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Paying the Piper for Music You Didn't Hear: California's No-fault Defense Responsibility Under Indemnity Agreements

by William A. Bogdan
(wbogdan@lgglaw.com)



onstruction liability insurers are paid to protect contractors against future claims. Compensation comes in the form of premiums. If premiums exceed the cost of claims, the insurer earns a profit. If claims are made, then the insurer funds a defense financed from pooled premiums of all insureds, even if the claim is unfounded. That is the business insurers are in.

Contractors are paid to build things in real time. Compensation comes in the form of payment for materials and labor as the work is performed. Once the project is complete, the contractor earns no further compensation. If compensation exceeds costs, the contractor earns a profit. That is the business contractors are in—or were prior to the California Supreme Court's decision in *Crawford*

v. Weather Shield. Now contractors are apparently also in the business of funding the defense of construction defect claims, even though allegations assailing the quality of the contractors' work are unfounded.

There is no line item in a construction bid for defense of future allegations of defects. Those legal costs come out of compensation earned on the project. Where that contractor's work is determined to be defective, paying for the hirer's defense was considered part and parcel of the duty to indemnify. Now, under the *Crawford* decision, a contractor can be penalized despite successfully completing the project, by saddling the contractor with hirer's defense costs, even though none of its work was defective.

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The *Crawford* facts are self-limiting, given the effect of recent amendments to Civil Code § 2782 regarding defense costs in a residential construction defect context. However, attempts to expand the scope of the ruling to claims of commercial construction defect or construction bodily injury are no doubt soon to come.

The Way We Were

Nine-and-a-half times out of ten, a construction tender of defense proceeded as follows: (1) contractor received tender; (2) contractor forwarded tender to its carrier; and (3) carrier responded to tender. The contractor itself would not respond to the tender; that was the insurer's job.

The carrier has a duty to defend from the moment of tender because its duty to defend is broader than its duty to indemnify. In contrast, contractors did not owe an instant defense because, according to *Regan Roofing v. Superior Court* (1994), until a duty to indemnify was demonstrated, there was no obligation at law for the contractor to provide a defense. Once a duty to indemnify was demonstrated, the contractor would owe indemnity as well as the cost of defending from the date of the tender.

The Legislature eventually amended Civil Code § 2782 for residential construction contracts signed after January 1, 2006, to preclude a residential contractor's responsibility for the defense of the hirer if the contractor's work was not defective. If the contractor participated in the defense of the hirer, it must be reimbursed for any fees deemed to

be the responsibility of those whose work was actually defective.

Won the Battle, Lost the War

The facts of *Crawford* pre-date the amendments to Civil Code § 2782. In exchange for successfully bidding a residential project, window supplier Weather Shield and window installer Darrow agreed to indemnify developer and general contractor JMP against all defect claims arising out of the work. They also promised to defend any suit or action brought against JMP "founded upon" such a claim. Homeowner Crawford sued JMP, Weather Shield, and Darrow for defects in the windows and in their installation. JMP settled with plaintiff, but maintained an indemnity cross-complaint against Weather Shield and Darrow, which was severed from the homeowner's action.

The jury awarded the homeowner \$1 million against Darrow, but returned a defense verdict in favor of Weather Shield. Darrow immediately settled with JMP and plaintiff.

At trial on the cross-complaint against Weather Shield, JMP represented that the defense of plaintiff's window claim cost it \$262,548, and that pursuit of its cross-complaint against Weather Shield resulted in additional legal fees of \$46,734. Despite the verdict in Weather Shield's favor on plaintiff's defect claim, the judge assessed Weather Shield 50 percent responsibility for JMP's legal fees on the window issue and all of JMP's fees for prosecution of the cross-complaint. So, despite having provided defect-free

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windows to the project, Weather Shield was liable to JMP for over \$178,000 in defense fees.

The Supreme Court held that, under the indemnity clause as phrased, Weather Shield was responsible for defense fees even though it was not negligent and owed no duty to indemnify JMP. In addition, the court ruled that Weather Shield's duty to defend arose as soon as JMP tendered its defense, because the duty to indemnify was separate from the duty to defend.

Manufacturing the Duty to Defend

The court conditioned its conclusion that Weather Shield had a duty to defend on two factors: (1) a lawsuit had been brought against both JMP and Weather Shield, and (2) plaintiff's complaint alleged construction defects arising from Weather Shield's work. Because plaintiff made a claim against JMP and Weather Shield alleging a defect in the windows, it followed that Weather Shield owed JMP a defense "founded upon" that claim.

The circumstances actually before the court comprise only a sliver of the types of potential suits triggering indemnity and defense clauses. What of the defect suit where the owner sues the developer alone, leaving the developer to involve the contractors through a cross-complaint? So long as the plaintiff's claims of defect encompass the contractor's work, a *claim* has been made against the developer for the contractor's work. The contractor will owe the developer a defense *founded upon* that claim, even though the contractor is only a cross-defendant.

More troublesome are construction personal injury actions, where plaintiffs are forbidden from suing their employers. The employer will not be a defendant, and plaintiff will disavow the employer's negligence to avoid a set-off of worker's compensation benefits received. Employer negligence will still be an issue, either as an affirmative defense or through a cross-complaint, if the hirer has a written contract for indemnity with the employer.

In this context, the rule set forth in the now-discredited *Regan Roofing* decision should still hold sway. Indemnity for sole negligence in construction contracts is barred by Civil Code § 2782. The plaintiff's complaint on its face does not present a claim arising out of the employer's work because the plaintiff has alleged that the harm arose out of the sole negligence of the third-party defendant. Until a jury finds the employer negligent and triggers a duty to indemnify, the mere filing of an affirmative defense or cross-complaint should not be sufficient to invoke the employer's duty to defend. The defendant may be entitled to a real-time defense from the employer's carrier, but obtaining a defense from the employer should still hinge on a finding that the employer is somehow culpable.

