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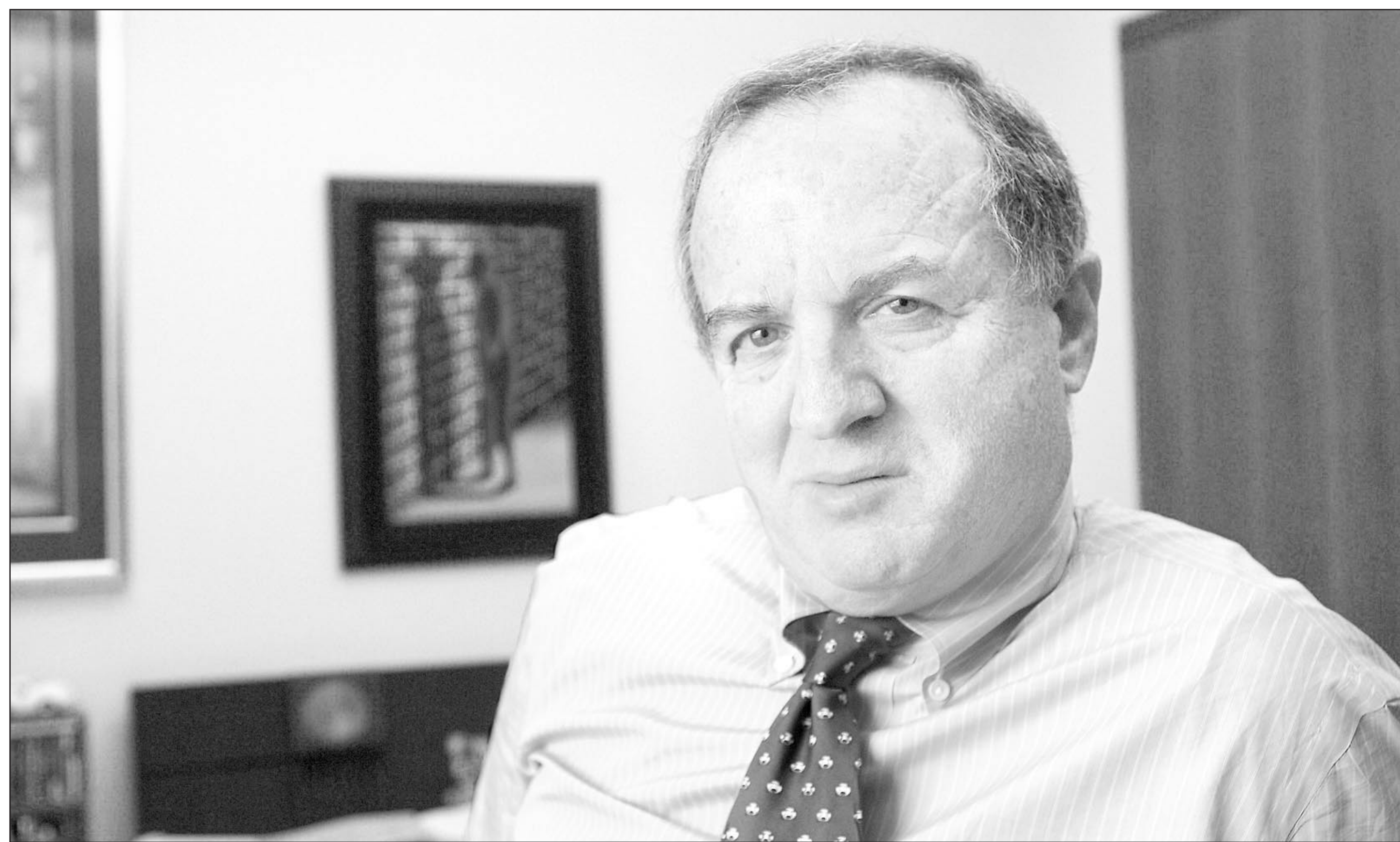

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San Francisco Superior Court Complex Litigation Judge Richard A. Kramer

Hip Replacement Litigation Will Be Heard in San Francisco

Some Lawyers Argued L.A. Should Handle The Hundreds of Cases

By Amy Yarbrough
Daily Journal Staff Writer

SAN FRANCISCO — San Francisco will most likely be home base for a glut of lawsuits against the makers of a recalled artificial hip.

On Wednesday, Superior Court Complex Litigation Judge Richard A. Kramer ruled the some 213 (and counting) state-court cases against DePuy Orthopaedics Inc. should be coordinated in San Francisco and any appeals heard by the 1st District Court of Appeal. But before he did, Kramer couldn't help be wowed by the nearly 50 lawyers who had crowded his courtroom for the hearing.

"Staggering, absolutely staggering," he said.

DePuy, its parent company Johnson & Johnson Services Inc., and two California doctors involved in the design and promotion of the ASR Hip Implant have been hit with lawsuit after lawsuit since the recall was announced on Aug. 26.

DePuy took the product off the market after evidence, including a study in the United Kingdom, revealed the device had a high fail rate and a large number of patients needed a second hip replacement, known as revision surgery. Plaintiffs allege in the suits that DePuy was aware of problems with their product which led them to suffer complications ranging from pain and loosening to high levels of metal ions in the body.

More than 300 cases filed in federal courts have been consolidated and coordinated and are pending before U.S. District Court Judge David Katz in Toledo, Ohio. But whether the state-court cases would be coordinated out of San Francisco or Los Angeles was still up in the air until Wednesday's hearing.

James G. O'Callahan, with Girardi Keese in Los Angeles, argued the cases should be coordinated out of Los Angeles County Superior Court, noting the huge size of the court and its significant resources.

> 'I would not assign something to San Francisco if I thought I couldn't do it.'
>
> — Judge Richard A. Kramer

"It seems to me you have an enormous amount to do," O'Callahan told Kramer. "It's important these cases get handled in an expeditious manner."

Kramer said there was "no wrong decision to be made," in choosing either court. But he noted that the majority of the state court cases to date have been filed in San Francisco and that one of the defendant doctors, Dr. Thomas Parker Vail, is based in the city.

"I would not assign something to San Francisco if I thought I couldn't do it," Kramer said.

Kramer, whose ruling must still be approved by the Judicial Council, said he envisions acting as the coordination judge for all of the discovery and pretrial hearings but that the cases would likely be sent back to the county where they were filed for trial.

Kramer pleased many in the courtroom when he suggested the oldest of the suits against DePuy could proceed to trial as early as September. *Magowan v. Depuy Orthopaedics,* 500668.

That case, filed on behalf of three people who received ASR Hip Implants before the official notice of the recall, already has a Sept. 12 trial date set. The suit, like many of the others, alleges that the plaintiffs' artificial hips became loose, caused them severe pain and that the device's metal-on-metal construction caused dangerous metal ions to be sloughed off into their bodies.

Michael A. Kelly, whose firm Walkup, Melodia, Kelly & Schoenberger is handling *Magowan* and dozens of other DePuy cases, said he was pleased Kramer wanted to move the first case along and said that shouldn't be a problem because he expected the discovery process to be fairly simple.

"I don't think this is very complicated, your honor," Kelly said. "These people either had a problem with the hip that is traceable to the hip, or they didn't. I think we are absolutely ready to gear up, do the discovery."

Drinker Biddle & Reath LLP Partner Michelle Childers, who is representing DePuy, said she had doubts the first trial could take place as early as September. She told Kramer she was nonetheless pleased the cases would be consolidated in San Francisco.

"On the defense … we believe this court has ample resources," Childers said.

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Securities Cases No Longer Yield Fee Lodestars

By Gabe Friedman
Daily Journal Staff Writer

LOS ANGELES — As dozens of major investors were clawing their way out of a $624 million shareholder settlement with Countrywide Financial last fall, plaintiffs' lawyers at Labaton Sucharow LLP scrambled to preserve the deal they'd crafted — including $47.3 million in attorney fees.

By the time a federal judge approved the final Countrywide settlement on Friday, Labaton Sucharow shaved nearly $1 million more off their award request, seeking $46.4 million in fees.

Although such fees might warrant celebration in many cases, that's not how observers of securities litigation received the award. At 7.7 percent of the total recovery in the case, it marks one of the lowest attorney-fee requests for a securities class-action settlement and just two-thirds of the firm's lodestar — the amount of money equal to the number of hours worked multiplied by the hourly rate.

