search warrant, I am entitled to a reasonable amount of time to call my lawyer and obtain legal advice.

    TRUE ***FALSE***

11. If a government agent wants to take my computer away he or she can probably do that.

    TRUE ***FALSE***

ANSWERS TO THE QUIZ

1. ***TRUE.*** This is the starting point for our discussion. It is a helpful point to remember when trying to deal with what is likely to be an unexpected and traumatic event.

2. ***TRUE.*** This basic right allows you to slow the process down and attempt to assume a little control over it.

3. ***FALSE.*** You are ***never*** entitled to physically restrain any government agents. The basic idea is for company people to adopt a posture of reasonable cooperation and hope that the government agents do the same. If, however, the government agents act harshly, the appropriate actions of the company people should be to object — firmly but politely and without any physical restraints — and write down exactly what happened so the lawyers can deal with it later.

4. ***FALSE.*** The agents must search only the locations specified in the warrant. This is one of the things you want to examine closely when you look at the warrant and try to make sure the agents stick within its boundaries.

5. ***FALSE.*** A search warrant is for seizing documents only, not taking testimony or interrogating anyone. For that, the individuals involved are entitled to insist that the agents follow appropriate procedures, which generally allow the affected people to have counsel present if they desire.

6. ***PROBABLY FALSE.*** The question of whether files which are physically located on the company premises are company documents or personal documents can be somewhat complex, but in the overwhelming majority of cases, it is held that the documents are corporate and not personal. You can make the objection and note it in writing for further discussion by the lawyers, but it will probably not be helpful.

7. ***FALSE — IN THE VAST MAJORITY OF CASES.*** The whole idea is surprise so that the company subject to the search warrant does not have any time to move or destroy any evidence.

8. ***FALSE.*** Both of these statements are false in that warrants must be specific, and when they are specific, there are very few "implied rights" to extend them past their plain meaning. It should be noted, however, that in today's climate, virtually all government warrants will consider the fact that many records are on a computer.

9. ***TRUE.*** Never attempt any physical restraint of any government agent attempting to execute a search warrant. Firm but polite objections, followed by whatever the lawyers think appropriate after the fact, is the correct procedure.

10. ***FALSE.*** This is one of the reasons this exercise is needed. While some agents may allow a reasonable and short time for you to bring in your lawyer, that will probably be the exception rather than the rule.

11. ***TRUE.*** Searching computers is a difficult and technical area. However, the bottom line is that the government holds all the cards, and if the agents want to take your computer, they can probably do that.

FRONTLINE COMPLIANCE

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Certificate of Completion

To: _____

_____

_____

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Name: _____ (Signature) Date: _____

Name: _____ (Printed)

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Web Site Review

Business Laws, Inc. Editorial Staff

I. Introduction

In this article, we continue our discussion of software-related Web sites. In our last issue, as you may remember, we included a listing of Web sites dedicated to software issues, and we continue that discussion in the next section of this article. We also include a list of Web sites relating to China, which we found and updated in connection with our March 2005 supplement of our book titled Corporate Counsel's Guide to DOING BUSINESS IN CHINA (Second Edition).

As a reminder, we are always looking for leads on helpful Internet resources for in-house counsel. So if you have any sites that you would like us to describe for our other subscribers, please feel free to e-mail your suggestions to Thomas J. Griffith, Esq., Vice President-Legal, at tgriffith@businesslaws.com.

II. Software-Related Web Sites

A. Introduction

As noted above, in the last issue of CORPORATE COUNSEL'S QUARTERLY, we provided a brief list of law firm Web sites covering software-related issues. The following provides some additional Web sites covering software topics.

B. Computer-Related Organizations

1. Association for Computing Machinery

www.acm.org

The Association for Computing Machinery (ACM) dates back to 1947 and was the first educational and scientific computing society. Its membership numbers over 75,000 and is devoted not just to computer technology but more broadly to the area of information technology (IT). ACM has within it thirty-seven special interest groups dealing with various categories of IT (including artificial intelligence and computer code languages) that produce information and material published through ACM. ACM also serves as a portal and "digital library" of computing literature. It provides its members journals and magazines, and it sponsors seminars, workshops, conferences, and electronic forums. The ACM's site itself is fairly straightforward and user-friendly, and membership is open to students and IT professionals. While much of the site is intended for ACM's members, the information on the site is generalized enough for someone with an interest or questions in the area to get answers.

2. Association of Shareware Professionals

www.asp-shareware.org

The Association of Shareware Professionals (ASP) describes itself as "the world's #1 trade organization for independent software developers and vendors." Its purpose is to promote shareware (*i.e.,* computer programming that is available on a "try-it-before-you-buy-it" basis) as a means of distributing and marketing software. There is a frequently asked question (FAQ) page describing the shareware system and how software can be shared legally. Furthermore, there are links to other related shareware sites. A visitor also can apply to become a member of the ASP via the Web site. In addition, there are a number of free resources, such as access to ASP's newsgroups, online articles, developer and distributor tips, and a listing of upcoming industry events.

3. Business Software Alliance

www.bsa.org

The Business Software Alliance (BSA) represents the majority of leading U.S. software companies in their worldwide fight against software piracy. Software publishers can join BSA in specific regions of the world, including Asia, Europe, Latin America, and North America. Furthermore, BSA has enforcement programs in various countries and antipiracy hotlines operating in nearly all nations. Litigation, raids, and audits are all means BSA uses against corporate end users, hardware dealers, bulletin board operators, and other

persons or entities suspected of violating copyright laws protecting computer software.

BSA's Web site is designed so that the user can click on a specific country or region on BSA's map, and then find out what BSA is doing in that part of the world to promote "a safe and legal digital world." We clicked on a few countries and found that the links were written in the country's home language (*e.g.,* German, Spanish, French, etc.).

4. Computer Law Association
www.cla.org

The Computer Law Association (CLA) is a nonprofit international association serving IT professionals, and its site offers numerous helpful links relating to computer and Internet law. For instance, the CLA's conference papers are accessible through the site's "Publications" link. The site also contains a wide range of articles, most notably dealing with international computer law topics. For instance, the site provides access to papers on the Digital Millennium Copyright Act, European privacy laws, domain name dispute resolution procedures, and outsourcing software development. The CLA also publishes the *CLA Bulletin,* and each current issue of the newsletter is available online to CLA's members. However, nonmembers can access back issues of the *CLA Bulletin,* and the CLA provides free and helpful case summaries and discussions of recent IT developments.