Likely also to be excluded under *Crawford* would be administrative or criminal actions pursued against the entity that hired the contractor. A defense is available only for claims "embraced by indemnity." (Civil Code § 2774(4).) At issue in OSHA citations or criminal investigations is a party's own conduct, and these procedures do not raise an implication of vicarious wrongdoing

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sufficient to trigger a duty to defend. There would be no potential for cross-actions bringing contractor negligence into play. A duty to defend might later be established through a breach of contract action against the contractor that alleged reimbursement for administrative defense fees arising out of the contractor's work as an element of damage, but a real-time defense would be unavailable.

I've Got Insurance, So Who Cares?

Everyone should.

In most situations, insurance coverage for the hirer is triggered under an additional insured endorsement, so that the contractor will not be out-of-pocket for the hirer's defense. However, how the carrier reacts to the claim may well put the contractor at potential risk.

In addition, construction contracts often require that the protections provided by the indemnity clause are distinct and separate from those under the insurance terms. The *Crawford* decision lends support to the argument that there may be two separate defenses owed: one by the indemnitor, the other by the insurer. Complicate the situation with a reservation of rights from the carrier, and the contractor may face a demand for an "unrestricted" defense in addition to the protection the insurance company is offering.

The *Crawford* holding is not a panacea for the entity that hires the contractor. In a circumstance where there is no insurance or a denial of coverage, the contractor is required to provide the hirer a defense. However, if there

is disagreement over appointed counsel's allegiance or possible conflicts of interest, there is no obligation at law requiring that the contractor provide independent or *Cumis* counsel—that is purely an insurance concept. As such, the hirer may still have to finance its own attorney and seek reimbursement later on.

Multi-party litigation, where several contractors owe the same duty to defend the hirer, further complicates the situation. The developer may want to be protected by the law firm which always represents that entity. Contractor X wants his insurer's panel counsel. Contractor Y wants its general counsel to defend. Contractor Z's carrier refuses to share in the cost of any joint defense and insists on its captive/in-house counsel.

The Supreme Court suggests that in such circumstances its new holding on a real-time defense should be ignored: the developer should pay for its own counsel, and the defense costs should be sorted at the end, like it traditionally has been:

[If] the affected parties, acting in good faith, then cannot agree on how such a defense should be provided or financed, the court may, in its discretion, permit the underlying litigation to proceed with counsel chosen and paid by the party to whom the duty is owed, subject to a later determination of how damages for breach of the duty to defend should be apportioned among the breaching parties.

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In other words, there is apparently nothing unreasonable or unfair in making the developer fund its own defense, so long as there are multiple suspects involved. This could lead to the inequitable situation where the developer directs its tender to just one contractor to ensure it does not need to fund its own defense.

Insurers as well have reason to be concerned. In circumstances where the contractor is not required to name the hirer as an additional insured, it may still face a claim for a defense as contractual damages under the policy. In the past, contractual damages would not accrue until a finding of liability on indemnity.

Because defense fees are no longer tied to liability for indemnity, carriers will face claims that a defense is owed as of the date of tender. This is also of concern because defense fees as contractual damages will reduce the policy limits available for indemnity.

Defending Against the Duty to Defend

The Supreme Court noted that, in the absence of contrary language, the duty to defend is implied in every indemnity contract and is immediately triggered upon tender. At that point, a defense free from conflict must be offered by the contractor. If it is offered, the hirer cannot substitute its own defense without good cause. If the hirer fails to tender to the contractor, or if the contractor's proffered defense is unreasonably rejected, *Crawford* should be of no help to the hirer.

The Supreme Court suggests a number of techniques to avoid the duty to defend, many of which sound better in theory than in practice. They are:

- Disclaim responsibility for a defense in the contract;
- Specify that reimbursement for defense will be provided, rather than a real-time defense;
- Specify that a defense is triggered only if the contractor is found negligent; and
- Provide that the contractor may seek reimbursement for defense fees if found not to be negligent.

These proposals are determined by the reasonableness (read "superior bargaining power") of the entity doing the hiring. The contractor may have input, but in reality may have very little control over the protections demanded as a condition of bidding the work.

Once a claim is filed, the court recommends positioning the case to demonstrate that there is no duty to defend. Such as:

- Prove that the contract is procedurally unconscionable (imposed without an opportunity to negotiate the terms) or substantively unconscionable (containing terms which shock the conscience or defeat the reasonable expectations of the parties);
- Demonstrate that the claims are not encompassed by the indemnity; and
- Eliminate the claims upon which indemnity is based.

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These suggestions are helpful only if a weakness is apparent from the face of the complaint. If the matter goes beyond a demurrer or motion to strike, the contractor is looking at a great expense in trying to dispose of the claim on summary judgment.

The Popeye Rule: The Contract Says What it Says, and That's All That it Says

The Supreme Court rejected many sound reasons to adopt a fault-based system for defense reimbursement, including:

- Large builders and developers use their superior bargaining power, and self-drafted contract terms, unfairly to shift the financial consequences of their own legal liability to faultless subcontractors, who are not compensated for the risk and agree only because they need the work;
- Risk shifting discourages builders and developers themselves from taking proper care in construction oversight;
- Small subcontractors lack the resources to fund a developer's defense "up front" while often simultaneously defending themselves in the same lawsuit, where the developer typically pursues the hostile and conflicting strategy of pinning blame on them;
- The developer can demand a defense from a single subcontractor among many, and the latter may later be unable to obtain contribution from other subcontractors;

- Subcontractors, unlike liability insurers, lack defense attorney "panels" available at favorable fee rates;
- Because of privilege and conflict-of-interest issues, contractors may lack access to the developer's attorney billing records;
- A contractor may be forced to pay exorbitant and unreasonable legal costs for the developer's defense;
- The vagaries of construction defect litigation in California have caused many insurers to leave the market.

