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On the Cover: Grandfather clock face at the Santa Barbara Club, by Michael Lyons, Esq.

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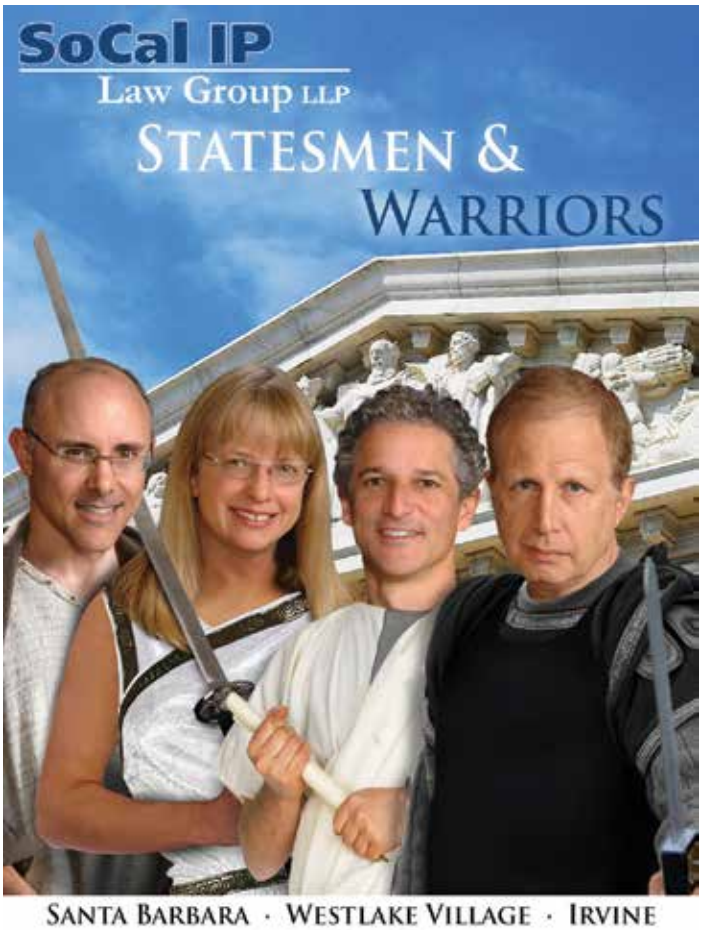
SBCBA Bench and Bar Conference: Superior Court Judges Patricia Kelly, Von Deroian, Kay Kuns

Budding Industry

The 2019 Bench and Bar Conference addresses legalized cannabis in California

On Saturday, January 26, 2019, the Santa Barbara County Bar Association hosted its annual Bench and Bar Conference at the beautiful Santa Barbara Club. This year, the Conference focused on the legal issues raised by the recent legalization of cannabis in California. As attendees discovered, this dramatic change in the law has opened the door to new business opportunities in California including new specializations within the practice of law. The change has also raised new issues and challenges that will need to be addressed by attorneys in established areas of the law, such as tax, contracts, corporate structuring, insurance, finance, employment and family law.



The event featured presentations from attorneys and professionals in the top of their fields. In the morning, William Makler of the Law Offices of William C. Makler, addressed substance abuse (competency) issues, trends in DUI enforcement and prosecution in the wake of cannabis legalization; Tava Ostrenger from the City Attorney's Office detailed the new cannabis laws and implementation thereof at the city level; Renee Fairbanks of the Law Office of Renee M. Fairbanks, along with P. Joseph Frawley, MD and Sherif Elasyouty, MD, spoke to family law and child custody issues; Brian Marblestone of the Stratton Agency, addressed insurance issues; and Jenn Duffy of Fell, Marking, Abkin, Montgomery, Granet & Raney LLP and David Secrest of the Law Offices of David S. Secrest offered their insights and expertise into the employment law issues raised by legalized cannabis from both the employer's and employee's perspective.

The Conference was honored to have First District Supervisor Das Williams as the keynote speaker for the event. As attendees enjoyed the exquisite lunch offerings of the Santa Barbara Club, Supervisor Williams provided the County's perspective on the new cannabis laws, and addressed permitting and licensing issues for cannabis growers and businesses.

With the afternoon sun came two additional break-out sessions featuring Amy Steinfeld of Brownstein Hyatt Farber Schreck, LLP, who shared her wealth of knowledge regarding cannabis and land use law, and Hilary Bricken of Harris / Bricken, who addressed corporate structuring, entity formation and contract issues as related to cannabis businesses.

The day was rounded out with the annual Judges' Panel, which this year featured Judges Patricia Kelly, Kay Kuns, Von Deroian and Thomas Anderle. The Judges addressed issues arising from the conflict between state and federal law on cannabis, including the enforcement of criminal laws and ethical issues raised by the prospect of representing cannabis clients.

Thanks to the exceptional caliber of our speakers and their thoughtful presentations, the generosity of our sponsors and beautiful ambiance of the Santa Barbara Club, the Conference was again a great success. A very sincere thank you to our sponsors: Fell, Marking, Abkin, Montgomery, Granet & Raney LLP; Goodwin & Thyne Properties, Law Offices of John J. Thyne II; Mullen & Henzell, LLP; Brownstein Hyatt Farber Schreck, LLP, and vendors Lawcopy, MyCase, and Veritext.

We hope to see you next year at the 2020 Conference! ■

See photos of the Bench & Bar Conference on page 18.

Vagueness and the United States Supreme Court

By Robert Sanger

Robert Sanger

In last month's *Criminal Justice* column, we discussed the possibility that the United States Supreme Court could modify the *Strickland*[1] standard for determining whether a criminal defendant had received effective assistance of counsel. The vehicle there was the *Skakel* case,[2] involving a Kennedy family member accused of murder. The update is that the case was conferenced on January 4, 2019 and, thereafter, the petition was denied without dissent.[3] Although a denial of *certiorari* may mean nothing doctrinally, it leaves in place *Strickland* and does not undercut the seriousness with which the Court addressed counsel's failures in *McCoy*[4] where they found structural error.

This is important because there are several areas of constitutional law where conservative doctrine, often promoted by the late Justice Scalia, has been favorable to the rights and liberties of the accused. In this month's *Criminal Justice* column, we will look at another such area, however, it is one in which the Court has granted the petition for writ of *certiorari* and has set the matter for oral argument. That means that there will probably be an opinion on the merits.