The site also provides links to timely IT resources designed specifically for attorneys. For instance, under the "Resources" link, the site offers access to legal news, summaries of legislation and case law, information about international law developments, and case summaries published by the Bureau of National Affairs, Inc. (BNA) in its *Electronic Commerce & Law,* one of BNA's weekly newsletters. All of those materials, including BNA's case summaries, are free and available to non-CLA members.

5. Software & Information Industry Association
www.siia.net

In January 1999, Software Publishers Association and the Information Industry Association merged and formed the Software & Information Industry Association (SIIA). The SIIA is the principal trade association for the software and IT industries. From its Web site, the user can access timely online reports, articles, and other materials on worldwide antipiracy initiatives and software compliance.

The Web site does not pull any punches when it comes to communicating

the SIIA's position on certain issues. For instance, the titles of news releases we found on the site when we accessed it in mid-2004 clearly indicated that the SIIA applauded the U.S. Senate for passing pending software legislation; supported the Federal Trade Commission's recently adopted "spyware" regulations; and labeled a pending accounting industry initiative as "misguided." As a result, while the user may not agree with the SIIA's stance on recent developments, its site definitely provides access to timely discussions. It also has links to press room information, a calendar of upcoming seminars and conferences, and summaries of government affairs and antipiracy efforts. In addition, e-newsletters and a bookstore are available from the SIIA's site.

C. Intellectual Property Organizations and Resources

1. General

a. American Bar Association, Intellectual Property Law Section *www.abanet.org/intelprop*

This is the site of the largest intellectual property organization in the United States. The home page of the Intellectual Property Law Section of the American Bar Association (ABA) contains a list of links detailing the organization's activities. Additionally, a few of the links provide current developments in intellectual property law. Some of the links available at the section's site include the following: "Publications and CLE Materials"; "E-mail Discussion Groups"; "IP Legislation"; "CLE Programs and Meetings"; "Section Advocacy"; "Committees"; and "Section Leadership."

The annual report of the Section of Intellectual Property Law is also available from this site. The report contains section and council actions on committee resolutions and the full text of committee reports. Information regarding the ABA's seminars, a schedule of upcoming section meetings and conferences, and membership information also are available through this site.

The "IP Legislation" link is a particularly valuable resource. This link contains a frequently updated list of current intellectual property law legislation, and the list is displayed in an easy-to-read format. By clicking on the name of the legislation, the user can be transferred to the actual text of the bill.

b. American Bar Association, Online Discussion Groups *www.abanet.org/discussions*

The ABA has established several online discussion groups divided into particular topics or areas of law, and there are a number of groups focused on intellectual property law. A complete listing of all of the groups is accessible from the ABA's site, and the user can become a subscriber by clicking on

"Subscribe" at the appropriate link identified at the group's site. Alternatively, the user can click on "Guest" or "New User" and still participate in the group's online discussion. Some of the groups relating to software and intellectual property include the following:

— the Web Board;
— the IPL Web Conference Board;
— the Law Practice Management Group; and
— the Section of Science and Technology Web Board.

c. American Intellectual Property Law Association
www.aipla.org

The American Intellectual Property Law Association (AIPLA) is a professional association of attorneys specializing in intellectual property law. It maintains a searchable Web site containing information on patent and trademark laws; alternative dispute resolution techniques; and discussions of recent legislation, congressional testimony, public statements and comments, and links to other online information on intellectual property law.

As an AIPLA member, the user can access the association's bylaws, articles of incorporation, summaries of board meetings, and members-only directories. Members also can read the AIPLA's e-newsletter, *AIPLA Reports.* The site was completely redesigned in May 2004.

d. Intellectual Property Owners Association
www.ipo.org

The Intellectual Property Owners Association (IPO) is a nonprofit trade association of owners of patents, copyrights, trademarks, and trade secrets, and it focuses on protecting their intellectual property rights. Among other things, it supports its members by tracking national and international developments, analyzing current intellectual property law issues, providing educational and information services, and disseminating publicly available materials explaining intellectual property rights.

The site provides links to several important law-related resources. For instance, one scroll-down menu provides access to the Federal Circuit's Web site, *amicus* briefs filed by the IPO, and other court documents. Under another icon, the user can access the IPO's position papers on pending legislation, as well as track international legislation pertaining to intellectual property. Obviously, the site also offers information and governmental materials prepared by and relating to the IPO itself (*e.g.,* scheduled meetings, upcoming events, committee listings, board actions, etc.).

One unique and valuable feature of the site is the *IPO Daily News.* This feature provides short descriptions of current lawsuits, legislation, inventions, and the IPO's committee activities. The *IPO Daily News* is e-mailed to members and posted on the Web site. The news reports usually include brief discussions of intellectual property law issues compiled from news and wire services, as well as other information relating to pending legislation, registration fees, and inventor news.

e. IP Law Practice Center
www.law.com/jsp/pc/iplaw.jsp

This site is part of American Lawyer Media's (ALM's) well-known site at <www.law.com>. The intellectual property law site offers timely, interesting articles written by renowned intellectual property experts and reprinted from the *National Law Journal, Corporate Counsel, IP Law & Business, Law Firm, Inc.,* and other ALM publications (all of which are accessible online from this site). The IP Law Practice Center site also provides access to timely news items, practice papers, professional profiles, practice tools, and judicial decisions.

f. IP Mall
www.ipmall.fplc.edu

The Franklin Pierce Law Center (FPLC) maintains this site, which contains a comprehensive, topically sorted index of intellectual property sites. The FPLC's IP Mall is a good starting point for anyone who needs to get a basic idea of what types of intellectual property sites are available. The site has a continuously scrolling list of recent developments that may be of interest to the user, as well as links to the FPLC's Web site and other IP Mall and Internet resources.

g. Kuesterlaw
www.kuesterlaw.com

Described as "the technology law resource," this award-winning site was designed "to be the most comprehensive resource on the Internet for technology law information, especially including patent, copyright, and trademark law." Among other things, the site provides an impressive conglomeration of intellectual property-related Web sites divided into the following categories:

— basic information about intellectual property law (*e.g.,* "what is a copyright?");
— technology law sites;
— nontechnology law sites;

— online intellectual property resources;
— government links;
— listings of technology lawyers;
— general law-related sites (*e.g.,* associations, law schools, etc.);
— Georgia law resources;
— Internet search engines;
— general news links (*e.g.,* CNN, *USA Today, Wall Street Journal,* etc.); and
— local links (for the Georgia users).