In the end, the Supreme Court could only interpret the parties' duties based upon the language of the contract. The contract provided that Weather Shield must defend any action against JMP "founded upon" a claim that Weather Shield's work was defective. Courts are required to give effect to the parties' mutual intent as primarily ascertained from the contract's language. Regardless of the parties' ability truly to negotiate the indemnity terms, judges consistently cite the parties' "great freedom" to allocate responsibility of risk. Where the parties knowingly bargain for certain protections, those protections will be afforded. If Weather Shield thought the contract was fair when it signed, the court would not let Weather Shield off the hook, because it was being required to do what it promised.

Despite all the problems resulting from the Supreme Court's holding, the

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justices viewed contractors better off from it, noting “[Contractors] may *prefer* to assume, and control, the defense of suits against builders...especially when the claims raised may expose the [contractors] themselves to direct or indirect liability.” (Emphasis in original) Perhaps the Supreme Court will be proved correct, but only if a contractor survives long enough after incurring the debilitating price of financing the defense to reap those benefits.

California Supreme Court to Consider “Prevailing Party” for Purposes of Attorney’s Fee Award

by *Randel J. Campbell*
(*rcampbell@lgglaw.com*)

The last issue of *Value Added* discussed *Brawley v. J.C. Interiors* (2008) 161 Cal.App.4th 1126, where the Court of Appeal held that a trial court judge had broad discretion in making a “prevailing party determination” to decide entitlement to recover attorney’s fees pursuant to California Prompt Payment Statutes (i.e., Civil Code §§ 3250, 3260, 3260.1). This discretion meant that receiving a net monetary recovery neither required nor guaranteed that the court would declare a party to be “prevailing” and entitled to attorney’s fees under California Prompt Payment Statutes. Rather, the judge could look at the extent to which each party had succeeded in its litigation objectives, based upon a comparison of settlement demands and the ultimate result.

Now, the California Supreme Court has decided to consider the meaning of “prevailing party” for purposes of an award of attorney’s fees, when the amount of damages awarded is less than the setoff from a pretrial settlement by other defendants. Toward this end, the Supreme Court has granted review in *Goodman v. Lozano* (Case No. S162655; June 18, 2008).

The Supreme Court website framed the issue as follows: *When a plaintiff settles with one tortfeasor and goes to trial against another but obtains no additional recovery because the amount of damages awarded is less than the setoff amount based on the pretrial settlement, is that plaintiff nevertheless a prevailing party as a matter of law for purposes of an award of fees and costs under Code of Civil Procedure section 1032?*

The case arose when Goodman (the buyer) sued Lozano (the seller), the builder, the architect, and the real estate brokers for construction defects in a new home. Goodman settled with all of the defendants except Lozano for a total of \$230,000. Goodman and Lozano then went to trial, where Goodman received \$146,000 in damages. However, Code of Civil Procedure § 877 reduces an award of damages by the amount of prior settlements paid by other tortfeasors who were liable for the same damages, which prevents a plaintiff from recovering for the same damages multiple times from different defendants. Here, since the \$230,000 in pre-trial settlements easily exceeded the \$146,000 trial award to Goodman and against Lozano, the trial judge entered judgment that Goodman take nothing further by the action.

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According to the Court of Appeal, the *Goodman* trial judge then “self-consciously exercised his discretion” under subdivision (a)(4) of Code of Civil Procedure § 1032 (which defines “prevailing party”), and he determined that Lozano was the prevailing party because Lozano would pay nothing under the judgment. He explained his reasoning by posing the question of how each side might have answered friends or neighbors who asked, “How’d that trial come out?”

The trial judge, in his statement of opinion, postulated that: *Lozano, would probably have answered, “Great! We don’t have to pay a thing.” Goodman, on the other hand, probably would have said, “Bad. We didn’t get anything because the judge missed the point on our damages and got it all wrong.”*

As a result of this analysis, the trial judge declared Lozano the prevailing party and awarded Lozano \$132,000 in attorney fees and another \$12,000 in costs. Goodman appealed from both the net zero judgment, as well as from the subsequent order that determined Lozano to be the prevailing party and awarded him attorney’s fees.

After an extensive analysis of existing case law on the “prevailing party” issue, the Fourth District Court of Appeal upheld the trial judge and said: *When litigation results in a net zero judgment as a result of the operation of Section 877, the plaintiff receiving the net zero judgment does not fall into the category of “the party with the net monetary judgment” set out in Section 1032.*

Despite the fact that Goodman received an award of \$146,000 in damages, the Court of Appeal said: *The trial judge was not compelled to declare plaintiff Goodman as the prevailing party because he had a “net monetary recovery” here. Goodman didn’t recover anything in this litigation, and the trial court correctly recognized that fact. And there is no dispute that under the circumstances of this case, the trial court’s exercise of discretion to declare Lozano the prevailing party was a reasonable one, and therefore must be upheld under an abuse of discretion standard.*

The Fourth District Court of Appeal recognized that its decision in *Goodman* contradicted the Sixth District decision in *Wakefield v. Bohlin* (2006), and contrary to the cases that followed *Wakefield*. The facts in *Wakefield* were remarkably similar to the facts in *Goodman*.

In *Wakefield*, a custom home buyer discovered construction defects, and sued the sellers, the realtors, and plasterers. Then, as in *Goodman*, all defendants settled except for the sellers, and the buyers and sellers went to trial. After trial, as in *Goodman*, the size of the pre-trial settlements dwarfed the amount awarded in damages at trial. And finally, like *Goodman*, the judgment entered by the trial court provided that the plaintiff take nothing, and the trial court therefore declared the defendants to be the prevailing party and awarded attorney fees and costs to the defendants. But unlike in *Goodman*, the Sixth District Court of Appeal in

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Wakefield, in a split decision, reversed the trial court. The *Wakefield* court held that, although plaintiff's judgment may have been reduced to zero by operation of Code of Civil Procedure § 877, that circumstance did not affect the prevailing party's determination under Code of Civil Procedure § 1032.