Securities litigation experts said that low percentage is part of a nationwide downward trend in fee requests for such cases due to several factors. These include the increasing frequency that large investors will opt out of the class and directly litigate, the rise of sophisticated investor plaintiffs who negotiate tighter fee schedules, and the glut of plaintiffs' firms flooding the securities bar.

In their class action, institutional investors accused former Countrywide executives of hiding the alarming risk that the real estate downturn could have on the company until it was too late. Countrywide, once the nation's largest mortgage lender, was purchased at a

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Another Howrey Group Splinters, Now to Pillsbury

By Sara Randazzo
Daily Journal Staff Writer

Partners continue to stream toward the exits at Howrey LLP, where a shrinking number of attorneys are still waiting to hear final confirmation from Winston & Strawn LLP on offers made to more than 75 percent of the Howrey partnership in late January.

Construction partners John R. Heisse II in San Francisco and Robert B. Thum in Los Angeles are the latest California departures. The two moved to Pillsbury Winthrop Shaw Pittman LLP this week, along with 13 other construction attorneys in Washington, D.C., New York and California.

Two additional Howrey construction attorneys, partner John W. Ralls and counsel Samuel W. Niece, opened their own firm Tuesday in Palo Alto: Ralls & Niece LLP, focused on construction law.

The defections follow the departure in mid-February of nine construction partners to Jones Day in San Francisco and Washington, D.C., led on the West Coast by Stephen V. O'Neal and David M. Buoncristiani.

Paul W. Berning in San Francisco is the only construction partner left at Howrey in California. He said Wednesday he has a couple of options pending and expects to make a decision soon.

The 40-person construction group Howrey acquired in fall 2008 from the now-defunct Thelen LLP didn't expect to disband, Heisse said Wednesday, but client conflicts prevented all of the attorneys from going to one firm. A core of the group had practiced together for 20 years, Thum said.

"There's absolutely no acrimony amongst the group," Heisse said. "You don't always get to do exactly what you want."

He and the other members of the construction group received offers from Winston — where Heisse said many of his former

See Page 6 — HOWREY

GUEST COLUMN

With lateral recruiting on the rise, what does this really mean in the context of partner equity accounts? By **Edwin B. Reeser**

Now that the cards are dealt and the ante is up, would you mind telling me what game it is we are playing? Again?

FIRST IN A FIVE PART SERIES

This series explores some of the current illusions and realities of partner capital and capital accounts treatment in some large law firms. It is intended to be illustrative of issues and does not present the profile of any specific individual firm, past or present.

With the broadly announced emphasis on lateral recruiting this year by many firms, let's take a look at what that may entail for partners, and what it means for firms, with respect to the partner capital account.

Mary Doe is a $750,000 annual forecast compensation level equity partner at a large law firm, with a 15-year tenure. Published profits per partner (PPP) for her firm are $1.2 million. Mary is about the "middle of the pack" for compensation as among partners. Her monthly draw has been measured at 60 percent of forecast compensation, less parking, PPO health insurance premiums and other partner charges, which aggregate about $2,000 per month. The firm has adopted for 2008 and the future a "more conservative" draw ratio of 55 percent.

Mary has a current portable book of client revenue that is approximately $2.2 million, which has varied between $1.8 million in 2004 and $2.75 million per year over the past six years, peaking in 2007 and declining about 20 percent from 2007 to 2009, remaining flat in 2010. Her forecast income for 2008 had been $910,000, but actually was $728,000 due to firm-wide profitability pressures brought about by the recession, and in 2009 it declined again to $715,000 compared to forecast of $800,000. With cost cutting and partner headcount reductions by the firm, she rebound-

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MORE NEWS

Litigation

San Diego County Judge Dwayne K. Moring draws on his time as a prosecutor and a criminal defense lawyer when dealing with the young defendants in his courtroom. **Judicial Profile, Page 2**

Shopping mall operators cannot discriminate against demonstrators by setting different rules for who can protest close to a targeted store, a state court of appeal has ruled. **Page 3**

Government

L.A. District Attorney Steve Cooley will appoint Jacquelyn Lacey to chief deputy, giving her campaign to succeed Cooley a boost. **Page 4**

Judicial nominee Goodwin Liu, of UC Berkeley School of Law, on Wednesday faced off against Republican senators for the second time in a year. **Page 4**

An amendment that would allow the U.S. Patent and Trademark Office to keep the fees it collects passed the Senate on Tuesday. **Page 4**

Corporate

To ensure transparency, proxy statements should provide shareholders with a clear explanation behind each compensation decision, write David McFarlane of Snell & Wilmer LLP and Samuel Krause. **Page 5**

What companies should consider now that the financial opportunities provided by IPOs are less attractive now than in previous years. By Thad A. Davis and Kyle A. Withers of Ropes & Gray. **Page 5**

The U.S. and the United Kingdom have taken recent steps to ramp up their anti-corruption regimes, explains Bethany Hengsbach of Sheppard Mullin Richter & Hampton LLP. **Page 6**

Jonathan R. Fitzgarrald of Greenberg Glusker Fields discusses effective strategies for keeping the peace in your law firm. **Page 7**

Nominations

The Daily Journal is accepting nominations for our annual lists of Top Intellectual Property Lawyers and Top Women Lawyers. To receive nomination forms for these lists, email: nominations@dailyjourn

Who's Holding You Hostage? How to Navigate Law Firm Politics

By Jonathan R. Fitzgarrald

Perfect scenario: Your state's legal publication is accepting nominations for its annual "Attorney of the Year" issue. As one who oversees some aspect of marketing for your firm, and in hopes of someone from your firm being included, you work with three of the attorneys in your office on their individual submissions. Upon publication, you are elated to find out that Mike Rogers, who recently made partner, was chosen. You hear through the grapevine that an attorney more senior to Mike, Harry Robbins, who was also submitted for the award, is perplexed by this "oversight," and he wants a meeting with you to discuss why he was passed over. You are subjected to 20 questions that imply you forgot to mention important matters or did not represent Harry well in the nomination process. Harry asks for a copy of the submission and your correspondence on his behalf.

Despite your best intentions, you are being held hostage by a situation that is largely outside of your control...or is it?

At some point during your legal career, emotionally charged situations — similar to the aforementioned — are sure to surface. Whether it is internally with one of your peers or externally with a client, how you handle these situations could mean the difference between an ongoing, successful future or you deflated on your therapist's couch.

Having directed the marketing at various law firms for the past 11 years, I have personally witnessed more *hairy* situations than I would like to remember. As a result, I have identified five time-tested techniques for successfully navigating the politics of a law firm.

Avoid knee-jerk reactions. Working environments ripe with high achievers require preparedness and professionalism at all times. Heated situations typically involve someone at or above your pay grade staring you down (or barking at you over the phone), demanding answers to questions you may or may not be prepared to answer on the spot. Whenever possible, avoid becoming defensive by buying yourself some time.

Success in any given situation is significantly increased if you are perceived as unbiased and neutral.

Listen to the individual, let them know that resolving their concern is your priority, and ask if you can get back to them in a specified amount of time. Doing so will allow you to gather your thoughts and examine the facts of the situation before having to respond or propose an appropriate solution. Lapsed time also tends to reduce "heat of the moment" emotions.

Remember role and objective. Success in any given situation is significantly increased if you are perceived as unbiased and neutral. This is best demonstrated by assuming the role of moderator versus that of decision maker. As opportunities present themselves, you are the vehicle between the decision makers (e.g., management committee, practice group leader, etc.) and those attorneys best positioned for the specific opportunity.

In the "Attorney of the Year" example, it is reasonable to assume that the firm had more than three attorneys interested in being considered for the award. It is also not too far fetched to anticipate hurt feelings by someone who was not chosen for consideration. By assuming the role of moderator, you are better positioned to appropriately deal with any recoil that may result from someone unhappy with the outcome.

Also, if spotlighting an attorney's accomplishments was the original intent (as was the case for Harry Robbins), focus on upcoming opportunities. Professional golfer Jack Nicklaus once said, "Focus on remedies, not faults." Brainstorm ways to distinguish Harry from his competitors. In his submission, include a client testimonial, ask one of Harry's esteemed contacts to make the recommendation, or concentrate on one of Harry's unique characteristics that will separate him from the pack.

Focusing on your role and the overall objective of the initiative will demonstrate your ability to maintain the firm's business objectives and reputation, while properly advocating on behalf of the firm's attorneys to position them in the best possible light.