The Return of the Vagueness Doctrine in Criminal Law

As we have commented from time to time, the United States Supreme Court has had a renewed interest in whether or not criminal statutes give notice. This is consistent with the concerns of progressives and conservatives alike and has resulted in collaborations between the Heritage Foundation, the Federalist Society, the CATO Institute, the ACLU and the National Association of Criminal Defense Lawyers. It should not be that surprising since a philosophical underpinning of the rule of law is that law is promulgated so that it can be followed. This is particularly true where a failure to follow the law can result in criminal sanctions.

Although it can be traced back farther, in 1964 the Supreme Court in the *Bouie* case explicitly recognized the "basic principle that a criminal statute must give fair warning of the conduct that it makes a crime."[5] A vague statute does not give notice. In fact, it simply invites a form of common law crime. In 2001, Justice Scalia, in dissent, made that point in *Rogers v. Tennessee*.[6] Then, in the *Sorich* case in 2009, Justice Scalia dissented again, this time from a denial of *certiorari*.[7] In *Sorich*, the issue was whether or not 18 U.S.C. section 1346, expanding the mail and wire fraud statutes to cover "honest services," was so broad and so vague that it would criminalize clearly legal and protected activities.

Justice Scalia's concern about the vague language of "honest services" was that the public would have no idea as to what was sought to be prohibited. The public cannot conform its conduct to vague laws. In addition, it gave prosecutors discretion to decide, case by case, what conduct and who would be prosecuted. Justice Scalia dissented to say that the court should grant *certiorari* and either find section 1346 unconstitutional or find a way to limit its scope. Otherwise, in his view, chaos would prevail.

These issues regarding the "honest services" statute, section 1346, were taken up by the Court the next term in the case of Jeffrey Skilling, the former CEO of the ill-fated Enron Corporation.[8] Justice Ginsburg in a fractured opinion held that 18 U.S.C. section 1346 is not unconstitutionally vague by judicially limiting "honest services" to cover only the "core cases" of actual bribery and kickback schemes. Mr. Skilling's conviction on those counts was overturned because it did not come within said core cases. To accomplish this result, the Court relied on prior judicial interpretations, most notably the *McNally* case giving rise to the so-called *McNally* doctrine.[9]

Justice Scalia was not pleased with this part of the opinion and concurred in part and concurred in the judgment reversing the conviction on the 1346 counts. However, he would have found that "honest services" "is vague, and therefore violates the Due Process Clause of the Fifth Amendment."[10] He believed that judicially circumscribing the conduct that could be prosecuted under a vague statute would be exercising a non-existent power to define new federal crimes. In other words, a statute must clearly define the conduct it proscribes or it is unconstitutional.

The Doctrine of Vagueness Makes a Doctrinal Comeback

Justice Scalia had one more chance to advance the jurisprudence regarding the due process requirement that statutes clearly state what is proscribed. In the 2015 *Johnson* case,[11] this time writing for the majority, Justice Scalia held that the Government violates the Due Process Clause "by taking away someone's life, liberty, or property under a criminal law so vague that it fails to give ordinary people fair notice of the conduct it punishes, or so standardless that it invites arbitrary enforcement."[12] The issue at bar was the enhanced sentence under the Armed Career Criminal Act for being previously convicted of a violent felony --- a term not defined in the federal statue. This required interpreting whether the state statute, under which Mr. Johnson was previously convicted, qualified. In this case, the state offense was possession of a short-barreled shotgun. Scalia expressly refused to evaluate the prior conviction in terms of the "ordinary case" and refused to look into the particular facts. Either the statute defines the prohibited conduct or it is vague and that is it. The due process vagueness doctrine was revived.

After Justice Scalia's death and his replacement on the Court by Justice Gorsuch, the Court had another opportunity to explore the due process void for vagueness doctrine in *Sessions v. Dimaya*.[13] There the issue was whether the federal criminal code's definition of "crimes of violence," as incorporated into the Immigration and Nationality Act's definition of "aggravated felony," was impermissibly vague. Justice Kagan wrote for the majority and so found even though the consequences here were civil, not criminal.

Justice Gorsuch wrote a concurrence[14] relying on Justice Scalia's analysis in *Johnson*. Justice Gorsuch dug deep into the history of the Constitution and laws, waxed eloquent and cited venerable authorities. He said that not only does due process require notice so that *ad hoc* decisions are not made by administrators, prosecutors, judges and juries, but that the vagueness doctrine is founded on the concept that the separate branches remain in their proper spheres. So, upon the filing of the opinions in *Dimaya*, the vagueness doctrine of the Due Process clause of the Fifth Amendment seemed to be alive and well.

Now Comes a New Effort to Re-evaluate the Vagueness Doctrine

Somewhat surprisingly, the Solicitor General of the United States has again brought the vagueness doctrine before the Court by filing a Petition for Writ of *Certiorari* in *United States v. Davis and Glover*.[15] More surprisingly, *certiorari* was granted. The matter is briefed and it is set for oral argument on April 17, 2019. The question presented is: "Whether the subsection-specific definition of "crime of violence" in 18 U.S.C. 924(c)(3)(B), which applies only in the limited context of a federal criminal prosecution for possessing, using, or carrying a firearm in connection with acts comprising such a crime, is unconstitutionally vague."

Of course, a grant of *certiorari*, the rule of four by tradition,[16] does not mean that an opinion will even be written, let alone that it will signal a substantial change in the jurisprudence. A writ can be discharged as improvidently granted or an opinion can be written but turn on some esoteric point. However, on the face of it, this seems either to be an opportunity for the Court to affirm the Scalia/Gorsuch vagueness jurisprudence or an opportunity to retract and set some limits.

The courts below have, for the most part, found the "crime of violence" language in the statue at issue in *Davis* and *Glover* to be unconstitutional. It seems to come pretty clearly within the *Johnson/Dimaya* rules. Of course, we have been fooled by the "all fours" doctrine before and have seen substantially similar statutes construed in different ways. Furthermore, as a practical matter, there is a lot at stake involved in going back to set aside convictions and sentences. The people sentenced to "crime[s] of violence," whatever it might mean, are not the clientele of most concern to the Federalist Society; they are not white collar defendants or CEO's of defunct corporations.

If the lower court's ruling in *Davis* and *Glover* that the code section is void for vagueness is upheld, the court could do so on a fairly straightforward reading of the current statute based on the *Johnson/Dimaya* vagueness doctrine. On the other hand, if the lower court is reversed and the statute construed in a fashion that saves it, either with "ordinary case" approach or by looking at the underlying facts, it would be a significant blow to the jurisprudence established by Justices Scalia and Gorsuch.