The Fourth District, in its decision in *Goodman*, said that it realized: *Our conclusions in this opinion will make work for our Supreme Court, if not in this case, then some other time, since we can't exactly claim that our analysis—basically just following the words of the statute and pointing out that they make sense if given their plain meaning—has led to a “uniformity of decision” in California’s case law.*

Well, the Fourth District was right, and *Goodman v. Lozano* is now pending before our highest state court. Opening briefs on the merits were filed by Goodman on August 22, 2008. By this time next year, we can expect the Supreme Court to have explained the interaction between Civil Procedure §§ 877 (pretrial settlement offsets) and 1032 (“prevailing party”).

If one wants to handicap how the Supreme Court will rule, one should probably take note that the Fifth District opinion in *Brawley v. J.C. Interiors* and the Fourth District opinion in *Goodman* both lean toward trial judges having discretion to weigh the facts and circumstances of a case to determine a prevailing party, rather than being obligated to mechanically apply certain words of the statutes.

One Theory, Not Two: OSHA Violations Inadmissible Absent Affirmative Contribution to Injury
(2008) *Madden v. Summit View*
165 Cal.App.4th 67.

Plaintiffs' counsel continue to perpetuate the misconception that an injured worker can pursue a contractor under two theories: affirmative contribution under *Hooker v. Department of Transportation* (2002), and violation of OSHA regulations under *Elsner v. Uveges* (2004). We now have yet another Court of Appeal decision proving this is a fallacy. Absent proof a contractor's act or omission affirmatively contributed to the worker's harm, evidence regarding violation of OSHA regulations is irrelevant.

A property owner hired Summit View as general contractor to build a home. Summit View hired Gary Tschantz Construction to be project supervisor. Tschantz was on site daily, but didn't consider jobsite safety to be part of its work. In fact, Tschantz was unaware that anybody at the site was responsible for safety and had no knowledge of OSHA requirements regarding fall protection.

Summit View hired Busch Electric as a subcontractor on the project. Madden was Busch's foreman. Madden injured himself when he fell from a raised patio while trying to untangle some electrical wire while walking backwards. The patio was between two and eight feet high, depending on the slope of the land that ran adjacent to it. Madden didn't know how high the patio was in the area he fell. There was no railing present along the edge of the patio.

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Madden sued Summit View under a premises liability theory, claiming his injuries were due to its negligence in maintaining the premises. The trial court granted summary judgment, and the Court of Appeal affirmed the ruling in Summit View's favor.

The court found that plaintiff had failed to present evidence that Summit View affirmatively contributed to plaintiff's harm. There was no evidence Summit View directed that a railing not be installed, nor that the absence of such a railing was an issue it considered prior to the incident. Because the absence of a railing was open and obvious, plaintiff was not induced to rely on Summit View's failure to act. As such, Summit View's "mere failure to exercise a power" was insufficient to establish that it affirmatively contributed to plaintiff's harm. Once Summit View presented evidence that it had no control over the subcontractor's methods and supplied none of the materials Madden's employer used, the burden shifted to Madden to produce evidence that Summit View retained control over safety and that it contributed by its affirmative conduct to an unsafe condition that caused Madden's injury.

Despite the suggestion that Summit View had retained control over safety, neither it nor its agent directed the lack of protection against falls, or prevented a railing from being installed. It did not remove or cause the removal of a guardrail. There was no evidence that it or its agents

participated in discussions about placing a railing, became aware of a safety concern from lack of a railing, or intervened in any way to prevent a railing from being erected.

The lack of a railing was open and obvious. Madden had worked in the area many times before, and he was in as good a position as Summit View to perceive the absence of a guardrail.

Given that the most immediate unsafe practice leading to Madden's injury was his walking backward on a raised patio, Summit View's failure to install a guardrail was at best passive conduct insufficient to raise a question of fact. The facts that Tschantz as Summit View's agent was ignorant of fall protection regulations, that it would have needed to have Summit View's permission to install a guardrail, and that the budget lacked an allocation to build a guardrail were irrelevant, given the absence of evidence establishing that Madden's employer was powerless to take safety precautions to prevent the harm. Madden's claim was "no more than a convenient assumption that his employer lacked the authority to take reasonable precautions to protect him from the kind of accident that occurred."

The existence of an OSHA regulation requiring a railing along any unprotected elevation 7½ feet above the ground was irrelevant to plaintiff's claim. OSHA provisions do not expand a general contractor's duty

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of care to an injured subcontractor; such safety violations are insufficient to create a triable issue of fact as to the general contractor's duty of care "where there was no evidence the general contractor affirmatively contributed to the plaintiff's injuries." In the words of the Court of Appeal, "Safety regulations are only admissible in an action...where other evidence establishes that the general contractor affirmatively contributed to the employee's injuries."

This case emphasizes the crucial role that the employer plays in providing safety precautions on the site. Absent evidence the employer could not perceive the danger or was precluded from taking safety precautions to forestall that perceived danger, the hirer will not be determined to have affirmatively contributed to plaintiff's harm. More importantly, plaintiffs are precluded from bootstrapping liability from an alleged OSHA violation as support for proof the hirer affirmatively contributed to the harm. It is the egg before the chicken: Without proof of affirmative contribution, evidence of an OSHA violation is inadmissible.

— William A. Bogdan
(wbogdan@lgglaw.com)

The Construction Law Group can answer questions about these and other construction litigation issues. Please contact department chair William Bogdan (wbogdan@lgglaw.com) or any member of our firm for more information.

INSURANCE

Product Performance Defects Do Not Qualify As "Negligent Publication" In Media Professional Policy, or As "Loss of Use" In Commercial General Liability Policy.
Sony Computer Entertainment America, Inc. v. American Home Assurance Co.
(9th Cir. 2008) 532 F.3d 1007.