Face the facts. Situations perceived to have gone wrong are typically laced with emotion, ego and hype. In some cases, attorney frustration is amplified as a result of their reputation "on the line," they believe their issue is not being heard or sufficiently considered, or they anticipate embarrassment. Ultimately, their perception quickly becomes your reality.

It is imperative in any situation to identify and work only with the known facts. Stripping the situation of unnecessary emotion will allow a reasonable solution to surface.

As early in the process as possible, it is critical to properly communicate the aspects of the opportunity over which you have control (e.g., the content and timeliness of the attorney's submission), as well as those aspects you do not (e.g., the final selection process). Proper expectation management demonstrates your ability to appropriately position the attorney, while diffusing any emotion that may result by the attorney not being chosen.

Maintain a paper trail. Partner "A" misses his shuttle to the airport = $25. Partner "A" misses his international flight = $1,500. Partner "A" misses the potential client meeting = $500,000. The e-mail paper trail from Partner "A" saying, *"I'll make my own travel arrangements"* = priceless!

No one wants to get into a "he said, she said" situation that could potentially compromise your credibility and good standing with the firm. Whether you detect a problematic situation or not, consider it good practice management to summarize via e-mail significant conversations and action items discussed. Doing so not only minimizes or eliminates the chance of you taking the heat for something you did not do, but more importantly improves communication by ensuring all parties involved are on the same page.

Provide a professional opinion or solution. Creative problem solvers are always in demand. Position yourself as a trusted advisor by being prepared to share your professional opinion or solution when solicited. Whether or not your proposal is employed, something you suggest may ultimately lead to the final course of action.

Frederick L. Collins wrote, "There are two types of people — those who come into a room and say, "Well, here I am!" and those who come in and say, "Ah, there you are."

More than just a professional with marketing responsibilities, you are a (crisis) negotiator. Your success is predicated on your ability in any given situation to "talk someone off the ledge." The stronger your relationship among those individuals you serve, the more persuasive and effective you can be. Strive to know your constituents on a more personal level. By doing so, you will gain a greater respect for them and a better understanding of how to serve them. In turn, they will see you coming and say, "Ah, there you are!"

Jonathan R. Fitzgarrald directs the business development and marketing for Greenberg Glusker Fields Claman & Machtinger LLP, a Los Angeles-based full service law firm specializing in entertainment and real estate law. He is President Elect of the Legal Marketing Association's Los Angeles Chapter.

Equity Partner Capital: How Does It Really Work for the Partner?

Continued from page 1

2009, though firm revenues were basically flat.

Mary has always been a model citizen in the partnership, submitting timesheets daily, getting her bills out timely each month and avoiding costly write-offs or collection problems. Her monthly billings average $185,000, and she carries an average accounts receivable inventory of between $350,000 and $450,000 through the year. She regularly bills between 1,900 and 2,000 hours per year of her own time at $650 per hour, of which 70 percent is on her own matters and the balance is for other partner's clients. She keeps one associate busy full-time and two others busy about 50 percent, a total of about 4,000 hours of associate work weighted at $350 per hour. She also puts in about 60 hours per year of pro bono time, and serves on two administrative committees of the firm.

Mary's firm required a 35 percent of projected income capital account, which in 2004 was $220,500 based on a $630,000 forecast income. She received a "raise" in 2006 to $800,000 after two years of collections at $2.4 million (with an increase in capital to $280,000), and in 2008 a forecast compensation of $910,000 (with an increase in capital to $364,000 and a new partner capital account requirement of 40 percent of forecast income) based upon her $2.75 million collection performance and expectations that it would stay stable or increase. Mary's firm tends to lag a bit on giving raises in income, stating that it is better to be conservative in making increases, but in the last three years has seemed to be willing to make decreases in income immediately with any drop in performance by a partner.

The firm has had some disruption internally, with a net headcount reduction among the associate ranks of about 15 percent over the past couple of years. There was a net decrease last year of 12 equity partners pursuant to an announced strategic restructuring, but in fact the departure was 40 partners and the aggressive lateral addition of 28 partners in just the last year. Another 10 partners were converted from equity to income or contract partner status. It is not always clear to Mary whether management desired all of the departures, though invariably it is announced as being so.

Now that the cards are dealt and the ante is up, would you mind telling me what game it is we are playing? Again?

The firm had raised hourly rates by an average of 6 percent per year from 2003 to 2008, but kept them flat for the last two years. Mary's hourly rate was about $500 per hour in 2003. Like many partners, Mary is under hourly rate pressure from her clients who are trying to cope with the financial adversities brought upon by the economic recession. She is well regarded in the market place, but her rate is already perhaps $50-$80 per hour higher than many capable and recognized professionals she competes directly with. Her clients are loyal and appreciative, but have been more vocal than ever that they cannot consider sending to her all of the types of matters they might unless there were lower rate arrangements.

Such types of work have been labeled by management as "commodity" work not in keeping with the strategic plan adopted in 2007 at the firm's annual meeting after a presentation by a famous consulting firm that went on for 30 minutes with dozens of tables, curves, lists of statistics and graphs of firms clustered in quadrants, showing relative financial performance of other firms and where their firm presently was positioned and where it needed to be positioned. Copies are not available for partners because management does not want it leaked to any infamous legal tabloid Web sites due to confidential and sensitive content.

Mary has made a request for rate accommodations to take on this potential additional work — although it is a lower rate, she is confident that it will be comfortably profitable. But management has rejected this. Mary does not do the type of work in the four practice areas that have been highlighted as the emerging backbone of the future firm. In fact, nobody in her California office does that type of work. She is now worried about losing existing work based on rate considerations, and is under pressure to raise her rates to $700 this year, a potentially critical blow for her business book.

It is clear from management that she will have further compensation reduction if she is not able to produce a client roster that can pay the rates this firm expects of its partners, based upon the vision of the firm's future practice composition and compensation targets that management has outlined to the partners, which is held out as the mandate for the direction of the firm. The plan was adopted by a roll call vote at the annual meeting and Mary voted in favor, but mostly because management said it was good, the consultants said it was good, certain key partners said it was good and she really does not get into that stuff anyway. Voting "no" would be akin to being the tallest blade of grass when the lawnmower arrived. Besides, an office in London sounded kind of cool.

Edwin B. Reeser is a business lawyer in Pasadena specializing in structuring, negotiating and documenting complex real estate and business transactions for international and domestic corporations and individuals. He has served on the executive committees and as an office managing partner of firms ranging from 25 to over 800 lawyers in size.

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Put Up or Shut Up, and Preferably Both

By Edwin B. Reeser

Mary is confronted with a difficult predicament — raise her rates and potentially lose clients, or experience a lower flow of assignments from her clients, which will result directly in compensation reductions for her in the immediate future. Her other option is not to raise her rates to keep her clients, and face compensation reductions in the immediate future, plus the displeasure of management. Worse yet, there are rumblings that anything less than a full raise in rates to the targeted $700 per hour could also result in compensation adjustments, so she could wind up with a partial rate raise, lose clients and have further compensation reduction pressure because she did not raise rates enough.

Management has used the "$2 million" comment as the minimum expectation of client business for the future equity partner. The timing for that being applied as an actual standard for existing equity partners is unclear, but the fundamental message is not. Mary would then be in the potential risk position of being "de-equitized" or even counseled out of the firm, in a weakened position with a smaller book of business. Her market value would be substantially diminished at precisely the time she had to depart.

SECOND IN A FIVE PART SERIES

This series explores some of the current illusions and realities of partner capital and capital accounts treatment in some large law firms. It is intended to be illustrative of issues and does not present the profile of any specific individual firm, past or present.

On top of all of this, Mary is concerned about the loss of culture the firm had been so proud of and which she enthusiastically subscribed to when she joined the firm. Associate and staff reductions have been emotionally wrenching, morale is battered, and confidence in the future of the firm, notwithstanding confident messages from the top, is balanced by the reality that she earned far less than she had been forecast to earn for the past three years. Assurances that the firm would hit certain targets were revised downward once in early summer, again in the fall, and then collections at year-end did not deliver the results notwithstanding heroic efforts by most of the partners. The firm has a closed compensation system so Mary does not know what all the other partners are making, but she has discovered that there are several newly arrived partners that are making more than she is, in some instances between $50,000 to $100,000 thousand more, with lesser books of business.