We have seen Justice Thomas take the position that vagueness is not even a constitutional problem, and we have seen other Justices find reasons to vote to allow a statute to stand. In *Dimaya*, Chief Justice Roberts was joined by Justices Kennedy, Thomas and Alito dissenting,[17] saying that they could distinguish the statute in *Dimaya* from that in *Johnson*. Of course, we do not know how Justice Kavanaugh will see this issue. He has replaced Justice Kennedy so that would not, in itself, change the balance. Nevertheless, new voices and new discussion could cause a realignment.

Conclusion

Oral argument is April 17, 2019 and we can expect an opinion by June or July at the latest. This case could be an

interesting bell weather regarding the strength of the vagueness doctrine. Time will tell. ■

Robert Sanger is a Certified Criminal Law Specialist and has been practicing as a criminal defense lawyer in Santa Barbara for over 45 years. He is a partner in the firm of Sanger Swysen & Dunkle and Professor of Law and Forensic Science at the Santa Barbara and Ventura Colleges of Law. Mr. Sanger is Past President of California Attorneys for Criminal Justice (CACJ), the statewide criminal defense lawyers' organization, and a Director of Death Penalty Focus. The opinions expressed here are his own and do not necessarily reflect those of the organizations with which he is associated. ©Robert M. Sanger.

ENDNOTES

1 *Strickland v. Washington*, 466 U.S. 668 (1984).
2 *Connecticut v. Skakel*, No. 18-185 (petition filed August 9, 2018).
3 *Connecticut v. Skakel*, --- S.Ct. ----2019 WL 113095 (Mem).
4 *McCoy v. Louisiana*, 584 U.S. ___ (May 14, 2018).
5 *Bouie v. City of Columbia*, 378 U.S. 347, 350 (1964).
6 *Rogers v. Tennessee*, 532 U.S. 451, 476 (2001) (Scalia, J., dissenting).
7 *Sorich v. United States*, 555 U.S. 1204 (Mem.) (Scalia, J., dissenting).
8 *Skilling v. United States*, 561 U.S. 358 (2010).
9 *McNally v. United States*, 483 U.S. 350, 360 (1987).
10 *McNally v. United States*, 483 U.S. at 415.
11 *Johnson v. United States*, 135 S.Ct. 2551 (2015).
12 *Johnson v. United States*, 135 S.Ct. at 2556.
13 *Sessions v. Dimaya*, 138 S.Ct. 1204 (2018).
14 *Sessions v. Dimaya*, 138 S.Ct. at 1223.
15 *United States v. Davis and Glover*, 18-431.
16 See the interesting exchange on the significance of this informal rule adopted by the Court to grant *certiorari* in *Rogers v. Missouri Pac. Co.*, 352 U.S. 521, 528 (1957) (Frankfurter, J., dissenting), and at 559 (1957) (Harlan, J., concurring in part and dissenting in part)
17 *Sessions v. Dimaya*, 138 S.Ct. at 1234.

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California's Workers' Compensation – It Doesn't Have To Be A Burden!

By Kristine McCardle and Susan Rodriguez

Have you ever felt frustrated or helpless by the Workers' Compensation system?

Although many employers are frustrated and feel that the system works against them, a good insurance broker can work with employers to provide valuable tools that empower them in order for them to provide a safe workplace for their most valuable assets: their employees.

Cumulative Trauma claims are on the rise. Cumulative Trauma is known in the insurance industry as "skin and contents" meaning every ache and pain is related and can span from hire date to current employment. Here are some CT claim facts:

- CT claim rates have grown by 50% since 2008.
- CT claim growth in Southern California is concentrated in lower wage workers.
- About 40% of recent CT claims are filed after the employee is terminated, about three-quarters are initially denied in part or in whole, and about one-quarter also involve an accompanying specific injury claim.
- CT loss payouts are much slower and the payout much higher than for specific injury claims.
- CT claims stay open longer than other claims, but claim settlement rates have accelerated across all claim types.

Employers often ask, "What happened to the California workers' compensation burden of proof requirement?" Labor Code Section 3600 states: "Liability… shall…exist against an employer for any injury sustained by his or her employees arising out of and in the course of the employment… in those cases where the following conditions of compensation concur:…"

Ten conditions are then listed in Labor Code Section 3600 for the employee to prove; ten! How can the employee possibly prove all ten conditions; seems like a win for the employer, right? WRONG.

Although it sounds like the ship is sinking for the employer, insurance brokers hand out life preservers.

PRO-ACTIVE APPROACH FOR EMPLOYERS

Legitimate WC claims happen, and the system is there to take care of the injured worker. For the employer, there are steps that can be taken to minimize an expensive unproven work comp claim. The following are a few recommendations employers may take:

- Lawful physical examinations after a contingent offer of employment. This will determine if the duties can be performed; with or without accommodations.
- Set the right company tone: "Safe Work, Saves Money."
- Take a photograph of each employee in the event the insurance carrier attempts to conduct an activity check (film) AKA: Sub-rosa.
- Inform new and current employees that all alleged injuries will be thoroughly investigated by the company. Train managers/supervisors on how to legally gather information which may result in a lower settlement, or an expedited settlement.
- Employers should attend depositions of their employees; employers know the job duties and happenings better than anyone.
- Attend training seminars about workers' compensation claims. Learn the claim procedures from beginning to end.
- Review the workers' compensation claim reserves. Often financial claim reserves are higher than settlement demands.

POSITIVE IMPACT FOR CALIFORNIA EMPLOYERS

Below is a chart showing the average pure premium rate reductions since July 1, 2015 to current. These reductions are a result of cumulative Workers' Compensation reform. Average rates are used to determine the actual base rate by classification code that employers see on their Workers' Compensation policies.

History shows that this downward trend in rates cannot continue forever. It is important that employers are diligent and prepared for the upturn in the marketplace.

2019 brings further changes to the experience modification calculation.

A new 2019 formula excludes the first $250 of each claim from the X-Mod computation. This change removes any experience rating incentive to not report the cost of small

Average Pure Premium rate reduction	
January 1, 2019	Pending approval
July 1, 2018	-7.2%
January 1, 2018	-16.1%
July 1, 2017	-16.5%
January 1, 2017	-12.6%
July 1, 2016	-10.4%
January 1, 2016	-7.8%
July 1, 2015	-10.2%

or "first aid" type claims to the insurer. The new simplified formula also places an emphasis on reducing the occurrence and cost of workplace injuries, as reflected in the actual primary losses.