When a manufacturer oversells the capabilities of its product, can the company pass along the consequences of its product's shortcomings to its media professional insurer as "negligent publication" or to its general liability insurer as "loss of use"? In a decision that should comfort media professional and general liability insurers everywhere, and that confounds the maxim of that insurers seldom win policy language battles, the Ninth Circuit Court of Appeals answered "no."

In *Sony Computer Entertainment America, Inc. v. American Home Assurance Co.*, the court applied California law and common sense to plain policy wording to conclude that "negligent publication" only means defective advice that incites harmful conduct, and that "loss of use" requires more than defects to the insured's own product, such that manufacturers themselves bear the risk that their products fall short of performance representations. In so doing, the court declined to turn liability policies into warranties of customer satisfaction.

Insurance

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In *Sony*, purchasers of the PlayStation 2 video entertainment consoles filed lawsuits against Sony, after it turned out that the consoles could not play DVDs or certain game discs, contrary to Sony's marketing of the devices as all-inclusive home entertainment systems that could handle all audio and video CDs, DVDs, and video games. The dissatisfied customer plaintiffs alleged that the PlayStation 2 units suffered inherent and fundamental design flaws that rendered them unable to play all of the formats as represented, and they asserted causes of action for breach of warranties, false advertising, negligent misrepresentation and fraud, based upon Sony's performance claims in press releases, packaging, advertisements, and instruction manuals.

Sony tendered the customers' PlayStation 2 lawsuits to American International Specialty Lines Ins. Co. (AISLIC) under a "Multimedia Professional Liability Policy" and to American Home Assurance Co. under a Commercial General Liability (CGL) policy. The AISLIC policy provided \$10 million protection for "wrongful acts," which it defined to include defamation, invasion of privacy, copyright or trademark infringement, defective advice, and "negligent publication." The AISLIC policy did not define "negligent publication," so Sony combined dictionary definitions of "negligent" and "publication" to contend that "negligent publication" obviously means "communication of information to the public, lacking or exhibiting a lack of due care or concern." Sony also asserted that Exclusion P obligated AISLIC at least to defend the customers' lawsuits,

as Exclusion P disallowed coverage for false advertising but imposed a duty to defend false advertising claims.

Under the American Home CGL policy, Sony contended that the customers' suits alleged "classic 'loss of use'" of tangible property within the "property damage" definition, as the plaintiffs claimed that the PlayStation 2 units could not play CDs, DVDs, or certain games, and that the discs skipped, froze, and caused clicking noises. Sony sought to avoid Exclusions (k) and (m) for damage to its own property, on the grounds of an exception for "sudden and accidental physical injury" to Sony's product after put to its intended use.

To the relief of media and general liability insurers, the Ninth Circuit Court of Appeals upheld the District Court's interpretation of California law in granting summary judgment to the insurers under both policies. As to the AISLIC media professional policy, the court noted the lack of definition to the phrase "negligent publication," but it examined the words within the context of the whole policy and found that Sony's contention about truncated dictionary descriptions did not fit the fundamental "plain meaning" rule. The court reasoned that, if the phrase "negligent publication" truly meant "communication of information to the public, lacking or exhibiting a lack of due care or concern" as Sony alleged, the policy structure of wrongful act categories would not make sense, and that the phrase would subsume virtually all of the other wrongful acts defined in the policy, including defamation and copyright infringement. Further, Sony's purported

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interpretation would extend the policy's protection far beyond the types of claims normally faced by media publishers, such as libel and unauthorized use, and into the realm of products liability. The AISLIC policy exclusions also clarified the intent only to cover media types of claims, as the exclusions disclaimed protection for breach of warranty, violations of consumer protection, or false advertising.

On top of these "plain meaning" in context principles to support its decision, the Court of Appeals also referred to caselaw that found "negligent publication" to describe a specific tort cause of action against communications that led readers to engage in wrongful conduct. Courts nationwide have held "negligent publication" to encompass such misconduct as a firearms advertisement that allegedly led to accidental death; a diet recommendation that resulted in cardiac arrest; or publication of the victim's address while the assailant was still at large. All of this caselaw concerned the contents of books, articles or advertisements, so the Court of Appeals limited the meaning of "negligent publication" to the transmission of material that leads the reader to commit a harmful act, and found that the PlayStation 2 plaintiffs had not made such allegations.

Sony did not have any better success trying to squeeze PlayStation 2 defect protection out of Exclusion P, which contained an exception that imposed a duty to defend false advertising claims. In rejecting the Sony argument on Exclusion P, the court followed the basic insurance analysis that the insured

must first find coverage in the insuring agreement before the exclusions come into play. Here, since the AISLIC policy did not cover "negligent publication" or other customer claims in the first place, the exception in Exclusion P did not need to be addressed.

The American Home CGL policy also did not protect Sony from the PlayStation 2 lawsuits. The only "loss of use" concerned the PlayStation 2 units themselves, as the consumers could not use them to play DVDs, CDs, and certain games as Sony claimed. None of the lawsuits alleged physical harm to third-party property, such as CGL policies were designed to cover. The court rejected as speculative the efforts of Sony's counsel to create physical damage from allegations the customers potentially could make. Even if Sony had established "loss of use" within the American Home policy, the customers' lawsuits fell directly within Exclusion (m), which eliminated protection for "loss of use" arising out of deficiencies in Sony's own product. Sony was left to bear the PlayStation 2 design flaws on its own.

As demonstrated by the *Sony* opinion, when presented with apparent overreaching by a sophisticated insurance purchaser like Sony, California courts will apply the fundamentals of insurance policy interpretation to enforce the policy's underlying intent. Since Sony had previously purchased an AISLIC policy with false advertising protection, and as it could have again purchased protection for product defects or false advertising, the court denied Sony's effort to obtain such protection under policies

As demonstrated by the *Sony* opinion, when presented with apparent overreaching by a sophisticated insurance purchaser like Sony, California courts will apply the fundamentals of insurance policy interpretation to enforce the policy's underlying intent.



intended for other risks. Insurers should not shy away from enforcing the fundamental purpose of the policy, just because creative attorneys cobble together policy language arguments that have appeal only in a vacuum.