This is definitely a helpful place to start for someone who is looking for another Web site relating to intellectual property or technology law.

h. World Intellectual Property Organization
www.wipo.int

The World Intellectual Property Organization (WIPO) site provides a substantial amount of international intellectual property information, with an emphasis on international treaties. On its "Activities & Services" link, the site provides access to information on various treaties, including the Patent Cooperation Treaty, as well as materials on international arbitration, international marks, IT, and domain names. All of the links describe WIPO's involvement in the relevant topics.

The "About Intellectual Property" page has links to WIPO's materials on so-called industrial property (*e.g.,* inventions and patents, trademarks, industrial designs, and geographic indications), copyrights, emerging intellectual property issues, and various intellectual property concerns that may be of particular interest to women. Additionally, the "News & Information Resources" page contains WIPO press releases, digital libraries, the *WIPO Magazine,* recent news items, and other news-related information. Lastly, the "About WIPO" provides comprehensive overviews of the organization, its corporate structure, members, programs, budgets, annual reports, and other institutional information.

2. Copyrights

a. Copyright & Fair Use, Stanford University Libraries
fairuse.stanford.edu

This site is maintained by the Stanford University Libraries and provides many links to information relating to copyrights and fair use. The site is fully searchable and divided into sections based on primary and secondary information. Primary materials include statutes, judicial opinions, regulations,

treaties, and conventions, while the secondary resources include lists of general copyright sites, relevant articles, and publications. The site also provides a brief description of each article, a link to the full text, and the date of the original article. While some of the articles are several years old, the list does include some recent entries and appears to be updated fairly regularly. This site also provides links to online copyright journals.

b. Copyright Website
www.benedict.com

This site focuses on copyright registration and information resources. It covers issues surrounding the Internet and is divided into useful categories of information. The "Info" section includes information on copyright notices and registration and provides copyright registration forms. The "Fair Use" link provides a succinct discussion, with some useful commentary, of the fair use provision as set forth in § 107 of the Copyright Act, and it provides a test for determining whether a use is, in fact, fair. Additionally, the "Digital" page discusses the copyright issues with regard to software development and distributing copyrighted materials over the Internet. The site also provides information on registering audio, visual, and digital copyrights. Copyright registrations can be done online for about a $100 fee.

3. Patents

a. Delphion
www.delphion.com

Delphion provides intellectual asset management software. Under the "Tools & Features" link, the Web site allows the user to search for patents in the United States, Europe, Japan, and other countries. The patents can be searched by either number or text, or the user can browse patent classes by title or number.

b. Express Search
www.expresssearch.com

The Express Search site is devoted to providing information on all aspects of the patent process. The site provides information on documenting inventions, selecting a patent agent or attorney, performing patent searches, and protecting patent rights. The site discloses search fees, maintenance fees, time frames, and format criteria.

4. Trade Secrets

a. 2003Law
www.2001law.com

Originally established in 2001, this site is maintained by the law firm of

Hancock, Rothert & Bunshoft. The site offers current news, case documents, and resources pertaining to trade secrets, among other intellectual property topics. The available primary source items include links to the full text of various state and federal laws.

The most interesting feature on this site is its "Headlines" section, which is a list of important news items involving trade secrets. Both published opinions and settlement agreements are described in this section. In some instances, the site provides links to the relevant online documents. The news topics appear to be updated fairly frequently and cover such topics as trade secret misappropriation, employment matters relating to nondisclosure and noncompetition agreements, and trade secret damages.

Users can subscribe to the site's free e-newsletter, as well as search its archives (arranged by topic). The general topics covered by the site include the following:

— computer and media torts;
— copyrights;
— Internet and technology insurance issues;
— online privacy;
— patents;
— trade secrets;
— trademarks and domain names; and
— viruses, hackers, and data losses.

b. LawGuru
www.lawguru.com/faq/19.html

While LawGuru contains an enormous amount of information and sample forms covering a plethora of legal topics, the above link to an FAQ page regarding trade secrets is quite helpful. The questions are provided by the Patent Cafe and include discussions of thirty-nine common concerns, ranging from basic questions about trade secrets, to tips on how documents should be marked, to explanations on the importance of conducting trade secret audits. At the time we visited the site, the FAQ link provided thirty-five discussion questions on patents and eleven questions on copyrights.

c. Trade Secret Office
www.thetso.com

The Trade Secret Office is a commercial technology site that purports to

revolutionize the law of trade secrets by providing mechanisms for establishing the existence of trade secrets similar to that of the U.S. Patent and Trademark Office. The site was in part developed by R. Mark Halligan, the author of the Trade Secrets Law Forum (discussed below).

d. Trade Secrets Law Forum
www.rmarkhalligan2.com

This is by far the most comprehensive Web site dedicated to the law of trade secrets available on the Internet. The site is maintained by R. Mark Halligan, a Chicago attorney with Welsh & Katz, Ltd., and most notably contains an archive of hundreds of trade secret case summaries dating from 1994 to the present. Each case description includes a brief synopsis of the facts and ruling. In some instances, the writeups provide practical tips gleaned from the decisions.

III. Web Sites Relating to Doing Business in China

A. Introduction

In this section, we provide a listing of Web sites that we found during our research relating to China. We found these materials over the years in connection with our book titled Corporate Counsel's Guide to DOING BUSINESS IN CHINA (Second Edition), which we recently supplemented in March 2005.

B. China Web Sites

1. Bureau of Industry and Security
www.bxa.doc.gov

As noted below, the Web site for the Bureau of Industry and Security (BIS), formerly known as the Bureau of Export Administration or BXA, is a division of the U.S. Department of Commerce (DOC). The BIS's Web site is linked to the DOC's home page. This site provides access to news stories on export-related topics, export rules and regulations, forms to download, policy fact sheets on various export topics, and links and addresses to other resources.

2. The China Law Center
www.chinalaw.law.yale.edu

The China Law Center (Center) was established by the Yale Law School in 1999. The Center and its Web site are dedicated to increasing the "understanding of China's legal system and supporting China's legal reform process."

3. China Law and Practice
www.chinalawandpractice.com

This Web site offers guidance on the legal aspects of doing business in China. It also provides access to *China Law & Practice,* "the world's only bilingual journal dedicated to the business of law in China." The publication was launched in 1987.

4. Chinalaw Web
www.qis.net/chinalaw

This site provides information about Chinese law and the legal system of greater China. It includes analyses of the four different legal systems in China, translations of Chinese laws and regulations, and articles on several law topics. The site is sponsored in part by the China Law Society of the University of Maryland School of Law.

5. ChinaLawInfo Co., Ltd.
www.lawinfochina.com

This site bills itself as the leading English-language Web site that publishes Chinese statutes, regulations, cases, government policies, legal news, treatises, law review articles, and links to other Web sites. It is sponsored in part by the Legal Information Center of Peking University.