Note: These changes apply at the employer's anniversary date (renewal date) in 2019. Example: If your Workers' Compensation renews on July 1, 2019, these changes take effect at that time.

The time is now to empower employers so they become more proactive prior to a claim occurring. With the right information, employers can be more engaged and enlightened about the entire work comp system. And just maybe, the work comp system will not be such a burden after all. ■

Kristine McCardle is the founder of Legal Professor Online℠ and a Workers' Compensation claims specialist. She has been a practicing California attorney for 18 years. Kristine works diligently to educate employers on the Workers' Comp system and bring claims to closure.

Susan Rodriguez, CIC, CRIS is Senior Vice President with Brown & Brown Insurance with emphasis in Workers' Compensation. She has been licensed by the California Department of Insurance for over 30 years.

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Two Types of Business Value? Know Which One Applies to You

By James Lisi

Why do business valuations arrive at such seemingly different answers to a single question? One reason is that valuation analysts hold opposing perspectives on the nature of business value. Some take this to an extreme to say that standard of value is irrelevant. While they battle to win the argument for best method, the result is confusion. In my opinion, the muddling of ideas stems from several driving factors, among them:

- Many of our practices being derived from court cases, not scientific method
- An inherent conflict between the demand for 'verifiable' open market conclusions and practitioners" use of proxy equity data
- Use of statistical analysis on data that is clearly not from a single variable, normal population
- Failure to properly define and categorize all variables needed for a solution
- Valuation teaching not rigorously describing the two primary views of value nature

We can't cover all of this in a short article, but will focus on what may be the biggest cause for argument - the effect of two top-level paradigms for problem definition: Value-in-Exchange and Value-to-the-Owner. While identified in valuation thought, these two concepts are basically orphans when it comes to relating them with their effect on value. We call this un-named concept about value's dual nature *Value Paradigm*[1] and have examined it under scientific method, the systematic test procedure first taught in junior high school. The results are clear. From these two classifications, key variables can be shown to fit the problem, or not.

The base hypothesis is that Value-in-Exchange, an open market viewpoint, represents value as an *asset*, while the Value-to-the-Owner represents value as *equity*. Tax and GAAP matters require Exchange-Asset conclusions, while divorce and partner matters are Owner-Equity conclusions. So, it is important to properly define the difference between conclusion types.

Value Paradigm

As mentioned, the paradigm concept is already established in valuation textbooks. In *The Business Valuation Bench Book*[2], the authors tell judges,

"The process begins with the consideration of the *overarching premise of value*, which represents the general concepts of property under which the standard of value falls. The two *fundamental premises of value* are value-to-the-holder and value-in-exchange. Under value-to-the-holder, the owner realizes the benefits of ownership by the cash flow received by owning the business. Under value-in-exchange, the owner realizes the benefits of ownership by selling the business." (italics added)

In discussing divorce valuations, the textbook *Understanding Business Valuation, Fifth Edition*[3] similarly states,

"Case law must be reviewed in order to properly categorize the Standard [of Value] into what the valuation profession has called value-in-exchange or value-to-the-holder. This is the difference between valuing the asset as if it were being sold in the open market versus valuing it as if kept by the owner (fair market value v. investment value)." ([ ] added)

The differentiating factor used to measure between Exchange and Owner transactions can be seen to rest on whether ownership is replaced or stays the same. Let's review the definitions of 'asset' and 'equity' to help frame these two conditions with Exchange and Owner nature.

An asset is a resource controlled by an entity from which future economic benefits are expected (International Accounting Standards, IAS 38.8). In-and-of-itself, an asset has no ability to confer control or other ownership rights. Whether it is a financial, intangible or tangible asset, it can be worth something, or nothing, but it is never negative.

On the other hand, equity is the bundle of rights held in a group of net assets. International Financial Reporting Standards for Small and Medium Enterprises Section 2 and Section 6 refer to equity under a conceptual framework as *the residual value of assets after deduction of liabilities, differing according to legal form and company policies*. Shares of equity, therefore, include the owners' selection of entity type, policy, distributions of cash flows and undertaking liabilities, along with the asset value. Unlike an asset, equity has a distinct risk of having negative value.

Clearly, selling a business – changing owners – is the Exchange definition. To a buyer, this is the acquisition of an asset from which future benefits are expected. Alternatively, the Owner view fits the definition of the asset value

less liabilities differing by legal form and company policies.

Core Dependent Variables

Analysts are not free to apply all variables across paradigms, or to mix asset and equity data. As with any trustworthy accounting practice, matching in time and character must occur. Here we have certain essential and optional variables. With our asset and equity framework, we designate as *Core Variables* those elements that apply to either framework. These variables are independent of the conclusion desired, such as:

- industry
- scale
- diversification
- liquidity
- entry and exit barriers
- capital intensity
- growth rate
- tax & regulatory environment
- management effectiveness
- economic, market and technology risks

Owner Dependent Variables

The optional variables are what we call *Owner variables*. Comparing the *asset sale* transaction to the *holding of a share block* where the owner obtains value from the current cash flows, reveals the owner variables. The owner variables are the ones that *do not* have to transfer when a company is sold, and include:

- all liabilities
- non-operating assets
- the owners
- distributions policy
- spending plans
- entity type

These variables are dependent upon Paradigm and only come into play for equity holders. So, elements like entity type, debt, accounting policy and level of reinvestment into the business are excluded for Exchange conclusions.

Nature of Whole Company Sales

Owner variables do not apply for asset value because, the transfer of a whole company is a clean accounting of the operating assets without the effect of an owner interest[4]. It is the reason that buyers evaluate companies based upon EBITDA and not net income. EBITDA represents the buyer's cash flow that they can reconfigure to their interests, which is different from the former owners' cash flow.

After close of a sale, the buyer may fold the acquisition into an existing company or set-up a new partnership, C-Corporation or other entity type. The capital structure may be set to all equity or heavy with debt. The dividend policy may distribute 80% of free cash flow to equity holders or distribute nothing with 100% reinvested for growth. Incoming ownership has all these prerogatives on how to use the EBITDA.

In application two Exchange conclusions are used. Banks, for example, only want the *asset value* identified, but we generally need to find *Equity Exchange Value* for tax related valuations. With the intangible value (Goodwill) set by the open market sale of the whole company, the only difference between *Asset Value* and *Exchange Equity* is simply the actual non-operating assets and liabilities of the subject.