— Wallace M. Tice
(wtice@lgglaw.com)

The Insurance Practice Group can answer questions about these and other insurance litigation, coverage, and claim handling issues. Please contact our department chair, Wallace M. Tice (wtice@lgglaw.com) or any member of our firm for more information.

EMPLOYMENT

“Reason-blind” Termination for Absences Can Create California Family Leave Act Liability
(2008) *Avila v. Continental Airlines*
— Cal.App.4th —.

Terminating an employee based solely on the number of absences may be illegal if the employer knew, should have known, or should have inquired, whether the employee was absent on grounds protected by the California Family Leave Act (CFRA). The Court of Appeal has held that documentation may put the employer on notice that an employee has taken CFRA leave and prohibit the employer from taking an

adverse employment action on that absence, even if the information is insufficient to establish a disability.

Under Continental Airlines’ attendance policy, an employee could be terminated for accumulating seven or more “recordable” absences within a rolling 12-month period. A recordable absence occurs every day an employee is absent, unless the employee submits medical justification for the absence. For medically documented absences, a recorded absence of one day would accrue regardless of how many days the employee was off for that condition.

Going into December 2004, Henry Avila had four recordable absences. As evidenced by a Kaiser health care “Documentation of Medical Impairment” form dated December 15, Avila was instructed not to work for one day for some unspecified medical condition. Based on a form dated December 19, plaintiff was precluded from working for five days from December 16 to December 21. Avila believed that he either handed the forms to his supervisor or left them on the supervisor’s desk. He was charged with two recordable absences for December 15 and 16, bringing his total of recordable absences to six.

In January, Avila was charged with his seventh recordable absence within 12 months and was suspended with an indication he would be terminated. He told his supervisors he had been sick. When his supervisors subsequently terminated him, Avila informed them that he had been hospitalized in December with pancreatitis. The next day, Avila’s family presented his supervisors with his medical

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records and requested his reinstatement or an appeal of the decision. A company appeals board affirmed the termination.

Avila sued, claiming he was discharged because of a disability and for exercising his rights under the CFRA. The trial court granted Continental summary judgment on both counts. Avila appealed, and the judgment was reversed on the CFRA count.

Under the CFRA, an employer cannot count CFRA leave as an absence for a serious health condition under a no-fault attendance policy. A “serious health condition” under the CFRA is defined as a condition that requires inpatient care in a hospital or continuing treatment by a health care practitioner. If Avila had merely called in sick, that would be insufficient to place Continental on notice that he had taken CFRA-qualifying leave. However, the Kaiser form indicated that he had been hospitalized for three days, and was enough to put Continental on inquiry notice that Avila needed CFRA leave.

Regulations regarding notice for CFRA leave mandate that an employee “shall provide at least verbal notice sufficient to make the employer aware that the employee needs CFRA-qualifying leave... The employee need not...even mention the CFRA...; however, the employee must state the reason the leave is needed. The employer should inquire further of the employee if it is necessary to have more information about whether CFRA leave is being sought by the employee if it is necessary to have more information about whether CFRA leave is being sought...” Notice on a hospital’s

preprinted form that an employee was hospitalized and unable to work may be sufficient to inform an employer that the employee suffered a serious medical condition requiring CFRA leave. In the words of the court, “The [employee’s] absence itself under such circumstances suggests the necessity of a leave.”

Continental argued that, because the supervisors were unaware of the need for the leave, their ignorance as to the cause of the absences precluded liability for plaintiff’s exercise of his rights under the CFRA. The Court of Appeal ruled that the burden was on Continental actually to inquire of plaintiff as to his condition as to whether plaintiff needed CFRA leave. To rule otherwise “would encourage managers to remain ignorant of the law and the facts relating to CFRA leave... Under the CFRA and the implementing regulations, the employer bears the burden to determine whether an employee’s leave is protected.” Because Avila had submitted documentation sufficient to qualify for leave under CFRA, Continental was charged with knowledge that his absence was protected. CFRA liability does not hinge on whether “a particular management employee subjectively knew that an employee’s absences were protected under the CFRA.”

On the other hand, the appellate court affirmed summary judgment on the FEHA disability discrimination claim. Though Avila provided generic Kaiser forms which failed to specify his medical condition and told his co-workers (but not his supervisors) he had pancreatitis, there was insufficient notice to management that plaintiff was disabled. The mere fact Avila had been hospitalized was

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Professional Liability

The Confidentiality of Medical Information Act (CMIA; Civil Code §§ 56, *et seq.*) is the principal California statute governing the confidentiality of medical information. The CMIA prevents a health care provider from disclosing patient medical information without a signed authorization by the patient.

insufficient notice that plaintiff suffered a disability: “He might have had minor elective surgery, or he might have sought preventive treatment for some other condition that was not disabling.” The fact Avila told fellow workers of his condition was insufficient notice to his employer. “There is no basis to impute to [plaintiff’s supervisors] actual knowledge of plaintiff’s statements to his co-workers concerning his disability.” The fact that Continental learned plaintiff might have been disabled after Avila was terminated was irrelevant.

Plaintiff’s allegation that Continental failed to accommodate his disability also failed. The employee must first request an accommodation, then the parties must engage in an interactive process. The law requires an accommodation only where the employer knows plaintiff has a disability. Insufficient information regarding existence of a disability is insufficient information to trigger a duty to accommodate.