Mary has an opportunity to go to another peer firm or a boutique law firm with hourly rates about $100 lower and income that is equal to or marginally lower than what she earned last year, though less than what has been forecast for last year. It is a group that is focused on her practice area of expertise, has a good reputation, and several professionals there are very well known and respected by her. Mary likes her firm comrades, but like most partners she never really has interfaced much with the senior management as they are located in another city and she only sees them twice a year when they cycle through the office on a periodic visit, and once more at the annual firm retreat.

Mary is confronted with a difficult predicament — raise her rates and potentially lose clients, or experience a lower flow of assignments from her clients, which will result directly in compensation reductions for her in the immediate future.

Mary's capital account is $364,000. Like most partners she has a loan for a substantial portion of that from the firm's primary lending bank. The terms are simple: prime rate minus 1 percent, payable interest only through the year, and 20 percent of the outstanding balance due by Jan. 31 of each year, right after the final year end distributions. Mary had paid the balance down to about $100,000 by 2006, but with the "raise" her capital requirement increased another $59,500. The loan was recast to another five-year amortization on the balance of $159,500. She paid it down in January 2007 and 2008 by $31,900 each year to $95,700, and then her "raise" in 2008 coupled with the 40 percent capital ratio increased her capital by another $84,000. That was recast to a balance of $179,700, with an annual principal reduction requirement of $35,940. But with the very difficult years of 2008 and 2009, the firm negotiated a forbearance of the principal reduction requirement for its partners on their individual capital loans from the bank, but did not reduce the partner-required capital to match the reduced incomes the partners were being distributed. (Indeed, the firm did not have the cash on hand to return the capital adjustment to all the partners, and the bank was tightening lending terms on the revolver that is used for working capital to the firm.) Her effective capitalization ratio to her projected income is now closer to 48.5 percent.

In 2010, the principal reduction payment was optional for all partners with loan balances of less than $200,000, but in 2011 it was required of all partners, and Mary now has an outstanding loan balance of $143,760. Her capital account is, of course, still $364,000. Basically every time she gets a raise, it takes almost one full year of earnings to pay the additional capital required, plus taxes thereon. She has paid in cash almost $100,000 over the past five years in additional capital, and the balance of her loan is up almost $43,760, while her actual distributable income over the past three years has been below management budget forecasts by about $267,000.

The firm has a capital return policy for departing partners that has three components. First, should any departing partner owe a capital loan balance to the bank, the firm will first pay 100 percent of all capital return amounts to the bank until the balance of principal and accrued interest is paid in full. This has always been a feature of partner capital loans. Second, the firm has recently adopted a new policy by which it pays departing partners a return of capital in three annual installments, without interest, commencing from the date the departing partner's accounts receivable have been collected by the firm by at least 90 percent. This is announced as a way to protect the firm by incentivizing a departing partner to collect the monies owed the firm. For partners that have been counseled out, the firm has commonly returned all of their capital once the 90 percent threshold has been reached, or if the remaining amounts to be collected are less than a comparatively nominal $50,000 and the history of client payment has been good plus they have a signed departure agreement with a non-disparagement clause in the firm's favor.

But for partners that are departing voluntarily without the firm initiating the move, the three-year rule is being applied quite regularly. For Mary, this means that she will leave with no capital return for the 90 to 120 days that it will take her to collect her accounts receivable to the 90 percent level. Then after the pay-down of one third of her capital balance by $121,333, the $143,760 loan balance to the bank is reduced to $22,427. She will receive no check from the firm and will continue to pay interest on the loan balance for another year. It will be a year after that (so 15 to 16 months after her departure) before she receives the second installment of $121,333, less the $22,427 principal balance, or $98,906. Some partners have taken as long as nine months to reach the 90 percent collection threshold after their departures. And partners with "citizenship" issues, the details of which are not discussed with partners at large and which are "murky" as to what exactly that means, have sometimes had their capital returns tied up for years.

The partnership agreement has a mediation or arbitration clause and confidentiality provisions so that no litigation of disputes is permitted. The non-disparagement clause in her departure agreement will put all capital return at risk in the event of violation by the departing partner. Mary's peer firm has a similar capital contribution requirement, while the boutique firm opportunity has a basic capital contribution requirement of $250,000. If Mary is going to leave, even on the best of terms, she is going to have to go an additional quarter million dollars into debt (if she can get it), and is at risk for the return of her prior firm capital account balance of almost another quarter million dollars over two plus years after the date of her departure. If she cannot get the loan to fund her new partnership capital position, she will either have to negotiate an installment buy in, and perhaps have a reduced draw or compensation package as a result, or come in to the new firm as a contract rather than equity partner at a lower salary (plus perhaps a performance bonus incentive) than she might have otherwise been able to command as an equity partner with a share of profits.

Edwin B. Reeser is a business lawyer in Pasadena specializing in structuring, negotiating and documenting complex real estate and business transactions for international and domestic corporations and individuals. He has served on the executive committees and as an office managing partner of firms ranging from 25 to over 800 lawyers in size.

BRIEFLY

The U.S. Senate rejected an amendment that would have weakened the proposed patent reform bill by a wide margin Thursday. Sen. Dianne Feinstein, D-Ca., sponsored the amendment, which would have done away with a proposed change to adopt a first-to-file patent system, instead of the current system that favors the first inventor. But U.S. Sen. Patrick Leahy, D-Vt., said Feinstein's amendment — which she said would help startup companies — would "kill" the overall patent reform bill, and the Senate tabled it by an 87-13 margin. Other amendments were being considered Thursday afternoon, and Leahy said he expects the final bill to be considered next week. If passed, the U.S. House of Representatives would take it up next.

If the Proposition 8 case returns to the trial court for any reason, the judge who struck the same-sex marriage ban down will not be the one to hear any additional proceedings. An appeal of U.S. District Judge Vaughn R. Walker's August ruling is pending at the 9th U.S. Circuit Court of Appeals and the California Supreme Court. Walker retired from the Northern District bench at the end of last month. On Thursday, the case was reassigned to Chief Judge James Ware.

Target Corporation will pay $22.5 million to settle an environmental lawsuit over improperly dumping chemicals at its stores throughout the state. Alameda County Superior Court Judge Steven A. Brick approved a $22.5 million settlement that includes civil penalties, costs and supplemental environmental projects, Santa Clara County District Attorney Jeffrey F. Rosen announced Thursday. Rosen, 19 other district attorneys, the California Attorney General and the Los Angeles and San Diego city attorneys field the suit in 2009 claiming that over a five-year-period the company had improperly handled and disposed of chemicals at more than 240 stores. As a result of the case, the stores have adopted new waste disposal polices including keeping hazardous waste in segregated, labeled containers to prevent customers and employees from being exposed and chemicals from mixing.

A federal grand jury indicted the former mayor of Upland and the mayor's appointee to a municipal board on corruption charges involving an extortion scheme targeting two local businesses. John Victor Pomierski, 56, who resigned as mayor last week, was accused in an 11-count indictment of extorting $45,000 from the business owners in exchange for helping them get permits, among other things. Also charged was John Edward Hennes, 54, a member of Upland's Building Appeals Board, who allegedly communicated Pomierski's demands and collected the money. Pomierski and Hennes were both charged with conspiracy and extortion under color of official right.

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Daily Journal

Lawyer Faces Charges in Separate Case

Continued from page 1

U.S. Code Sec. 441f, which says, "No person shall make a contribution in the name of another person."

U.S. District Judge S. James Otero threw out the indictment against O'Donnell in 2009, finding the law does not explicitly bar a person from funneling donations through third parties and that it only applies to the person who made the contribution.

The 9th U.S. Circuit Court of Appeals reinstated the charges last June, saying Otero's interpretation of the law was inconsistent with its purpose.

If convicted of the federal charges, O'Donnell would likely face further State Bar discipline.

O'Donnell is best known for representing clients such as the late writer Art Buchwald in his successful lawsuit against Paramount Pictures over the 1988 Eddie Murphy film "Coming to America."

For the past six years, O'Donnell said his focus has been on public justice litigation. O'Donnell led a team of lawyers seeking compensation from the U.S. government for victims of Hurricane Katrina.

"That focus will continue and intensify once I resume the active practice of law," he said.

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Bratz Judge's Order Deemed Highly Rare by Legal Experts

Continued from page 1

schedule conflicts," Zeller said.

Questioning Eckert on the stand this week, Mattel lawyers sought to show that MGA severely harmed the toy company in pirating the Bratz concept by secretly working with a Mattel employee on the idea.

During questioning by Quinn Tuesday, Eckert said Mattel was "highly concerned and anxious" about the huge success of Bratz several years ago, and that the doll forced the company to lay off employees and cut into its bottom line.