6. China-laws-online.com
www.china-laws-online.com

This site is a research center with the most updated and comprehensive Chinese case law, statutes, regulations, analyses, and other materials.

7. Cornell Law Library, International Resources
www.lawschool.cornell.edu/library/International_Resources/intres.html

The materials on Chinese law under the international resources section of the Cornell Law Library's Web site is very impressive and comprehensive. Among other things, the database cites several useful Web sites on China.

8. Hieros Gamos
www.hg.org

Hieros Gamos has links to anything and everything on the Internet relating to multinational organizations, treaties, and the laws of other countries. There are also links to sources of U.S. law.

9. Holland & Knight, LLP
www.hklaw.com

Holland & Knight's Web site provides information about the firm and its lawyers, as well as access to several timely articles on Chinese law and other legal issues. Kenneth A. Cutshaw is one of the coauthors of our China book and a partner in the Atlanta office of Holland & Knight.

10. Internet Chinese Legal Research Center
law.wustl.edu/Chinalaw

This Web site provides links to Chinese legal resources on the Internet, as well as legal research guides and other information relating to legal research on various Chinese law issues.

11. Jun He Law Offices
www.junhe.com

This Web site provides profiles of its practice groups and lawyers, as well as updates of recent legislative and regulatory developments. This Chinese law firm is one of the coauthors of our book on doing business in China.

12. New York University School of Law
www.law.nyu.edu/library/foreign_intl/china.html

This collection of databases provides a wealth of information on Chinese legal resources, including bibliographies and links to other Chinese legal resources. Materials are presented in both English and Chinese.

Quarterly Updates

Sentencing Law

Supreme Court Ruled That the Federal Sentencing Guidelines Are Not Mandatory

In a landmark decision that will generate considerable amounts of litigation and legislative activity, the Supreme Court in *United States v. Booker,* No. 04-104 (U.S. Jan. 12, 2005), ruled that the Federal Sentencing Guidelines (Guidelines), which are used in the vast majority of federal criminal cases, could not be considered mandatory and binding on sentencing judges. Rather, they are only advisory. The Court did not throw out the Guidelines as they stand at present, but it did make substantial changes to sentencing procedures in the federal courts. With respect to corporate counsel, it is especially significant to point out that the Guidelines affected the Organizational Sentencing Guidelines, which are used by counsel for many companies to guide the company/clients' compliance efforts.

Justice Stevens's opinion portrayed *Booker* as the next in a line of Supreme Court precedents holding that the Sixth Amendment requires all facts used in determining a sentence to be found by a jury. The problem with the Guidelines, as the Court saw it, was that they were "mandatory and impose binding requirements on all sentencing judges." Some of the Justices suggested that "the ball now lies in Congress's court," and that the legislature "is equipped to devise and install, long-term, the sentencing system, compatible with the Constitution, that Congress judges best for the federal system of justice." Until such a determination is made, the lower courts will have a great deal of work to do to determine the contours of the new advisory status of the Guidelines. This work began in earnest on January 24, 2005, as the Court remanded approximately 400 cases back to the circuit courts for further reconsideration of sentences in light of the *Booker* ruling.

Employment Law

Similar Titles Were Insufficient to Establish Equal Pay Act Violation

The Fourth Circuit in *Wheatley v.*

Wicomico County, 390 F.3d 328 (4th Cir. 2004), rejected the claim brought by two female supervisors that their employer had violated the Equal Pay Act (EPA) by paying them less than male department supervisors who had performed substantially equal managerial work. The court reached that conclusion by finding that "equal work" under the EPA cannot be established "when two employees have similar titles but responsibilities that bear no more than the most general resemblance."

Rejecting the plaintiffs' arguments, the court found that they had presented the "classic example of how one can have the same title and the same general duties as another employee, and still not meet two textual touchstones of the EPA — equal skills and equal responsibility." First, the court stated that "it is simply not the case that all department director positions require[d] equal skills." The court noted that some of those positions required the director and deputy director to hold graduate degrees in civil engineering, but the plaintiffs' jobs did not require advanced degrees. The court also found that the plaintiffs failed to show that their jobs and the jobs of other department heads carried substantially equal responsibilities. Thus, the court affirmed dismissal of their EPA claim.

Court Held That an FMLA Eligibility Rule Was Invalid

The Tenth Circuit in *Harbert v. Healthcare Services Group, Inc.,* 391 F.3d 1140 (10th Cir. 2004), has continued the judicial "chipping away" at the Department of Labor's (DOL's) regulations implementing the Family and Medical Leave Act (FMLA) by invalidating a regulatory provision that defined the term "work site" as it applied to employees who were jointly employed. The holding essentially resulted in the plaintiff-employee being found ineligible for FMLA leave after being injured in an automobile accident.

Nancy Harbert sued her former employer, Healthcare Services Group, Inc., after it terminated her when she failed to report to work after her second thirty-day non-FMLA leave expired. In finding that Healthcare Services had violated the FMLA, the district court relied on an FMLA regulation stating that an employee's FMLA eligibility depends on the location of his or her primary work site. Reversing, the Tenth Circuit concluded that the DOL had exceeded its authority in promulgating the regulatory provision. Among other things, the DOL's definition of the term "work site" contravened the plain meaning of the term. The circuit court also pointed to evidence suggesting "congressional intent that militate[d] against deference to the agency's construction of the statute."

Two Courts Upheld the Employers' Appearance Policies

In *Jespersen v. Harrah's Operating Co., Inc.,* 392 F.3d 1076 (9th Cir. 2004), the Ninth Circuit concluded that an employer's requirement that female employees wear makeup did not discriminate on the basis of sex in violation of Title VII of the Civil Rights Act (Title VII). Based on that conclusion, the court upheld Harrah Operating

Company's termination of Darlene Jespersen for refusing to wear makeup pursuant to Harrah's employee appearance policy.

Similarly, the First Circuit in *Cloutier v. Costco Wholesale Corp.,* 390 F.3d 126 (1st Cir. 2004), held that requiring an employer to accommodate one of its female employees by exempting her from its dress code prohibiting the wearing of facial jewelry on the job would impose an undue hardship on the company. Thus, the employer, Costco Wholesale Corporation, did not violate Title VII when it terminated Kimberly Cloutier for refusing to comply with its policy. According to the First Circuit, a ruling in favor of the plaintiff would have imposed an undue hardship on Costco because such a result would adversely affect the company's public image.