For employers, this case instructs that ignorance is not bliss, it is remiss. What not knowing may save you on a disability claim will cost you just as much on a CFRA claim. An employee claiming sick leave gets a free pass if an absence is due to a “serious health condition” requiring inpatient care or continuing treatment. If an employee absent for the umpteenth time indicates the absence was due to a hospitalization or as part of continuing treatment, you have a duty to inquire whether the employee meets the other criteria for CFRA leave. If you take an adverse employment consequence on a lack of information, you could be open to legal action as a result.

— *William A. Bogdan*
(wbogdan@lgglaw.com)

The Employment Law Group can answer questions about these and other employment litigation and training issues. Please contact Arif Virji (avirji@lgglaw.com), Gary M. Ittig (gittig@lgglaw.com), or any member of our firm for more information.

PROFESSIONAL LIABILITY

Protected Health Information Regarding HIV: What Are the Disclosure Requirements When Sending Information to Health Care Plans?

by Claudia X. Lozano
(clozano@lgglaw.com)

The Confidentiality of Medical Information Act (CMIA; Civil Code §§ 56, *et seq.*) is the principal California statute governing the confidentiality of medical information. The CMIA prevents a health care provider from disclosing patient medical information without a signed authorization by the patient. The two other statutes that govern disclosure of medical information are the Insurance Information & Privacy Protection Act (IIPA) and the Health Insurance Portability and Accountability Act (HIPPA).



Medical information protected under the CMIA includes electronic or physical form information regarding a patient's medical history, medical or physical condition or treatment and whether derived from or in the possession of a health care provider, health service plan or contractor. HMOs and other Knox-Keene Plans, such as Blue Cross and Blue Shield, are subject to the rules under the CMIA. Pursuant to the CMIA, doctors are authorized to disclose medical information concerning their patients *without the patient's written authorization* for several purposes, including, *to the extent necessary to allow responsibility for payment to be determined and payment to be made, whether to the physician, another provider of health care or the health plan.*" (Civil Code § 56.10(c).) Said disclosure must, however, comply with more stringent confidentiality requirements, if such apply.

HIV Test Results Are Strictly Protected

The law requires that a patient must provide written authorization for each and every disclosure of HIV test results. (Health & Safety Code §§ 120980, 121010, 121020.) A general disclosure for medical information is not sufficient. This section *does not* apply to HIV-related information contained in a patient's medical chart. However, HIV-related information is protected by other confidentiality laws, such as Civil Code §§ 56, *et seq.*, HIPPA and by the state constitutional right to privacy.

HIV-Related Information is Protected Under Certain Circumstances

California statutes only require an express written authorization to release HIV test results, but not to release other

HIV-related information. However, other HIV-related information may be protected by the state's more general right to privacy laws.

California courts have construed Health & Safety Code § 120980 narrowly and have only applied it to the *records of HIV test results* (*Urbaniak v. Newton* [1991].) The *Urbaniak* court ruled that the fact that a person is HIV seropositive may be protected by the California constitutional right to privacy *if the patient had a "reasonable expectation"* under the facts presented that his seropositivity would not be disclosed without his consent.

In order to show violation of the state's privacy protection, the patient must establish that he had (1) a legally protected privacy interest; (2) a reasonable expectation of privacy under the circumstances; and (3) a serious invasion of that privacy interest by the defendant. (*Hill v. National Collegiate Athletic Association* (NCAA) [1994].) To defend against such a claim by the patient, the defendant must prove that there are countervailing privacy or non-privacy interests that outweigh the plaintiff's right of privacy under the circumstances.

In situations where the patient signs an Authorization to Release his medical information for, among other things, to "obtain payment from third-party payers," and is being treated for HIV disease, it will be difficult for the patient to establish that he had a *reasonable expectation* that his records would not be disclosed pursuant to the request of his health insurance company to process payment for his care. Should the patient argue that he orally

In order to show violation of the state's privacy protection, the patient must establish that he had (1) a legally protected privacy interest; (2) a reasonable expectation of privacy under the circumstances; and (3) a serious invasion of that privacy interest by the defendant.



HIPPA states that a patient has the right to receive an accounting of disclosures of his protected health information for a six-year period prior to the request. (C.F.R.164.528.) However, this right *does not* include disclosures to carry out treatment, payment or health care operations (C.F.R. 164.528(a)(1)(iv).)

restricted or revoked a prior authorization for release of information, the revocation must be in writing in order to be effective.

Patient Request for an Accounting of Protected Health Information

HIPPA states that a patient has the right to receive an accounting of disclosures of his protected health information for a six-year period prior to the request. (C.F.R.164.528.) However, this right *does not* include disclosures to carry out treatment, payment or health care operations (C.F.R. 164.528(a)(1)(iv).) Therefore, doctors generally do not have to log their disclosures to health plans. A health care provider has 60 (sixty) days to respond to a patient's request for an accounting of disclosures of his protected health information and can obtain a 30-day extension by informing the patient of the reasons for the delay and the date by which the accounting will be provided. (45 C.F.R. § 164.528(c)(1).)

Recommendations for Release of HIV-Related Information

It is clear that *HIV test results* can only be released with the patient's specific written authorization. A general authorization is not sufficient. It is a good idea to flag or keep HIV test results in an envelope in the chart with a designation NOTICE NOT TO PRODUCE (unless pursuant to a signed authorization from the patient specifically identifying the disclosure of HIV test results).

With regard to HIV-related information, it is recommended also to obtain a written authorization from the patient expressly releasing this type of information just to be on the safe side.

This can be part of the general release by inserting a paragraph that protected health information includes HIV-related information and HIV test results.

Recommendations on How to Handle Patient-Requested Restrictions re: Release of Protected Health Information

If a patient signs an authorization to release his protected health information for payment purposes, including HIV-related information and/or HIV test results, and then attempts to revoke or restrict the information to be disclosed, the physician may consider the following responses:

First, disclose the information requested that is not subject to the patient's restrictions.

Second, if the information that the patient is asking the physician to restrict is not subject to more stringent protections, such as certain mental health information, substance abuse records or HIV test results, then the physician should advise that refusal to disclose that information may open himself up to liability for misrepresentation and possibly fraud.