Keller tried to punch holes in Eckert's credibility. On questioning by Keller, he said he wasn't sure of the day-to-day responsibilities of Carter Bryant, the toy designer who allegedly created Bratz on Mattel time.

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If I Am Winning, Why Do I Have Fewer Chips?

By Edwin B. Reeser

Additional pressure arises because Mary has to decide what to do, and decide fast, or sit tight another year. That is because the firm only credits departing partners with draws received to the date of departure. A 55 percent draw on $750,000, less monthly costs, is $32,375 per month. Every month she waits costs her $28,125 in lost income, which is hoped to be received in the following January from the year end distribution (less the principal paydown on the capital loan due the bank and the contribution to the 401k retirement plan).

Even more pressure is brought by the need to make quarterly installments of federal and state estimated taxes, which for Mary are roughly $56,250 or $18,750 monthly, leaving her $13,625 per month. She and her husband bought a new home with a $900,000 mortgage at 6 percent on a $1.5 million property in 2006 when life was "good," so after $5,400 in mortgage, $1,000 in insurance and $1,500 in real property taxes each month, she is down to $5,725 to cover all living expenses for the family.

THIRD IN A FIVE PART SERIES

This series explores some of the current illusions and realities of partner capital and capital accounts treatment in some large law firms. It is intended to be illustrative of issues and does not present the profile of any specific individual firm, past or present.

Mary has gotten used to having a personal line of credit to cover those shortfalls in her living expense requirements, which she pays off every January with some of the net proceeds from the year end distribution. It typically runs up to about $50,000 or $60,000 per year. She took out a home equity line mortgage last year for $100,000 to pay off the credit line and get a little extra cash.

Now, this is not to demonstrate that we should all lose sleep or shed tears for Mary's situation, but simply to illustrate that there may not be as much freedom of choice in making the decision as one would initially surmise for a "successful" partner in a large law firm. As the year goes by, the economics make a departure in the second half of the year simply unthinkable.

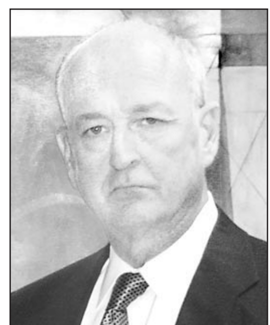
So, what if Mary stays and the firm fails? She likely will not get any capital back, and she will still owe the bank $143,760. There may or may not be additional liabilities. Equity partners have personal recourse risk if there is a bankruptcy, where the facts and law support a creditor clawback of distributions made to all or some of the partners in the period before the bankruptcy. But if the firm survives, she will pay down that loan balance another $60,000 or so over a couple of years, the economy should recover, the firm will do better as should she — and maybe things will work out. If she goes to another "peer group" firm like the one she is leaving, for all practical purposes the survival prospects may not be any better, and she will be increasing her capital at risk for the next two to three years.

Mary is struggling with the unknown of what is happening in her own firm, the inertia associated with a decision of this type and feeling that she is perhaps hostage to her own capital invested in the firm.

With an "aspirational" forecast of income by the managing partner at this year's annual retreat that is meaningfully higher than last year and an official message of supreme confidence in the future of the firm, things should be better. Except for that little problem with getting those rate increases and what it may do to her client roster. How does Mary weigh those two factors against each other? After all, it seems like notable law firm failures recently were all preceded with strong future forecasts of income and supreme confidence in the future — except they didn't happen that way.

Mary is struggling with the unknown of what is happening in her own firm, the inertia associated with a decision of this type and feeling that she is perhaps hostage to her own capital invested in the firm. The fact is that while she feels she has done everything that has been asked of her and more than carried her share of the burden, she is much worse off financially than she was five years ago. Her debt is higher, her capital investment at risk is greater, her monthly distributable income is lower, her departure costs are greater, the firm culture is frayed, her client roster is at risk, her options for increasing her contribution to secure greater or even the same income seem to be diminishing and the announced direction of the firm is not one that necessarily must include her any longer. In fact, the only way to fulfill the strategic plan is to laterally acquire significant numbers of high priced partners, putting the future of the firm into the hands of people that are not even known yet.

This is the part that Mary sees from her perspective and information directly available to her. Next, we will look at the mechanics of how partner capital is handled by the firm itself, something that is not discussed openly or known to Mary or to most of the partners in the firm. If Mary thought her situation was anxiety provoking before, what will follow is going to bring home a new reality.



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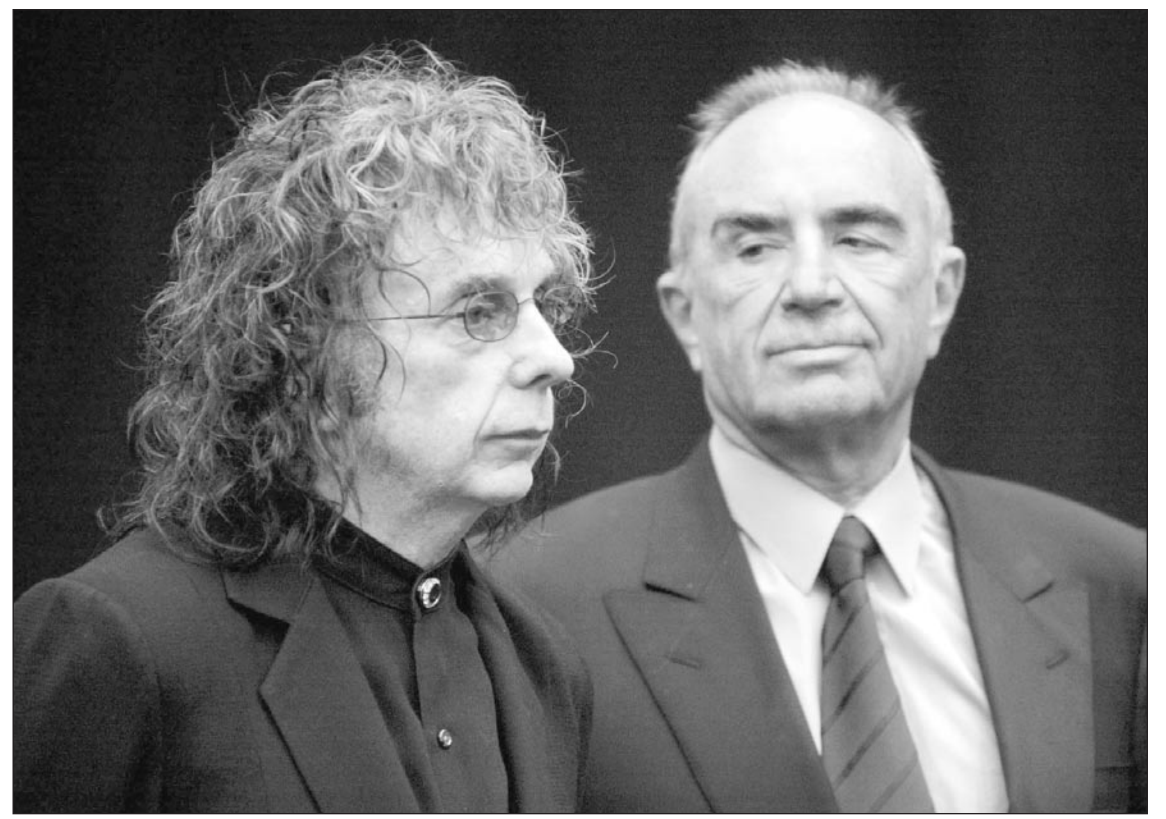
'True Retainer' Deal Leaves Law Unsettled

Dispute settled over $1 million fee paid by Phil Spector to Robert L. Shapiro before trial.

By Ciaran McEvoy
Daily Journal Staff Writer



Associated Press

Record producer Phil Spector, left, with his attorney Robert L. Shapiro

LOS ANGELES — A long-running fee dispute brought by music producer and convicted murderer Phil Spector against his ex-lawyer Robert L. Shapiro settled last week on the eve of trial.

With the confidential settlement, a chance may have passed for California courts to clarify the meaning of a "true retainer."

Had the case gone to trial, it likely would have centered on such a retainer — where an attorney charges a fee solely for availability over a period of time, not for actual legal services rendered. When an attorney's services are needed later, they are billed and paid for separately.