Tenth Circuit Recognized Hostile Environment Claim under the ADA

Although the Tenth Circuit affirmed summary judgment for the employer in *Lanman v. Johnson County, Kansas,* 393 F.3d 1151 (10th Cir. 2004), it did join with the Fourth, Fifth, and Eighth Circuits in concluding that hostile work environment cases are actionable under the Americans with Disabilities Act (ADA). What ultimately defeated the employee's perceived disability claim was her failure to prove that her employer had regarded her as being substantially limited in a major life activity.

Susan Lanman sued her former employer, the Johnson County Sheriff's Department, for constructive discharge and for creating a hostile work environment based on its perception that she had a mental disability. Based on the similarities between Title VII and the ADA, the court held that a hostile work environment claim is actionable under the ADA. Next, the court tackled the issue of whether Lanman was a qualified individual with a disability under the ADA. According to the court, the evidence revealed that she had problems only with her co-workers, and that those problems arose after thirteen years of employment. Thus, the evidence did not establish that the employer had viewed Lanman as substantially limited in a major life activity, as required by the ADA.

Court Affirmed Sexual Harassment Verdict

The Sixth Circuit in *McCombs v. Meijer, Inc.,* Nos. 03-3612, 03-3758, 03-4357 (6th Cir. Jan. 19, 2005), affirmed a district court's denial of Meijer, Inc.'s motion for judgment as a matter of law on a sexual harassment claim brought by Amber McCombs, a former employee. In its challenge to the sexual harassment finding, Meijer tried to argue that there was not legally sufficient evidence for a jury to find that the company was liable for sexual harassment, since it did not know that the perpetrator was sexually harassing McCombs. Meijer also maintained that there was insufficient evidence that it failed to take prompt action to correct the problem.

Disagreeing with the company, the Sixth Circuit concluded that the evidence was legally sufficient to establish

that Meijer had acted both indifferently and unreasonably toward the plaintiff and her situation. In addition, the court affirmed the district court's award of punitive damages, finding that a reasonable jury could have found that the company had "acted with substantial disregard for McCombs's safety by not immediately addressing her complaints regarding the harassment."

Securities Law

District Court Approved a Partial Settlement in the *WorldCom* Case

The district court in *In re WorldCom, Inc. Securities Litigation,* No. 02 Civ. 3288 (S.D.N.Y. Nov. 10, 2004), approved a partial settlement reached by the parties in connection with the financial collapse of WorldCom, Inc. The lead plaintiff in this consolidated securities class action lawsuit petitioned the court for final approval of the $2.575 billion settlement with the Citigroup, Inc. defendants. The lead plaintiff also sought approval of a proposed plan of allocation of the settlement funds, and an award of attorneys' fees, reimbursement of expenses, and the creation of a $5 million fund for the continuation of the litigation against the nonsettling defendants.

Without getting into too much detail about the terms of the settlement (which were discussed in great detail by the court), we can say that the court approved the settlement with these defendants in its entirety. It also generally approved the plan of allocation for the settlement funds, except that the $5 million to support future litigation expenses will be taken solely from that portion of the settlement funds that will be paid to the class members with claims under the Securities Act of 1933. The court also awarded attorneys' fees of over $141 million, as well as reimbursement for expenses totaling about $13.5 million.

We highlight this massive settlement simply to point out that it represents only a partial conclusion to this and several other pending civil and criminal lawsuits arising out of WorldCom's collapse. No doubt, additional developments and related court rulings will be coming, but the shear magnitude of this partial settlement alone should at least give us pause to consider the magnitude of this and other landmark corporate scandals.

2002 Act Does Not Apply Retroactively

Ruling on two unrelated securities fraud cases that it had consolidated because of their substantially identical issues, the circuit court in *In re Enterprise Mortgage Acceptance Co., LLC Securities Litigation,* 391 F.3d 401 (2d Cir. 2004), held that the Sarbanes-Oxley Act of 2002 (2002 Act), Pub. L. No. 107-204 (2002), did not revive previously time-barred securities fraud claims. In both cases, the lower courts had held that the claims were time-barred, and that the 2002 Act did not revive those claims for trial. The circuit court affirmed the lower courts' decisions to dismiss the plaintiffs' complaints, finding that the "resurrection of previously time-barred claims has an impermissible retroactive effect."

In each of the two cases, the plaintiffs

filed securities fraud claims prior to the passage of the 2002 Act. After the 2002 Act's enactment in July 2002, the plaintiffs in one case added additional claims to their complaint, while the plaintiffs in the other case joined an additional defendant and tried to argue that the 2002 Act had extended the applicable one-year/three-year limitations period. *See In re Enterprise Mortgage Acceptance Co.,* 295 F. Supp. 2d 307 (S.D.N.Y. 2003); *McBride v. Ernst & Young LLP,* No. 02-CR-1266 (E.D.N.Y. Dec. 3, 2003). Because neither the relevant statutory language nor the 2002 Act's legislative history required the court to apply the statute retroactively, the court declined to do so. Rather, it chose to "defer to the long-standing presumption against retroactive application" and affirmed the lower courts' decisions to dismiss the plaintiffs' complaints.

Cautionary Language Shielded Company from Liability

The circuit court in *In re Amdocs Limited Securities Litigation,* 390 F.3d 542 (8th Cir. 2004), held that the plaintiffs failed to satisfy the pleading standards of the Private Securities Litigation Reform Act (PSLRA) and, thus, affirmed the trial court's decision to dismiss the case. Under the PSLRA, a misrepresentation or omission is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Under the so-called bespeaks caution doctrine, cautionary language that relates directly to the statement that allegedly misled the plaintiff, if sufficient, will render the alleged misrepresentation or omission immaterial as a matter of law.

Since the defendants' warnings put the plaintiffs on notice that consumer demand had softened and that the company's customers were in fact altering their purchasing patterns, the relevant cautionary language related directly to the statements on which the plaintiffs allegedly relied. As a result, the circuit court held that the allegedly fraudulent statements were immaterial as a matter of law.

Court Affirmed Insider Trading Conviction

The circuit court in *SEC v. Happ,* 392 F.3d 12 (1st Cir. 2004), rejected the defendant's arguments on appeal and affirmed the jury's conviction. Among other things, the court held that the defendant had special financial expertise that allowed him to turn otherwise vague statements about the company's financial difficulties into inside information suggesting that he should sell the company's stock.

On appeal, the defendant tried to argue that the relevant voicemail messages did not include inside information to support the jury's verdict. According to him, the statements about the company's "difficulties" were "too generic and too true of all public companies to be material." The circuit court rejected that argument primarily because of the defendant's financial expertise. According to the court, a rational jury could find that the messages communicated material, nonpublic in-

formation to him, thus triggering his insider trading.