Effect of the Equity Viewpoint

When we shift to Owner view, we no longer have an open market view based on cash flows to a buyer, but need a different conclusion. Not only do we have the quantitative effect of liabilities and non-operating assets, but the inability to change owner variables alters the intangible value because both cash flows and risk are different. Do the owner choices enhance value, impair value or have no effect in comparison to the open market reference point? The change in intangible value is reflected in:

- Cash Flows of Debt
- Cash Flows of Capital Expenditure
- Cash Flows of Entity Type
- Cash Flows of Policy (Growth, Dividend, Harvest)

Ownership Dispersion, Resources & Network

As one example, Aswath Domadaran, Stern School of Business at New York University Kerschner Family Chair in Finance Education, has addressed the debt question, 'Will the value of operating assets increase as debt goes up?' He states that generally, debt increases value to a point, after which it decreases value. Similar to Damodaran's conclusions on the risk of debt, analysts must consider all owner variables for their effect on Owner value with respect to the central tendency of data that they select.

Entity Conclusion Options

Thus, specific variables clearly distinguish Owner from Exchange conclusions. Technically, we have applied scientific method, and identified the independent and dependent variables for the desired conclusion types. Valuators must comply with this Paradigm structure. It is not discretionary nor a place to apply opinion. With a subject's non-operating assets, liabilities, core variables and owner variables separately identified, three types of entity-level conclusions are possible.

PARADIGM OF VALUE & CONCLUSION ENTITY REPRESENTATION		
CONCLUSION	**REPRESENTATION**	**PARADIGM**
ASSET VALUE	OPERATING ASSETS ALONE	VALUE IN EXCHANGE
EQUITY VALUE	ASSET VALUE PLUS ACTUAL LIABILITIES AND NON-OPERATING ASSETS	VALUE IN EXCHANGE
EQUITY VALUE	EQUITY VALUE ADJUSTED FOR OWNERSHIP RISKS SUCH AS HIGH DEBT, POTENTIAL DILUTION, ENTITY TYPE	VALUE TO OWNER

Table 1. Entity Conclusion & Paradigm Representations

Share Blocks

So far, we have presented issues surrounding valuations of whole companies. However, we also have the case of valuing shares. After analyzing the company, we have two possible kinds of equity to start the shares analysis, either the Entity's Exchange Equity Value or its Owner Equity Value. Share block valuation *always* begins with entity Owner Value because ownership choices are fixed as we look at equity and all Owner variables that we have discussed apply to company shares. So those company valuations that terminate with Exchange Equity value must convert to Owner value before proceeding to value a share block.

The question then arises about when to apply discounts. *Holding* the shares is an Owner view where all equity holders are seen to have the same stakes in the company. Often disputes result in the exit of an equity holder, but Owner value, without an agreement to the contrary, is determined as if the shares are held in a single block - based upon the original investment basis when there was an alignment in value and ownership rights among parties. When all investors enter under the same conditions, the share block is valued pro rata, the same as if the company was sold and each was distributed their share of the proceeds. If a share block was discounted in this case, the discount unfairly provides a windfall to one owner over another.

Selling the shares represents the Exchange, open market, FMV view, where the share block is valued as if it were separated from current equity holders. This separation from the other interests invokes a Discount for Lack of Marketability (DLOM). Similar to selling the company assets in pieces instead of as a stand-alone entity, we have a loss of value when equity is sold in pieces.

For example, dividends are not a dependent variable to analyze for the Owner interest because Owners together can change dividend policy to suit their needs. However, under an Exchange view, dividend policy becomes fixed for a share block and must be analyzed. Similarly, liquidity can change. Instead of being able to sell the company in the open market in about a year, it may be ten years until the controlling shareholder is willing to sell. This means that the owner of the share block is at a disadvantage relative to owning the company outright. Variables which become dependent when a block is separated for transfer are those such as:

- Cash Flow to Shares (diversions of owner interests)
- Expected Time to Exit and return of principle (liquidity)
- Risk of adverse decisions during holding period (control)
- Holding & Selling Costs

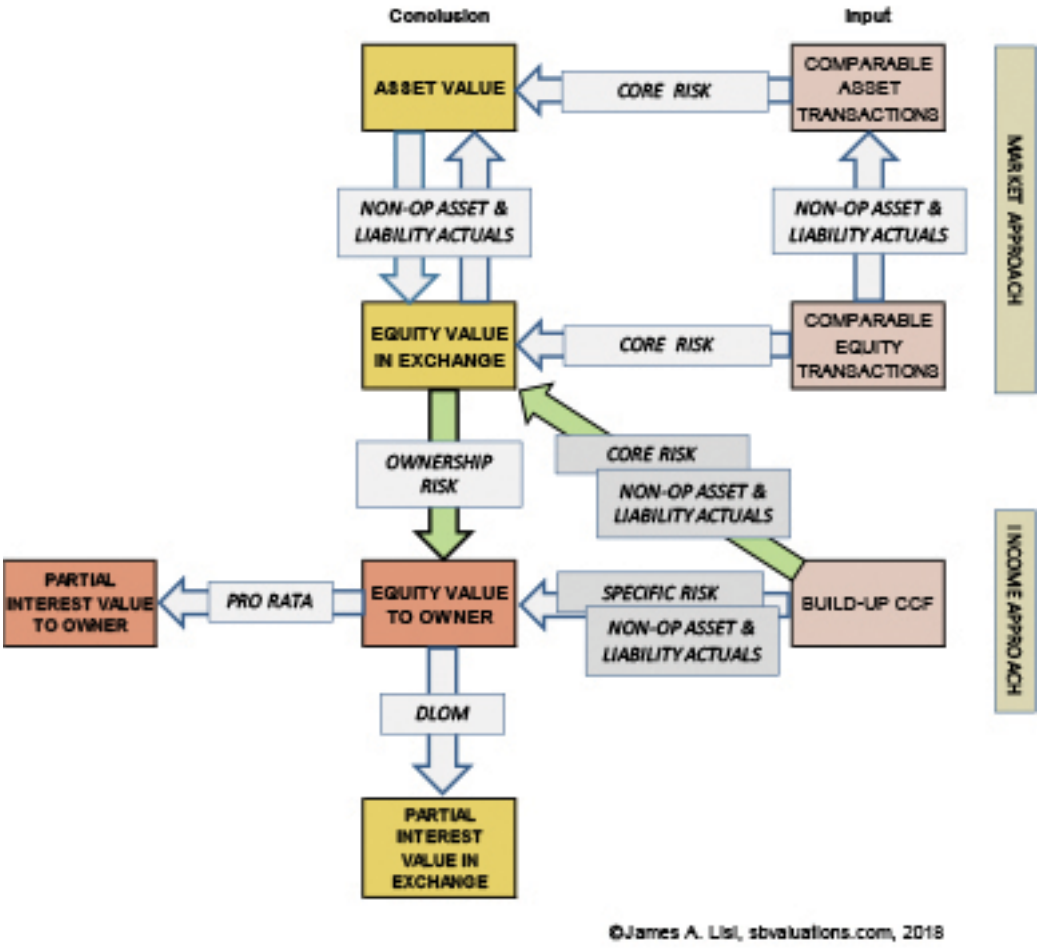
These factors are used to quantify the impairment of owner rights versus the Owner interests acting together. The table below shows the possible conclusions from entity to share block.