When Spector was arrested on suspicion of murdering actress Lana Clarkson on Feb. 3, 2003, he hired Shapiro, who charged him $1 million. Shapiro claimed that fee was a non-refundable true retainer and that he had turned down Robert Blake's and Scott Peterson's requests to represent them at their murder trials to focus exclusively on the Spector case. Shapiro deposited the money in his personal bank account, according to briefs filed by Spector's lawyers.

In January 2004, Spector fired Shapiro, "after almost a year of being ignored by Shapiro and constantly being told he was out of the country, in court or otherwise not available to speak to him," court papers state. He later sued for a refund of the $1 million fee.

The lawsuit settled Thursday in the courtroom of Los Angeles County Superior Court Judge Peter D. Lichtman Jr., according to Spector's lawyer Michael D. Dempsey of Dempsey & Johnson P.C. The terms of the settlement are confidential.

"It's a resolution and that's about it," said Joel N. Klevens of Glaser, Weil, Fink, Jacobs, Howard & Shapiro LLP, one of Shapiro's attorneys, when contacted Friday. Glaser Weil also was a defendant in the suit.

Once common, true retainers are a rarity today.

"It would be good to clear this up in the future because I found many of my colleagues didn't know what it was," Shapiro said in an interview last week.

The overlay between contract law and legal ethics rules has led to some confusion among legal practitioners, experts said.

"An amazing number of lawyers do not understand the law of fees," Dempsey said.

California's Rules of Professional Conduct require attorneys to refund money advanced by a client but not earned by the lawyer. Legal ethics officials are concerned that attorneys will double-bill their clients or charge a true retainer then do no work on the client's behalf, experts said.

"The [State] Bar is very cautious about saying whether true retainers are ethically proper," said Gregory

> 'It would be good to clear this up in the future because I found many of my colleagues didn't know what it was.'
>
> — *Robert L. Shapiro*

L. Ogden, a professor at Pepperdine University School of Law.

Sometimes clients in expensive family law cases will pay true retainers as a tactical move to block their estranged spouses from hiring an opposing counsel.

In criminal law, defense attorneys often demand large payments up front because of concerns prosecutors could seize a client's assets early in a case.

"If you don't get the money up front you'll never get the money from the client," Ogden said.

That may have been Shapiro's reasoning behind charging the well-known music producer such a fee up front.

Shapiro argued he quickly hired a team of high-profile experts including Drs. Henry Lee and Michael Baden, who assisted in Spector's defense.

In 2005, Spector dropped his initial lawsuit against Shapiro without prejudice and then re-filed his complaint two years later. *Spector v. Shapiro*, BC382572 (L.A. Super. Ct., filed Dec. 19, 2007)

After his first murder trial ended with a hung jury, Spector was retried and convicted of Clarkson's murder in 2009 and was sentenced to 19 years to life in state prison. He is appealing his conviction.

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The Play's the Thing

Continued from page 1

tem? But giving out "Oscars" would be so...so derivative. Instead, the winners would receive an "Oliver."

I devised a list of categories eligible for awards: a dramatic role for trial lawyers (I rejected creating an award for best comedy judge and lawyer for obvious reasons, though I had some candidates in mind); supporting roles for law firm associates and judicial research attorneys; behind-the-scene roles for secretaries, assistants and paralegals; writing awards for briefs (comparable to original screenplays) and judicial opinions (comparable to screenplays adopted from another source).

And then I became stymied for the award that would parallel "Best Picture." Pardon my bias, but I wanted this award to reflect some great spectacle in the judiciary. I needed something that contained drama, conflict and tension — something like *The Social Network*. I was at a loss. *The Fighter* had no appropriate counterpart in the court system, and I was ready to throw in the towel. (Sorry.) And then I found a way to solve my dilemma. It was in the very opera I was attending, *Il Turco in Italia*.

The opera involves a playwright who is looking for ideas for his next comedy. Only he cannot come up with something that is original or novel. He visits a gypsy camp where he hopes to find material and inspiration. He watches a drama unfold, which becomes his play, much like my writing about the lady in the men's room. We need not repeat here the events in the opera because they involve multiple love affairs, a Turkish prince, his slave paramour, an unfaithful wife and mistaken identities. I cannot speak for the legal profession, but the plot of the opera bears no resemblance to the California judiciary...as far as I can determine.

I decided to use the device of the playwright in the opera to find material for my column. I would simply write about dramatic events unfolding in the judiciary. From this I might get a handle on what would qualify for the counterpart of "Best Picture" in the Academy Awards. *The King's Speech* was a wonderful movie, certainly deserving an Oscar, but my choice was *The Social Network*. But what in the judiciary could be comparable to the tension, the animosity, recriminations and rancor involving a billion dollar company?

I was ready to exit center stage (better than a boxing metaphor here) when it hit me like a perfect high C. It was right in front of my face — the drama involving the Court Case Management System (CCMS) alleged to cost $2 billion or more. The state auditor had sharply criticized the management of the project and the oversight of its costs. Some legislators and judges were appalled by the way the project was handled, and a number of judges called for abolishment of the entire project. Even Justice Terry Bruiniers, Chair of the Judicial Council's CCMS Executive Committee, appeared to agree with most of the auditor's critiques. But he and others have taken strong positions against abandoning the project.

Shortly after the auditor's scathing report, the Judicial Council received a cost benefit analysis from a prestigious audit tax firm that concluded the "statewide case management system...has an essential role in the operation of our state justice system" and, when in operation, will save the state $300 million a year.

A recent epistolary exchange between Justice Bruiniers and Los Angeles Superior Court Judge J. Stephen Czuleger highlighted great differences in perception about the manner in which the project was presented to judges statewide and to the Legislature. Some judges in those courts where a version of CCMS (V-3 the civil module) was implemented think it is wonderful. Others tell me it is a failure.

The playwright in *Il Turco in Italia* finds a happy ending to his play. The wayward wife decides it is more prudent to be more conservative and stay home with her husband and gives up her two lovers, one of whom is the Turk. The Turk settles down with the woman he truly loves, a slave from his harem, and the wife's other lover repents and gains forgiveness from her husband.

But I am facing an obstacle. There is not as yet an ending to the CCMS drama, let alone a happy one. Is there a way to bring this drama to a happy ending? Perhaps we all can agree that a statewide case management system that works will be beneficial and efficiently improve the administration of justice. But a good ending for this drama lies in the answers to some questions. Is CCMS worth the cost? If so, how do we pay for it when the judiciary's budget may be cut by $200 million? If we halt the project now, will we lose the investment we have made to date if we resume the project in the future? The AOC just answered this question in minutes of its last meeting. Canceling the program will result in an unrecoverable loss of 270.5 million already spent on the development of CCMS-V4. With that good news in mind, how does the judiciary decide its spending priorities with a drastically reduced budget?

The playwright in *Il Turco in Italia* intervened on occasion to prod the characters in certain directions to achieve a good ending. I too wish to nudge us in a direction toward a satisfactory ending for our drama. I suggest an approach that reflects a paramount value: all players in our drama, the judges, lawyers, and administrators throughout the state, whatever their opinions about CCMS, unite in support of our highest priority — keep the courts open.

To close the courtroom in the middle of a trial and tell litigants they must go home and come back in two days because we have other things to pay for is not a good ending to our drama. It is disheartening to the judges and court staff who have devoted themselves to the cause of justice. And it is most unfair to the public who trusts us and depends on us to resolve their disputes.

Keeping our values straight will provide a good ending to our drama. And the award, the coveted Oliver, will go to those who sacrifice to make this ending possible.

Arthur Gilbert is a presiding justice of the 2nd District Court of Appeal, Division 6. His previous columns are available on www.dailyjournal.com and gilbertsubmits.blogspot.com.

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Doubling Down for Growth

By Edwin B. Reeser

We have talked about a fictional partner Mary Doe in a fictional large law firm, and the pressures she is facing with her practice and considerations of future economic pressure and career opportunity. We also looked closely at her capital account position in the firm and how it evolved. Now we are going to look at what is happening with the capital accounts in the firm from the perspective of the management.

The 10 partners who were de-equitized but retained in the firm received back all of their capital immediately, a typical arrangement as they did not leave the firm. This amounted to about $2.5 million of cash payments from the firm, a lower per capita average, as they were among the lower producing equity partners and already earning lower compensation figures. They have business ranging from as low as $400,000 to just under $1 million per year. Their salaries are reduced to fairly reflect what management believes is their contribution to the firm. The difference now is that they are effectively salaried employees at will. The good news is that they no longer have capital at risk, they get 100 percent of their salary in 12 equal monthly distributions, and it actually winds up costing the firm $1.7 million more in cash through the year to fund that compensation package as compared to when 45 percent was withheld from them as equity partners. But this increases the firm's profits per partner figures reported to the *American Lawyer* without increasing the gross revenue to the firm.