Executive's False Statements about His Background Were Immaterial

In various SEC filings, the CEO of MCG Capital Corporation inaccurately indicated that he had earned a bachelor's degree from Syracuse University. In fact, he had only attended the university for three years and never graduated from college. Despite such blatant and intentional misinformation perpetuated by the CEO and inaccurately disclosed to investors in the company's SEC filings, the circuit court in *Greenhouse v. MCG Capital Corp.,* 392 F.3d 650 (4th Cir. 2004), held that the defendants were not liable solely because of those falsehoods.

In its earlier ruling, the district court had dismissed the investors' complaint and found that the CEO's statements were immaterial. The plaintiffs appealed and the circuit court affirmed. While it freely acknowledged that the CEO's conduct was "indefensible," the circuit court nevertheless agreed that "the actual fact misrepresented was immaterial under the securities laws." The circuit court pointed out that the securities laws "are only concerned with lies about material facts." Under the plaintiffs' theory of liability, "any misrepresentation by a CEO — including, perhaps, one about his or her marital fidelity, political persuasion, or golf handicap — that might cause investors to question management's integrity could, as such, serve as a basis for a securities-fraud class action." The circuit court ruled that federal law "simply does not permit such a result."

International Law

SEC and DOJ Brought an Action against Titan Corporation

Titan Corporation, a defense contractor, tentatively agreed to plead guilty to criminal charges and pay $28.5 million in fines to resolve charges that illegal payments were made by overseas consultants in violation of the Foreign Corrupt Practices Act (FCPA), according to the *Wall Street Journal.* The company had been investigated by the SEC and the Department of Justice (DOJ), with the investigations causing the derailment of Lockheed Martin's proposed $1.6 billion acquisition of Titan in June 2004. The suspicious payments were made by Titan consultants in the Middle East, Asia, and Africa. If the payment is made, it would be one of the largest fines ever paid under the FCPA. The FCPA criminalizes the payments made to foreign government officials in order to obtain or retain business. *See Wall St. J.,* Jan. 20, 2005, at A10.

Company Settled Claim of Antiboycott Violation

Alison Transport, Inc. paid a civil penalty of $22,500 to settle charges that it violated the antiboycott provisions of the Export Administration Regulations (EAR). The Bureau of Industry and Security (BIS) of the Department of Commerce, which administers the EAR, alleged that on three occasions, in connection with transactions involving the sale and transfer of goods from the United States to Oman, Kuwait, and Saudi Arabia, Alison furnished prohibited information about

another company's business relationships in violation of the EAR, and it failed to report its receipt of a request from Oman to provide a certificate that the aircraft used in the transactions was not blacklisted by the Arab League Boycott committee. The U.S. antiboycott laws prohibit U.S. persons from complying with unsanctioned foreign boycotts by furnishing information about a business relationship with another person who is known or believed to be restricted from having a business relationship with or in a boycotting country.

Foreign National Working Overseas Was Not Covered by the 2002 Act

The DOL's administrative law judge (ALJ) in *Concone v. Capital One Finance Corp.,* DOL ALJ No. 2005-SOX-00006, 2004 WL 3127233 (Dec. 3, 2004), ruled that an Italian citizen employed by a U.S. company in two European countries had no claim under the whistleblower provisions of the 2002 Act. The employee alleged that he was terminated after notifying his employer of accounting irregularities. The employee argued that the statute applied without respect to nationality or location of the whistleblower because it prohibited retaliation against persons reporting a federal offense to a law enforcement officer.

The ALJ found that neither the language of the statute nor the regulations promulgated by the DOL answered the question of whether the provision applied to individuals employed outside the United States. The ALJ also noted that the employee had worked for the company in England and Italy, and that giving the 2002 Act extraterritorial application could create a conflict with the laws of those countries. The ALJ also cited a recent district court decision, *Carnero v. Boston Scientific Corp.,* 2004 U.S. Dist. LEXIS 17205, 2004 WL 1922132 (D. Mass. Aug. 27, 2004), that reached the same conclusion.

The ALJ noted that the remedies sought by the complainant, including back pay, reinstatement, and other benefits, could conflict with the laws of the home countries. The ALJ also ruled that, although the respondent argued the language of the statute meant it should only apply to U.S. citizens working in the United States, he did not need to decide the issue to dismiss the instant case. But he saw no reason why the statute would not protect foreign nationals working in the United States.

Antitrust/ Trade Law

EU Upheld Record Fine and Other Penalties against Microsoft

Despite the fact that Microsoft Corporation's antitrust struggles with the U.S. government were settled quite some time ago (with the exception of a few isolated cases brought by states that chose not to follow the federal government's settlement agreement), the European Union's (EU's) competition officials have continued to pursue the company.

In March 2004, after a six-year investigation, the European Commission (Commission) formally announced its

ruling that Microsoft had abused its monopoly in the computer operating system market. Microsoft appealed the Commission's decision to the European Court of First Instance, the second-highest court in the EU, and on December 22, 2004, the court rejected Microsoft's motion for a temporary injunction suspending the enforcement of these penalties until the court could rule on Microsoft's appeal of the full ruling (a process that could well stretch into 2006).

The court held that the Commission's penalties would not cause Microsoft "serious and irreparable damage" if allowed to stand through the appeals process. However, the court did note that Microsoft had met its burden for pleading a *prima facie* case against the Commission, meaning that the court will review the full appeal. In the interim, Microsoft planned to comply with the Commission's March 2004 ruling by posting a Web site that would explain how its competitors could obtain the technical information necessary for developing more compatible software for WINDOWS. Meanwhile, Microsoft began offering a stripped-down version of its software in early 2005.

FTC Found That Gas Storage Tank Merger Was Anticompetitive

In a relatively rare final decision by the full panel (since most of its enforcement activities are settled by consent decrees), the Federal Trade Commission (FTC) ruled that a merger between the two dominant competitors in the market for industrial gas storage tanks in the United States was anticompetitive and invalid under § 7 of the Clayton Act for substantially lessening competition in the relevant product market.

The case of *In re Chicago Bridge & Iron Co. N.V.,* No. 9300 (FTC Jan. 6, 2005), involved the February 2001 acquisition of certain assets of Pitt-Des Moines, Inc. (PDM) by Chicago Bridge & Iron Company N.V. (CBI). Prior to the merger, the two companies had been the leading producers of large industrial storage tanks. The FTC's complaint alleged that the merger "significantly reduced competition in four separate markets involving the design and construction of various types of field-erected specialty and industrial storage tanks in the United States." An ALJ heard the case and ruled that the acquisition was anticompetitive. The ALJ, thus, ordered CBI to divest all of the PDM assets it had acquired. Both sides appealed to the full commission.