Table 2. Conclusion & Paradigm Representations

PARADIGM OF VALUE & CONCLUSION REPRESENTATION		
CONCLUSION	**REPRESENTATION**	**PARADIGM**
ASSET VALUE	OPERATING ASSETS ALONE	VALUE IN EXCHANGE
EQUITY VALUE	ASSET VALUE PLUS ACTUAL LIABILITIES AND NON-OPERATING ASSETS	VALUE IN EXCHANGE
EQUITY VALUE	EQUITY VALUE ADJUSTED FOR OWNERSHIP RISKS SUCH AS HIGH DEBT, POTENTIAL DILUTION, ENTITY TYPE	VALUE TO OWNER

Conclusions Flow Chart

The paths from transaction data to the five possible conclusions are depicted in the flow chart to the right with the market and income approaches. Today, the 'Asset' crowd generally operates in the gold-colored boxes and the 'Equity' crowd operates in the rose-colored boxes. Not recognizing the need to match data with conclusion type, these often get mixed, and the analyses required by the green shaded arrows are commonly overlooked. The mismatched data, risk rates, cash flow streams and conclusions cause confusion, as do adjustments for the subject's actual non-operating asset values.



With a clear understanding of the Exchange and Owner views we can better align conclusions between analysts and resolve nagging industry disputes. For example, we can see why an unrelated third-party buyer of a whole company will value an S-Corp the same as a C-Corp, but that this same buyer would take tax impacts into consideration if they bought shares instead and could not change the entity type.

In closing, Standard of Value, which defines the applicable paradigm, is critical to defining business value. Identifying its impact can help avoid conflict, poorly written government regulation and unfair windfalls in disputes. Since the conflicting 'schools of valuation' are focused upon different value natures, judges and other stakeholders would do well to evaluate whether the desired conclusion is properly defined and that the correct valuation ideology is applied to the question at hand. It is vital to providing an equitable result. ■

ENDNOTES

1 Book value is also a usable paradigm, and it is employed for share transfers and negotiating deals, but we set it aside because it measures the value of historical equity contributions and earnings, not current market value.
2 William J Morrison and Jay E. Fishman, Business Valuation Resources
3 Gary R. Trugman, Wiley, AICPA
4 Note that conceptually, non-operating assets needed to 're-boot' the business, such as cash and inventory, are supplied by the buyer. Inventory is often purchased separately from the business to distinguish these elements.

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James A. Lisi is Managing Director for Central Coast California at The Mentor Group Inc., and owner of Santa Barbara Valuations Inc. He has over fifteen years of valuation experience and twenty years in executive and strategic positions at Fortune 100, Private Equity and his own personally held businesses, and extensive operating experience in manufacturing, distribution, rental and youth services.

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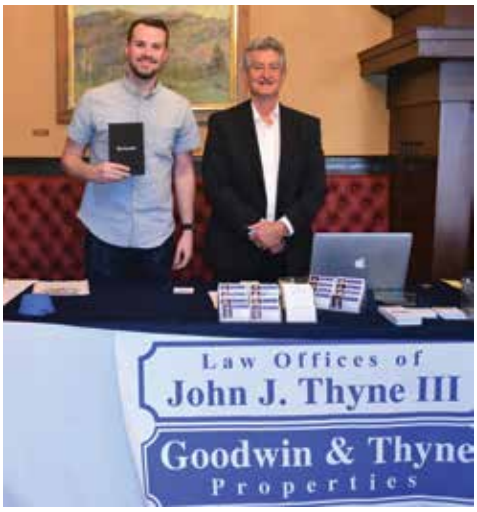

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Disengaging From the Difficult Client

By Michael D. Stewart

Michael D. Stewart

This article addresses the rules governing California lawyers who seek to withdraw or disengage from representing a client in civil proceedings. It also discusses certain practice management tips regarding withdrawal. (Unless stated otherwise, references to "Rule" or "Rules" mean those contained in the California Rules of Professional Conduct, approved on May 10, 2018 by the California Supreme Court, which are renumbered and effective November 1, 2018. Because the new Rules use "lawyer" and not "member," this article does the same.)

Representing a difficult client is sometimes part of the job. But there are times when we need to disengage from such a client. There are myriad reasons for doing so, some of which are mandatory and others discretionary. The client may ask us to do something that violates ethical rules. For example, the client may insist that the lawyer assert a non-meritorious claim or defense (see Rules 1.16(b)(1) and 3.1), or demand that the lawyer threaten an adversary with criminal, administrative, or disciplinary charges to obtain an advantage (see Rule 3.10), or that the lawyer not comply with the ethical duties concerning inadvertently transmitted writings (see Rule 4.4).

Even if the client is not difficult, changing circumstances may require us to cease representing the client. For example, the matter may morph into an area of law with which the lawyer does not possess sufficient competence and does not wish to, or cannot, acquire competence (see Rule 1.1), or a conflict of interest may develop (Rule 1.7). Or perhaps the client cannot or will not pay the lawyer's invoices, in which case the lawyer is permitted to withdraw only after "giv[ing] the client a reasonable warning after the breach that the lawyer will withdraw unless the client fulfills the agreement or performs the obligation." Rule 1.16(b)(5); *but see* California Central District Rule 83-2.3.2 ("Failure of the client to pay agreed compensation is not necessarily sufficient to establish good cause.)".