FOURTH IN A FIVE PART SERIES

This series explores some of the current illusions and realities of partner capital and capital accounts treatment in some large law firms. It is intended to be illustrative of issues and does not present the profile of any specific individual firm, past or present.

As noted, 40 more partners departed, and the combined capital accounts of those partners amounted to $15 million. However, only $5 million cash was paid out currently. The remaining $10 million is carried as a liability on the balance sheet. Twenty-eight partners have joined the firm, with a collective capital infusion of about $10 million. Netting out the amounts, the firm has paid out $7.5 million, taken in $10 million, and retained $2.5 million of cash, against an increased liability of $10 million. Next year, this liability will generate a $5 million payout, and the same the following year.

In addition, those 28 partners accrued recruitment commissions of $5 million, which were paid in full. However, those were "capitalized" and given a three-year amortization period, so that $1.66 million was expensed and $3.33 million carried as a liability. In addition, the firm is "fronting" the pipeline expense of paying the new partners, and their associates and staff for the better part of 90 days — before there is any stabilization of cash flow from the matters they have brought. This amounts to another $5 million cash outlay, which is also capitalized with a three-year amortization period. Taken together, this pipeline and commission eliminate the $2.5 million of surplus capital raised from new partners in the first year, and consume another $1 million of cash, to which is added the $10 million of out of pocket commissions and pipeline advances.

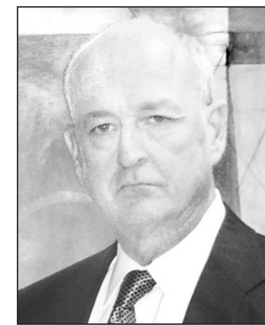
If you look at the dynamic, the new partners basically finance their own recruiter commission and pipeline period of 90 days with their capital account on joining the firm. Then, the cash they have contributed is gone! They each put in hundreds of thousands of dollars of capital, that is then distributed currently, with a future expense burden from amortization. The departing partners are financing the return of their capital with the collection of their accounts receivable. Using this technique, however, the departing partners collect their money in 90 days, paid in one-third increments over two years. This serves to increase distributable cash and reported revenue for the firm currently, but with a future nondeductible cash outlay burden for the unreturned partner capital. One could change the analysis and interpret this as new partners paying the old partners, or one set of capital replacing another, but that is not how the money is actually flowing and not how it is being treated on the books. I suggest we *look* at the money flow and *then* make the call.

The monies collected by the firm on the departing partner accounts receivable are income, without the departed partners having a distributable share as income since they are no longer partners of the firm. So there should be another cash flow "pipeline" as they leave from which the firm receives an increased income benefit. And it does, immediately in the months following departure. But not so over the next two years when the firm has to pay back the departed partners' capital. So what happens when you have a "frictional" or transactional cost of paying several millions of dollars of recruiter fees and capital returns to stay at or about the same size? The firm is beating up its financial statement with a sledgehammer, *paying millions of dollars to stay in the same place.* Income is artificially inflated: cash is taken in from the new partners not as income but as capital, and distributed to the partners in the firm, at the cost of carrying a significant liability to be paid off in future years from future year collections. Simultaneously, income is taken from the collection of departing partner accounts receivable while adding more term liability for the balance of their capital accounts. And of course, if the firm basically "runs in place" for three years with significant lateral hires and departures cancelling each other out, a big "bubble" of balance sheet liability to pay to departing partners has built up, while operating income (and thus profits per partner) has been inflated.

Assuming that the partnership had net zero change in its equity partner numbers, but in the other two years had 40 departures and 40 additions at roughly equal capital balances, by the third year the firm would be carrying an annual current obligation of $15 million of deferred capital returns payments to departed partners, with another $10 million due the following year and $5 million the year after, assuming this process was immediately halted "cold turkey." But if partners keep departing, then the capital outlay requirement continues without an offset from new arriving partners. Thirty million dollars of nondeductible capital returns is a lot of after tax income to redirect for this purpose.

Consequently, the departing partners are effectively providing interest-free financing to the firm, as unsecured lenders. And that capital return to them is not a deductible expense to the firm. So where is that cash money going to come from?

The money has to come from cash that is borrowed from a bank; contributed as increased capital from existing partners; contributed from capital due to growth of the number of equity partners in the firm; or earned by partners, taxed to them, and applied to the obligation rather than distributed to the partners. (This fourth and last option is unpopular with partners as they are paying taxes on money they do not receive, but it does not adversely impact reported profits per partner.) Only the third option above is truly attractive, as all others increase liability, or cause commitment of after tax income from partners.



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Congratulations to our partner
Kent Richland
for receiving his second Attorney of the Year Award from California Lawyer Magazine.

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All in for the Last Hand

By Edwin B. Reeser

Suddenly, it all begins to make sense. The increase in capital of 5 percent of projected income in 2008 amounts to roughly $60,000 per partner. The firm has shifted to its partners a personal recourse obligation — a borrowing item that the bank would not permit on its working capital line of credit to handle repayment of departing partner capital. In the aggregate, that was probably enough to generate a one-time $15 million of increased capital for the firm. The "freezing" of capital commitment to the older "aspirational" budgeted income forecast for 2008 was critical, otherwise the firm would have had to return an average of $96,000 per partner to bring the balance back to a 40 percent ratio of capital to income. The firm did not have the cash to do that, even after a raise in the capital ratio from 35 percent to 40 percent. The bank was certainly not going to authorize an application in stressed times for return of capital to partners funded by a loan from the bank!

LAST IN A FIVE PART SERIES

This series explores some of the current illusions and realities of partner capital and capital accounts treatment in some large law firms. It is intended to be illustrative of issues and does not present the profile of any specific individual firm, past or present.

It even makes sense to management to pay a premium compensation package over what the existing partners receive to attract new partners and continue growing its business book, if the firm gets more money to pay down these obligations as a result. (It doesn't hurt a whole lot to get the higher capital contribution tied to the compensation package either).

Do the math. If the firm has a net gain of 10 equity partners at an average compensation package of $1.1 million each, the short-term positive impact is $5 million of additional capital. Part of the reason for this is there is no payout to departing partners for that net increase of 10 partners. That money goes to fund the departed partners' payout program. The problem has not gone away — the firm just does not have to recognize it right away because of the added bodies. But once a firm starts to shrink, the negative leverage can become overwhelmingly difficult to survive.

The partner capital line item on the firm balance sheet is not matched by tens of millions of dollars in cash in a bank account. It is typically consumed within months, if not immediately. "Expand or die" can become a very real pressure in such circumstances. The growth is because the firm is sick, not because it is successful. Suddenly, new lateral partners, new practice group additions, new locations have a different potential motivator for addition. "Strategic" downsizing is not an option in as many situations, and has to be carefully reviewed by outsiders when a firm announces it is doing so as a means of improving its financial condition. One reason for the almost obsessive focus of some firm management teams upon reporting increases in profits per partner, especially in the midst of a recession, is when the firm desperately needs partner growth to cover the capital drain from departing partners. This metric of PPP can be portrayed as a symbol of success and stability to attract new laterals, and retain high producers, when in fact the steps taken to achieve it are destructive and destabilizing in themselves.

> The growth is because the firm is sick, not because it is successful.

It behooves the individual partner as lateral candidate to clearly understand which of the strands to the partnership web are sticky before making a landing. And it behooves the existing partner to understand it when measuring the true cost of staying against the cost of leaving.

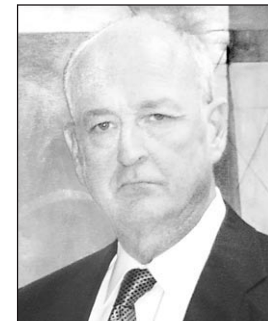
Should the firm not follow this creative practice, and instead currently expense all of the recruiter and pipeline costs, the immediate impact to the income statement is a negative $10 million. Assuming that the newcomers, though fewer in number, are "better" producers, the 28 will have a collective book that is equal to or greater than the 40 departed partners (the 10 de-equitized partners still have their clients in the firm). The income received by the firm from the accounts receivable of the departed partners is hopefully enough as collected to be an income offset to that $10 million expense, with a net result of zero. And, the firm has not overstated its income and distributed what really is capital, as taxable income. But there still is that issue of deferred capital returns to departing partners. Where has that money gone?