The full commission rejected CBI's suggestion that the merger's effect on the market could be offset by the entry of new competitors or the expanded market share of the smaller existing competitors. Examining the difficulty faced by new entrants to the market, the FTC looked to the standard of "established antitrust principles," which holds that entry of new market participants "must be not only likely to occur in a timely manner but also sufficient to constrain post-merger price increases to premerger levels."

DOJ Cannot Unilaterally Revoke a Consent Decree under Its Leniency Policy

In a key ruling that illustrated the

limitations on the DOJ's control over settlement agreements, the district court in *Stolt-Nielsen S.A. v. United States,* No. 04-CV-537 (E.D. Pa. Jan. 14, 2005), ruled that the DOJ could not unilaterally terminate an immunity agreement without a judicial determination that the other party had violated the agreement. The court also ruled that the party had not violated the agreement.

The DOJ's Corporate Leniency Program grants immunity from antitrust prosecution to the first party to come forward with information about an antitrust violation, so long as that party fulfills its promise to cooperate. The company in this case took advantage of the program and filed an official proffer with the DOJ in January 2003. Under the parties' immunity agreement, the company agreed to turn over all information relating to the relevant customer allocation scheme, while the DOJ agreed not to prosecute the company for any offenses committed before the date of the agreement. Three months later, the DOJ notified the company that it was suspending the immunity agreement because of the company's alleged misrepresentations. In response, the company filed suit seeking an injunction to prevent the DOJ from revoking the agreement.

In its analysis, the court noted that "[i]mmunity agreements, like plea agreements, affect the due process rights of the party giving up valuable constitutional rights in return for the government's promise not to prosecute." Because the immunity agreement was a binding contract on both parties, and because of the special concerns of due process, the court ruled that "the government cannot unilaterally declare an immunity agreement void" without a "judicial determination that the defendant breached the agreement." In other words, the court ruled that the company's constitutional due process rights won out against the DOJ's interest in prosecutorial discretion.

Court Upheld Class-Action Settlement in Debit Card Tying Case

The Second Circuit in *Wal-Mart Stores, Inc. v. Visa U.S.A., Inc.,* Nos. 04-0344, 04-1052, 04-0514, 04-1055 (2d Cir. Jan. 4, 2005), rejected an appeal of several corporate merchants that were dissatisfied with the terms of a settlement agreement in a huge antitrust case against the two largest U.S. credit card networks, Visa, U.S.A., Inc. and Mastercard International, Inc.

The case began in 1996, when Wal-Mart Stores, Inc., Sears, Roebuck & Company, and other merchants filed a class action lawsuit on behalf of approximately 5 million merchants alleging that a policy of both Visa and Mastercard constituted an illegal tying arrangement. After a long discovery process, the parties settled the case and agreed that Visa and Mastercard would discontinue the challenged policy and would create a $3.38 billion settlement fund to remedy damages to members of the class. *See In re Visa Check/ Mastermoney Antitrust Litig.,* 297 F. Supp. 2d 503 (E.D.N.Y. 2003).

On this appeal, the merchants objected to the scope of the settlement

agreement, in so far as it would release Visa and Mastercard from liability for all conduct prior to January 1, 2004. The merchants argued that this would bar their own class action lawsuits, which were filed separately but based on the same facts. Rejecting their arguments, the Second Circuit ruled that the "identical factual predicate" doctrine allows for a class settlement to release the defendant from different claims arising out of the same conduct. The court also stated that the district court had "carried out its responsibilities with admirable care and thoroughness." With this presumably the final word on the matter, the settlement should go down as the largest (in terms of its dollar amount) in the history of antitrust law.

Intellectual Property Law

Fair Use Defendant Did Not Need to Disprove Consumer Confusion

In a unanimous ruling making it more difficult for a trademark owner to sue a competitor for infringement, the Supreme Court in *KP Permanent Make-Up, Inc. v. Lasting Impression I, Inc.,* 125 S. Ct. 542 (2004), held that the party raising the fair use defense does not have the burden of disproving that the alleged trademark infringement confused consumers. In the Court's words, "[i]t takes a long stretch to claim that a defense of fair use entails any burden to negate confusion." The Supreme Court went so far as to suggest that the possibility of consumer confusion is, in fact, compatible with fair use. As a result, the Court vacated the circuit court's ruling to the contrary and remanded the case for further proceedings. *See KP Permanent Make-Up, Inc. v. Lasting Impression I, Inc.,* 328 F.3d 1061 (9th Cir. 2003) (reversed and remanded).

The Supreme Court first noted that the Trademark Act expressly places the burden of proving the likelihood of confusion on the plaintiff. However, that same statutory language does not impose a similar burden on the defendant who is relying on the fair use defense. Next, the Supreme Court noted that a look at "the typical course of litigation in an infringement action point[ed] up the incoherence of placing a burden to show nonconfusion on a defendant." If the plaintiff were to succeed in proving consumer confusion, the defendant would be hard-pressed to rebut that evidence. According to the Court, it is only when the plaintiff has shown a likelihood of confusion that the defendant would have a need for the affirmative fair use defense. As a result, the Court held that the fair use defense does not impose a burden on the defendant to negate any likelihood that the alleged infringement confused consumers as to the origin of the goods or services affected.

Defendants' Web Site Violated the ACPA

In 1999, Congress passed the Anticybersquatting Consumer Protection Act (ACPA) to prohibit cybersquatting, which occurs when a person or entity (other than the trademark holder) registers a domain name of a well-known trademark, and then tries to profit from that by either selling the

domain name to the trademark holder, or by using it to divert business from the trademark holder's own Web site.

The plaintiff in *DaimlerChrysler v. Net Inc.,* 388 F.3d 201 (6th Cir. 2004), successfully showed that the defendants had violated the ACPA by registering the domain name foradodge.com. The circuit court concluded that the domain name was confusingly similar to the plaintiff's distinctive and famous DODGE mark. The court also evaluated the usual nine factors for establishing bad faith under the ACPA and concluded that the defendants had registered the domain name with a bad faith intent to profit. In fact, all but one of the nine factors supported a finding of bad faith, and the last one (selling the domain name for financial gain) was neutral. After considering the other factors, the court found that its conclusion in favor of the plaintiff was "inescapable."