If this second situation occurs, the physician should state to the patient, in writing, that absent special confidentiality protections, he is bound to release the entire record pursuant to a signed authorization by the patient or to notify the entity/person requesting the information that a portion of the chart has been withheld pursuant to the patient's instruction. The health care provider should copy the patient on this notification to the requesting party, so that the patient



and the requesting party can directly communicate with one another and remove the physician from the conflict regarding the need for the protected information.

Summary of Recommendations

- Have the patient sign an authorization that includes language for disclosure of HIV-related information and HIV test results for purposes of payment by third-party payors.
- Inform the patient (include this in the authorization) that if he wants to revoke or restrict the authorization in any way, that such revision has to be made in writing.
- Should the patient restrict the protected health information to be sent to a third-party payor for purposes of processing payment, notify the requesting party and the patient, in writing, of said restriction and produce only the information not subject to the restriction.
- Flag, clip, and/or otherwise identify information held to a higher level of confidentiality, such as HIV test results and HIV-related information, and label with a note NOT TO PRODUCE until the patient is contacted and his express written authorization is received.

The Professional Liability Group can answer questions about these and other professional liability litigation issues. Please contact Robert T. Lynch (rlynch@lgglaw.com) or any member of our firm for more information.

FIRM NEWS

Attorney **Wally Tice's** article, "Insurers Lose the 'Genuine Dispute' Defense to Bad Faith Claims by Failing to Conduct an Adequate Investigation of the Coverage Issue," which was featured in the March/April 2008 edition of *Value Added*, appeared in the July 11, 2008, issue of DRI's Covered Events, which highlights national insurance coverage developments.

Attorney **Bill Bogdan's** article, "PAYING THE PIPER FOR MUSIC YOU DIDN'T HEAR: California's No-fault Defense Responsibility Under Indemnity Agreements," first appeared in the September 17, 2008, issue of the San Francisco Bay Area legal newspaper, *The Recorder*.

Our client Barry Sims signed a two-year deal with the San Francisco 49ers. Formerly with the Oakland Raiders, Barry also received offers from the Rams, Ravens and Patriots and we are glad that he decided to stay in the Bay Area. Barry is represented by attorney **Ken Vierra, Jr.**, an NFLPA certified contract advisor.

Attorneys **Robert Lynch, Gary Ittig,** and **Ronald Souza** have been designated as "SuperLawyers" by *Law & Politics* magazine for the year 2008–2009.

Attorney **Jennifer Riso** and her husband welcomed a baby girl on July 26, 2008. Congratulations!

Value Added is available via email as well as on www.lgglaw.com. If you would like to receive *Value Added* and other legal updates by email we encourage you to send the following information to Katie O'Donnell at kodonnell@lgglaw.com, or call (415) 397-2800:

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CASE TRACKER

Subsequent Action on Recent and Noteworthy Appellate Decisions

TOPIC	CASE NAME/ACTION	DESCRIPTION
Employment	<i>Edwards v. Arthur Anderson</i> Case decided: 8/07/08	As previously reported in <i>Value Added</i> , the California Supreme Court recently reviewed whether Business & Professional Code § 16600 prohibits all employee non-compete agreements (apart from certain limited statutory exceptions) or if Section 16600 invalidates non-compete agreements only to the extent that they prevent the pursuit of lawful trade or business. The California Supreme Court held that Section 16600 prohibits all employee noncompetition agreements unless the agreement falls within a statutory exception. In so holding, the court noted that California courts “have been clear in their expression that Section 16600 represents a strong public policy of the state which should not be diluted by judicial fiat.”
Arbitration	<i>Berglund v. Arthroscopic & Laser Surgery Center</i> Case decided: 7/17/08	As previously reported in <i>Value Added</i> , the California Supreme Court reviewed whether a discovery dispute involving a nonparty to an arbitration proceeding had to be submitted first to the arbitrator. The court also reviewed the related issue on the scope of judicial review of an arbitrator’s order compelling a nonparty to the arbitration to comply with a party’s discovery subpoena. Recently, the court held that discovery disputes involving a nonparty must be first submitted to the arbitrator and not to the judiciary. The court further held that the nonparty is entitled to full judicial review of the arbitrator’s discovery order.
Employment	<i>McCarther v. Pacific Telesis Group</i> Review granted: 8/20/08	The California Supreme Court will review two significant employment issues. First, whether Labor Code § 233, which mandates that employees be allowed to use a portion of “accrued and available sick leave” to care for sick family members, applies to employer plans in which employees do not periodically accrue a certain number of paid sick days but are paid for qualifying absences due to illness. Second, the court will review whether Labor Code § 234, which prohibits employers from disciplining employees for using sick leave to care for sick family members, prohibits an employer from disciplining an employee who takes such “kin care” leave if the employer would have the right to discipline the employee for taking time off for the employee’s own illness or injury.
Employment	<i>Harvey v. Sybase, Inc.</i> Review granted: 7/23/08	The California Supreme Court will review whether a plaintiff in a discriminatory termination case under the Fair Employment and Housing Act must present stronger evidence of bias if the person responsible for the termination had previously treated the plaintiff favorably.
Tort	<i>Boeken v. Phillip Morris</i> Review granted: 5/21/08	The California Supreme Court will review whether the doctrine of <i>res judicata</i> bars plaintiff’s claim for non-economic damages in a wrongful death action after her husband died, due to the fact that she had dismissed with prejudice a claim for loss of consortium while he was alive.

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**LYNCH, GILARDI
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A PROFESSIONAL CORPORATION
ATTORNEYS AT LAW

475 SANSOME STREET
SUITE 1800

SAN FRANCISCO, CA 94111

FAX (415) 397-0937

PHONE (415) 397-2800

www.lgglaw.com

EDITOR:

WALLACE M. TICE

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