It may be absorbed into the pay down of the revolving line of working capital credit to the bank. If so, then that is potentially a good thing. Borrowing interest free from partners is cheaper than borrowing from the bank. Especially if the firm uses that revolver to advance draws to its partners in the early part of the calendar year when income is less than expense. But it does not take away from the reality that the firm has to come up with millions of after tax dollars to pay back the departed partners.

One critical factor to look at is when does the firm's revolving line of credit that it has been drawing get reduced to zero? If historically, the date of repayment is stretching deeper into the year (say from May or June to mid-August or later), or the absolute maximum amount drawn has been increasing, especially in per partner terms, precisely why it is happening may be something to be concerned about. It could be that some of it has been used to pay the deferred returns of capital to departed partners.

There shall be a day of reckoning. Does it make a difference to Mary Doe which method her firm is using to characterize recruitment and pipeline expenses for laterals on its financial statements? Does it make a difference how capital is provided to the firm and how it is repaid if it alters reportable income? Does the historical payback and maximum amount drawn on the working capital line make an important difference in how her evaluation is made of the underlying stability of the firm she is a member of, or might be moving to? These and dozens of other ways of reporting "book" and "tax" income, expense and balance sheet items can be critical to understanding the financial stability of her firm. But only if she knows what all of these cards are, and how they are being dealt around the partnership table. Every partner's situation is unique, as is their persona, so what motivates their ultimate decision to stay or leave is not possible to determine. What is important is having all of the information to make a fully informed decision. If none of this comes as a surprise or concern to a partner like Mary Doe, then she is clued in to the material elements that allow her to make her decision. If some of these issues do come as a surprise with material weight to Mary, then she needs to find out.

While it is often stated that law partnerships are comprised of volunteers, and not victims, the closed compensation systems and selective disclosure of "techniques of financial reporting" have become increasingly opaque to partners, to the point where they may have taken a seat at the table for a game in which the rules have never been fully explained, and where it is of increasing concern that there may not be any rules at all. Changing the card dealer may not be enough.



Edwin B. Reeser is a business lawyer in Pasadena specializing in structuring, negotiating and documenting complex real estate and business transactions for international and domestic corporations and individuals. He has served on the executive committees and as an office managing partner of firms ranging from 25 to over 800 lawyers in size.

SF Prosecutors Drop More Cases in the Wake of Hotel Video Scandal

By Brandon Ortiz
Daily Journal Staff Writer

San Francisco prosecutors dismissed eight additional criminal cases Tuesday in the wake of a growing police scandal involving eight undercover officers accused of conducting warrantless searches and lying on police reports, officials with the public defender's office said.

The scandal came to light last week after San Francisco Public Defender Jeff Adachi publicly released hotel surveillance videos that allegedly contradict official police accounts of three unrelated drug busts. The claims have reportedly spurred three separate investigations by prosecutors, police and the FBI and could lead to the review of thousands of cases.

It's also the first test of new District Attorney George Gascon, who is running for election this year and is the city's former police chief.

Eight cases unrelated to the drug busts were dismissed by prosecutors on Tuesday, said Tamara Aparton, a spokeswoman for Adachi. Officers who were implicated in the video tapes Adachi released had worked on the cases, including one in which an accused officer had testified at a preliminary hearing, she said. Two men whose cases were dismissed were facing prison sentences of 35 and 27 years each for felony drug charges, Aparton said.

> Growing concerns over alleged warrantless searches and false police reports could be the first test of new District Attorney George Gascon, who is running for election this year and is the city's former police chief.

Aparton said a total of 13 cases had been dismissed by prosecutors or judges as of Tuesday afternoon, including four directly tied to the video tapes.

Adachi is planning to review every case the implicated officers have ever investigated or testified in, which could number 2,000 to 3,000, Aparton said. He may seek to reopen the cases to have defendants' convictions overturned.

A spokeswoman for Gascon did not immediately return phone calls Tuesday. Last week, Gascon announced that he is investigating the incidents and will review cases the officers had worked on.

On Dec. 23, undercover police arrested a man at the Henry Hotel in the Tenderloin district on accusations he was dealing heroin and crack cocaine at the hotel. According to a sworn police report signed by Officer Arshad Razzak, police were acting off of a tip from a confidential informant. The officers knocked on a hotel room door and announced themselves. After they didn't hear a response, they used a master key to partially open the door and told a woman that they were obtaining a search warrant for the room.

Razzak wrote that the woman gave them permission to search the room and that they found heroin and crack on a male occupant.

But Adachi said the hotel's video surveillance footage tells a different story. He said it shows four officers using a master key to barge into the room without knocking or asking for permission.

Charges against hotel occupants were dropped last week after the public defender's office showed prosecutors the video footage.

In a separate Jan. 5 drug arrest, Officer Richard Yick swore in a police report that officers spoke to a woman in a hallway of the Henry Hotel who agreed to open the door to her room. A man who came to the door told police officers that he was on probation, which police confirmed with dispatchers before searching the room, the report stated. Police arrested the man and woman after officers found heroin in the room, according to the report.

But in the security video, Yick allegedly covers the surveillance camera with his hand while three officers barge into the room.

After watching the surveillance video last week, a judge dismissed charges stemming from the Jan. 5 arrest.

In a third video taken on New Year's Eve, police kicked down a door at Hotel Royan in the Mission District and didn't confirm the suspect within had a misdemeanor bench warrant until after his arrest, the public defender said.

The officers involved in the arrests have been placed on administrative duty while the department conducts an internal investigation, a police spokesman said.

The scandal grew Monday when Adachi released a video that private defense lawyer Scott Sugarman obtained involving the arrest of another man at the Henry Hotel on Dec. 2. The video involved some of the same officers.

Sugarman and Adachi accused police officers of framing a 29-year-old man on drug charges.

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State High Court Grapples With Defining Pimp

By Paul Elias
Associated Press

SAN FRANCISCO — When is someone a pimp?

The California Supreme Court grappled with that question Tuesday in the case of a man who was convicted of pandering in Los Angeles after he tried to recruit an undercover police officer to work as a prostitute for him.

His lawyer urged the high court during oral arguments to toss out the conviction, arguing that only pimps who recruit innocent victims — rather than working prostitutes or someone posing as a prostitute — can be guilty of pandering.

The case of Jomo Zambia boils down to defining the phrase in California law that makes it a crime for anyone who "induces, persuades or encourages another person to become a prostitute."

Zambia was arrested in 2007 and sentenced to four years in prison. He's been paroled but wants his conviction erased.

His lawyer Vanessa Place argued that Zambia should have been charged with a lesser crime, such as attempting to pander or solicitation of a prostitute.

She said people can't be convicted of pandering when they attempt to persuade a working prostitute to change management.

"You can't become what you already are," Place argued.

California Deputy Attorney General Rama Maline countered that the law was meant to imprison any would-be pimp regardless of the target's status as a prostitute or innocent victim.

The Supreme Court appeared divided on the issue. Justices Marvin Baxter, Ming Chin and Patricia Bamattre-Manoukian seemed ready to side with the state.

Bamattre-Manoukian, an appellate court judge temporarily filling in because of the retirement of Carlos Moreno, said the law could be read as making Zambia's action illegal because the person was "becoming a prostitute for him for the first time."

Justice Joyce Kennard , however, said Zambia made a compelling argument.

"When one is already a prostitute, one can't be encouraged to be a prostitute," Kennard said. "That seems to be a common-sense interpretation."

The court will rule within 90 days.

Office Depot to Pay $4 Million to Settle Overcharges

Associated Press

SAN FRANCISCO — The city has reached a $4.25 million settlement with Office Depot Inc. over allegations the company overcharged for office supplies, officials said Tuesday.

Mayor Edwin Lee signed a Board of Supervisors resolution authorizing the settlement, which includes a $3.75 million payment and a $500,000 purchasing credit.

A 2009 audit by the city controller found that Office Depot deprived the city of an estimated $5.75 million in discounts mandated under its five-year, $18 million contract.

Office Depot initially claimed the overcharges totaled less than $50,000 and were the result of accounting errors.

The Boca Raton, Fla.-based company strongly disputes the audit's conclusions but views the settlement as a reasonable compromise, Office Depot spokesman Jason Shockley said.

Last year, the company settled contract disputes with government agencies in Missouri and Florida.

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