State Court Ruled That Maryland's Antispam Law Was Unconstitutional

A judge ruled that Maryland's antispam law unconstitutionally discriminated against interstate commerce in violation of the Dormant Commerce Clause. *See MaryCLE, LLC v. First Choice Internet, Inc.,* No. 248514, 2004 WL 2895955 (Md. Dec. 9, 2004).

To determine whether a state law violates the Dormant Commerce Clause, the court applies a two-part test. First, it looks at whether the particular statute discriminates against persons in other states. If so, the state statute is typically declared unconstitutional. Second, if the law is neutral on its face, then the court must conduct a balancing test to determine whether the burden on interstate commerce outweighs the benefits of the statute. Analyzing the facts in this case, the court held that the state law violated the Dormant Commerce Clause. In addition, the court determined that it had no jurisdiction over the defendants because they did not engage in any act or omission in Maryland, nor cause tortious injury within the state. Furthermore, it had no personal jurisdiction over the defendants because they did not regularly conduct business, engage in persistent conduct, or derive revenues from Maryland.

Circuit Court Ruled in Favor of an ISP

The circuit court in *In re Charter Communications, Inc.,* No. 03-3802 (8th Cir. Jan. 4, 2005), held that the Digital Millennium Copyright Act (DMCA) does not permit copyright owners to serve subpoenas on Internet service providers (ISPs) to obtain personal information about the ISPs' subscribers who have allegedly transmitted copyrighted works over the Internet using peer-to-peer (or P2P) file-sharing software. Favorably citing *Recording Indiana Ass'n of America v. Verizon Internet Service, Inc.,* 351 F.3d 1229 (D.C. Cir. 2003), the Eighth Circuit concluded that the plaintiffs in this case were not entitled to a subpoena to obtain confidential information, since the ISP merely operated as a conduit between its users and the copyright owners.

In its earlier decision, the *Verizon*

court considered whether the relevant DMCA provision permitted the copyright owner to obtain and serve a subpoena on the ISP for identifying information about an alleged infringer. The court held that, where the ISP performs only the conduit functions, the statute does not authorize the subpoenas because the ISP cannot remove or disable one user's access to the infringing materials resident on another user's computer. It also pointed out that it was Congress's responsibility to decide whether the DMCA should be amended to "accommodate fully the varied permutations of competing interests that are inevitably implicated by such new technology." Agreeing with the *Verizon* court's analysis, the Eighth Circuit held that the statute did not authorize the subpoenas at issue. Thus, it vacated the lower court's decision to issue the subpoena and remanded the case for further proceedings.

Foreign Grocer May Be Entitled to Trademark Protection

The court in *Grupo Gigante S.A. de C.V. v. Dallo & Co., Inc.,* 391 F.3d 1088 (9th Cir. 2004), analyzed the famous mark exception to the territoriality principle and held that a foreign grocery store chain may be entitled to trademark protection in the United States, so long as its trademark from another country is familiar to consumers in the relevant U.S. market. Since the district court did not consider the relevant factors in sufficient detail, the circuit court vacated its decision and remanded the case for further proceedings.

The circuit court acknowledged that this was the first decision in which a U.S. court was asked to hold that U.S. fame of a foreign mark can suffice to establish rights in the United States. Generally, the territoriality principle states that priority of a trademark right in the United States depends solely on the priority of use in the United States, not on the priority of use anywhere in the world (such as in Mexico). However, there were sufficient matters of fact as to whether the foreign mark at issue in this case had become sufficiently famous in the San Diego area to obtain trademark protection under U.S. law. In the court's words, "when foreign use of a mark achieves a certain level of fame for that mark within the United States, the territoriality principle no longer serves to deny priority to the earlier foreign user." As a result, the court held that "there is a famous mark exception to the territoriality principle."

Legislation/ Regulations

President Signed the CREATE Act

On December 23, 2004, President Bush signed the Intellectual Property Protection and Courts Amendment Act of 2004 (CREATE Act), Pub. L. No. 108-482 (2004), which tightened the prohibitions on trafficking in counterfeit labels. Among other things, the CREATE Act banned the use of illicit labels, *i.e.,* genuine labels that are stolen or otherwise illegally distributed with counterfeit goods.

The CREATE Act also incorporated the Fraudulent Online Identity Sanc-

tions Act, which amended the Lanham and Copyright Acts to provide that a trademark or copyright violation will be considered willful if the violator knowingly provided material and false contact information in making, maintaining, or renewing the registration of a domain name used in connection with an online location.

In addition, in January 2005, the Patent and Trademark Office (PTO) issued interim rules designed to implement the CREATE Act's obviousness standards. *See* 70 Fed. Reg. 1818 (Jan. 11, 2005). The PTO's guidance was designed to provide that subject matter developed by another person or entity "shall be treated as owned by the same person or subject to an obligation of assignment to the same person for purposes of determining obviousness," if the following three conditions are met: (1) the claimed invention was made by or on behalf of parties to a joint research agreement that was in effect on or before the date the claimed invention was made; (2) the claimed invention was made as a result of activities undertaken within the scope of the joint research agreement; and (3) the application for patent for the claimed invention discloses or is amended to disclose the names of the parties to the joint research agreement.

IRS Released Guidance under the AJCA

On December 20, 2004, as mandated under the American Jobs Creation Act of 2004 (AJCA), the IRS and U.S. Department of the Treasury issued Notice 2005-1, which was designed to provide interim guidance under new § 409A of the Internal Revenue Code (Code), the AJCA provision that made sweeping changes to the federal tax rules for nonqualified deferred compensation arrangements. As noted by the *Wall Street Journal,* Notice 2005-1 "gave a holiday gift to companies and executives worried about the future of stock appreciation rights" (SARs) and other forms of deferred compensation. *See Wall St. J.,* Dec. 21, 2004, at D3.

In their thirty-six-page release, the IRS and Treasury Department provided guidance as to how companies and their executives can make the transition from the old tax laws to the new deferred compensation requirements. For instance, SARs and other forms of deferred compensation will have "limited exceptions" from the new AJCA rules, so long as the compensation programs "do not present potential for abuse or intentional circumvention" of the rules.

Written in question-and-answer format, the notice first outlines the scope of Code § 409A's coverage and provides clarification of some of the key statutory terms. In particular, the notice provides input as to the nature of deferred compensation plans and when amounts are subject to a substantial risk of forfeiture. Next, the release provides guidance with respect to change in control events and the acceleration of deferred compensation payments. Probably the longest section of the notice relates to transition relief and effective dates, while the last two sections discuss reporting requirements and wage withholding.