The contingency fee lawyer who terminates the client but hopes to collect in *quantum meruit* from any later recovery will be precluded from doing so if he or she withdraws without justifiable cause. *Estate of Falco*, 188 Cal. App. 3d 1004, 1016, fn. 12 (1987) ("In cases involving permissive withdrawal it is within the discretion of the trial court, with heightened scrutiny consistent with the standards articulated here, to determine whether counsel's withdrawal was justified for the purpose of awarding fees"); *Ramirez v. Sturdevant*, 21 Cal. App. 4th 904, 916 (1994) (an attorney may withdraw for any of the reasons stated in Rule 3700 (see Rule 1.16 as of November 1, 2018), but jeopardizes a *quantum meruit* recovery absent "justifiable cause").

Even where withdrawal is proper, the lawyer may in a joint representation context wish to terminate one client and not the others. California courts have enforced advance waivers stating that the lawyer has the choice of continuing to represent one or more jointly represented clients if the lawyer terminates one of them. *See Zador Corp. v. Kwan*, 31 Cal. App. 4th 1285, 1301-02 (1995). Any such joint-representation waiver would need to be carefully drafted to properly warn all clients of the consequences of the lawyer's termination right.

Nothing in the Rules expressly precludes the lawyer from terminating a disfavored client in order to resolve a conflict. In fact, comment 10 to Rule 1.7, entitled *Conflict of Interest: Current Clients*, states: "depending on the circumstances, the lawyer may have the option to withdraw from one or more of the representations in order to avoid the conflict." However, a lawyer cannot drop a client simply to keep a better client, especially if the lawyer intends to be adverse to the dropped client. *Truck Ins. Exch. v. Fireman's Fund Ins. Co.*, 6 Cal. App. 4th 1050, 1057-58 (1992).

Even when permitted or even required to withdraw, a "lawyer shall not terminate a representation until the lawyer has taken reasonable steps to avoid reasonably foreseeable prejudice to the rights of the client, such as giving the client sufficient notice to permit the client to retain other counsel, and complying with" other requirements discussed below. Rule 1.16(d). Indeed, avoidance of prejudice is the guiding light in terminating a client before the natural completion of the matter.

In the transactional setting, the withdrawing lawyer need not seek or obtain court approval. However, unlike in

litigation where the withdrawing lawyer generally seeks a substitution or files a motion to withdraw, the transactional attorney needs to ensure the client does not mistakenly believe the lawyer is handling a matter when the lawyer is in fact no longer doing so, especially if there is a long-term relationship. A polite disengagement letter can serve as a clear line of demarcation. Some lawyers insert into their engagement letters a provision stating that unless the lawyer and client otherwise agree in writing, the representation will terminate upon completion of the matter. However, that provision might not address the situation where the matter is not complete, or where completion is difficult to ascertain. (The same situation can arise where the potential client consults with, but does not formally engage, the lawyer. In that case, the lawyer may wish to confirm with the non-client in writing that he or she has not been engaged to represent the non-client and is not acting as their lawyer.)

In litigation, the lawyer can only withdraw by following the rules of the "tribunal." Rule 1.16(c). In state court, the lawyer may withdraw with the client's consent by filing and serving an executed substitution of attorney form. Cal. Civ. Proc. Code § 284(1). In federal court, the lawyer must file and serve a noticed application. California Central District Rule 83-2.3.2 ("An attorney may not withdraw as counsel except by leave of court" via a noticed "motion . . . supported by good cause."). If the state court lawyer's client is not inclined to consent to the lawyer's withdrawal, the lawyer should explain to the client the possible inferences the adversary may make if the lawyer is forced to file a motion. Rule 1.4(b) ("A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions . . . .").

Assuming the client refuses to consent to withdrawal, the lawyer will be required to file a motion to be relieved as counsel using the Judicial Council forms required by California Rule of Court, Rule 3.1362(a) and (c). A lawyer is well-advised to strictly comply with Rule 3.1362 and applicable laws governing the process. In particular, the withdrawing lawyer must not disclose attorney-client communications (Rule 1.16, comment 4) or other client secrets, and at least one California decision allows the lawyer to seek the court's *in camera* review of such communications to the extent necessary to establish a basis for withdrawal. *See Manfredi & Levine v. Superior Court*, 66 Cal. App. 4th 1128, 1136 (1998) ("we trust the court will accommodate counsel with an *in camera* hearing if requested."). Note that the California and ABA ethics committees have differing views on *in camera* review. *Compare* Cal. Bar Formal Opinion 2015-192 ("Because a court cannot order an *in camera* inspection . . . it logically follows that a court may not review information that unquestionably is privileged—like the communications between Attorney and Client here—for purposes of ruling on a motion to withdraw.") *with* ABA Formal Opinion 476 (suggesting *in camera* review is appropriate).

In all cases (transactional, litigation, consensual, or contested), the withdrawing "lawyer promptly shall refund any part of a fee or expense paid in advance that the lawyer has not earned or incurred." Rule 1.16(e)(2). Additionally, the lawyer "must promptly . . . release to the client" the file, including the "correspondence, pleadings, deposition transcripts, experts' reports and other writings, exhibits, and physical evidence, whether intangible, electronic or other form, and other items reasonably necessary to the client's representation, whether the client has paid for them or not." Rule 1.16(e)(1).

The withdrawing lawyer may wonder if he or she needs to send the client their "work product," often consisting of certain notes or internal emails reflecting the lawyer's impressions, conclusions, opinions, research or theories. Cal. Civ. Proc. Code § 2018.030(a). It bears noting that the work-product doctrine can protect certain information from disclosure to an adversary or third-party; it does not bestow ownership of the work product on the lawyer. In assessing what work product the lawyer may need to send the client upon withdrawal, some lawyers focus on what "items [are] reasonably necessary to the client's representation" under Rule 1.16(e)(1). Although Rule 1.16, entitled *Declining or Terminating Representation*, does not expressly mention work product, comment four to Rule 1.4 states that in the context of the lawyer's general duty to communicate with the client, the "obligation of the lawyer to provide work product to the client shall be governed by relevant statutory and decisional law."

Some argue that the duty to send the client work product is broader than the touchstone of "reasonably necessary to the client's representation," but the issue is not settled. Some lawyers insert provisions in their engagement agreements stating that their work product is not part of the client's file. While a lawyer may not contract around the California Rules of Professional Conduct, such a provision may help define what is and is not part of the "client file," and may also inform the client's expectations.

Because Rule 1.16(e)(1)'s production mandate is so broad (all "deposition transcripts, experts' reports and other writings"), it could include items that are subject to a protective order. Imagine, for example, withdrawing from a trade secrets case and sending the former client its business competitor's "attorneys-eyes only" business plan. Fortunately, compliance does not mean having to choose between a duty to the former client and the possible violation of a

court-entered protective order. In fact, the Rule resolves that issue by stating transmittal of the client file is "subject to any applicable protective order, non-disclosure agreement, statute or regulation." Rule 1.16(e)(1). As a practical matter, the withdrawing lawyer will need to remove such items from those being sent to the client if required by the protective order. However, in order "to avoid reasonably foreseeable prejudice to the rights of the client" (Rule 1.16(d)), the withdrawing lawyer should anticipate how his or her successor can step into the withdrawing lawyer's role and be subject to the benefits and burdens of the protective order or non-disclosure agreement.

Depending on the context of the withdrawal, the lawyer and client may not be parting on ideal terms. The lawyer may not have been paid, or the client may have accused the lawyer of mistakes, or worse. The lawyer nevertheless has a duty to ensure that his or her withdrawal will not prejudice the client. The withdrawing lawyer should notify the client, perhaps in a cover letter sent along with the file transmission, of any upcoming or urgent items, dates, or deadlines. Simply assuming successor counsel will review the file contents and learn of such dates is risky, and under certain circumstances might run afoul of Rule 1.16(d).

Some question whether the withdrawing attorney has a duty of cooperation with the former client's new lawyer. An official comment to the current version of the applicable rule (CRPC 3700) differs from Rule 1.16 (which, along with the other Rules, is not effective until November 1, 2018). In addressing what steps the lawyer should take to avoid prejudice to the client, the existing comment to CRPC 3-700 states:

What such steps would include, of course, will vary according to the circumstances. Absent special circumstances, "reasonable steps" do not include providing additional services to the client once the successor counsel has been employed and [the rule governing transmittal of the client file and return of unearned fees] has been satisfied.

Rule 1.16's omission of the above-quoted comment might suggest the withdrawing attorney could, under certain circumstances, have an ongoing duty of cooperation with successor counsel. However, Rule 1.16 itself does not expressly address any such duty, and retains from its predecessor (CRPC 3-700) the general proviso that the lawyer "shall not withdraw from employment until the [lawyer] has taken reasonable steps to avoid reasonably foreseeable prejudice to the rights of the client."

Lawyers also may wonder whether they can charge the former client for costs incurred in duplicating and keeping a copy of the client's file. If the engagement letter with the client allows the lawyer to charge for such duplication, Rule 1.16 does not prohibit such charge. Of course, the question is whether pursuing reimbursement from the former client is prudent. As mentioned earlier, the circumstances may be that the withdrawing lawyer and the former client are parting on less than ideal terms, and pursuing a relatively small payment may be not only unfruitful but unwise. Regardless, the lawyer cannot condition transmittal of the client file to either the client or successor counsel upon payment. Rule 1.16(e)(1).

If the terminated client fails to pay the lawyer, then the lawyer may need to consider whether to take collection efforts. While most insurance carriers would advise against pursuing collection, the lawyer may well be fully entitled to payment. When pressed for payment, the former client (or his or her lawyer) may respond by claiming that the former lawyer failed to adequately represent the client's interests and is therefore not entitled to payment.

Whether or not to pursue payment depends on many factors and is beyond the scope of this article. However, disengagement can result in the lawyer and former client reaching an agreement regarding payment and the client's possible claims against the lawyer. Not surprisingly, Rule 1.8.8(a) precludes a lawyer from prospectively limiting the lawyer's malpractice liability to a client. However, Rule 1.8.8(b) does allow the lawyer to settle a malpractice claim or potential claim if either the client is represented by an independent lawyer concerning the settlement, or the withdrawing lawyer advises the client in writing to seek the advice of an independent lawyer and provides the client with a reasonable opportunity to seek that advice. Rule 1.0.1, entitled *Terminology*, does not define "independent," but the withdrawing lawyer would be well-advised to avoid referring the former client to a friend for purposes of settlement representation. ■

Michael D. Stewart is a partner and Deputy General Counsel of Sheppard, Mullin, Richter & Hampton LLP, in Costa Mesa. He is also a member of the OCBA's Professionalism & Ethics Committee. The views expressed herein are his own. He can be reached at mstewart@sheppardmullin.com.

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Motions

Buynak, Fauver, Archbald & Spray, LLP (BFAS) of Santa Barbara has announced the addition of new attorney, **Christopher de la Vega**, who joins the firm with a concentration in civil and public litigation.

Prior to working with BFAS, Mr. de la Vega worked with a public interest advocacy organization where he managed all phases of civil litigation. This included pre-trial motions, discovery, settlement negotiations, trials, and post-trial motions and settlement compliance.

His professional experience also includes research on the state and federal levels, advising and representing hundreds of clients in a range of civil litigation matters, and arguing in the Los Angeles Superior Court regarding discovery issues arising out of an Anti-SLAPP motion.

Mr. de la Vega has already assisted BFAS Partner, Tim Buynak, with an 11 day trial in the Superior Court of California, County of Santa Barbara where he represented aggrieved homeowners concerning a boundary dispute.

Mr. de la Vega earned his J.D. from University of San Francisco and his B.A. in Dramatic Arts from UC Berkeley. He also dabbled in professional theater and voice-over work. Currently, Mr. de la Vega and his fiancée spend much of their personal time raising their eleven-month-old daughter.

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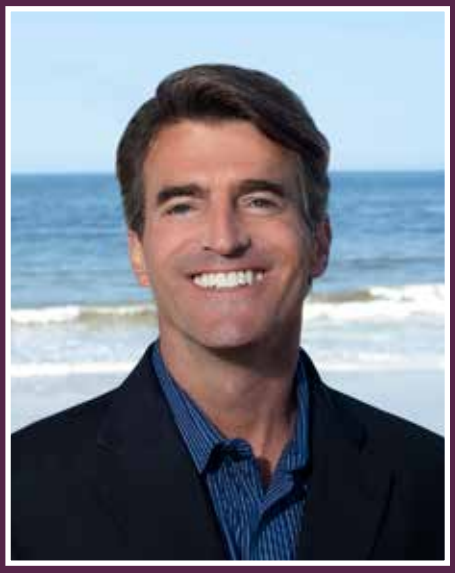

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