FROM THE CHAIR

by Elizabeth S. Stong

Business lawyers and business litigators have moved from the business section to the cover pages of newspapers, magazines, weblogs, and web-zines, and the activities of the Business and Corporate Litigation Committee reflect our profession’s response to the heightened scrutiny that has been placed on business people and their inside and outside professional advisors, including lawyers. We marked the close of 2002 with our Winter Committee Meeting on December 12 and 13, 2002, in New York City, participated actively in the ABA’s and Business Law Section’s comment process on proposed regulation of attorneys by the Securities and Exchange Commission under Section 307 of the Sarbanes-Oxley Act, and assisted the Section in arriving at positions on a range of subjects pertaining to litigation and dispute resolution that are slated to come before the House of Delegates at the ABA’s Mid-Year Meeting in February, 2003. In addition, we have planned an outstanding slate of timely programs and subcommittee meetings for the Business Law Section’s Spring Meeting on April 3-6, 2003, in Los Angeles.

Business and Corporate Litigation Committee Stand-Alone Winter Meeting - December 12-13, 2002 - New York City

The Committee achieved a near-record attendance at its stand-alone Winter Committee Meeting in New York City. Held at the Le Parker Meridien Hotel in New York City, the meeting began with a reception hosted by Willkie Farr & Gallagher.
and committee dinner on the evening of December 12, 2002. We were fortunate to be joined by many of our speakers that evening, including Chief Justice E. Norman Veasey and Justice Myron Steele of the Delaware Supreme Court and Vice Chancellor Jack B. Jacobs of the Delaware Court of Chancery. On December 13, 2002, we presented over five hours of first-rate CLE programs, including an “Early Bird Update on Bankruptcy Developments” presented by William K. Zewadski, “Ethics for Breakfast,” chaired by Anne C. Foster and Lisa K. Wager, an update on hot topics in ethics for business lawyers, including developments under the Sarbanes-Oxley Act of 2002, and “Corporate Governance Standards After Sarbanes-Oxley: More Issues than Answers?” a panel discussion and mock oral argument chaired by Peter J. Walsh, Jr. on the implications of the Sarbanes-Oxley Act for the standard of conduct of corporate officers and directors, including its impact on the definition of “intentional” conduct, the role of federal and state law in setting substantive standards for corporate governance, and the new ethical obligations imposed on lawyers. In addition to Chief Justice Veasey, Justice Steele, and Vice Chancellor Jacobs, our speakers included Vice Chancellor Leo E. Strine of the Delaware Court of Chancery and Neil MacBride, Chief Counsel to the U.S. Senate Judiciary Committee, as well as Prof. Lawrence A. Hamermesh, and Prof. Charles M. Elson, among others.

Business Law Section Spring Meeting - April 3-6, 2003 - Los Angeles

We will continue our focus on topics that are timely at the Business Law Section’s Spring Meeting on April 3-6, 2003, in Los Angeles. Our program offerings will begin on Thursday morning, April 3, 2003, when, from 9:00 AM to 11:00 AM, Jay Eisenhofer will chair a program on “Third-Party Liability in the Post-Enron Environment.” On Thursday afternoon, from 2:00 PM to 5:00 PM, we will present our annual, and ever-popular, “Review of Developments in Business and Corporate Litigation,” which will provide concise and informative updates on developments in about a dozen substantive areas that are routinely encountered by both in-house and outside business lawyers. On Friday morning, April 4, 2003, from 8:15 AM to 10:00 AM, we will present our Committee Forum, chaired by Andrew Halaby, on “Finding the Hidden IP Claims in Business Disputes.” This program promises to offer insights for both the experienced and the novice IP lawyer, and is a must-attend for transactional lawyers and litigators alike. Finally, on Saturday morning, from 8:00 AM to 10:00 AM, Abigail Pessen will chair a program co-sponsored with the Alternative Dispute Resolution Committee on “Xtreme Litigation: Asbestos Claims Test the Legal System”, which will explore the asbestos juggernaut that has spread to more than 6,000 companies and already bankrupted more than 60. Judicial, ADR, and legislative solutions to the crisis will be discussed.

Our substantive Subcommittees, from Alternative Dispute Resolution to Securities Litigation, with more than a dozen in between, will also meet at the Spring Meeting on Thursday, Friday, and Saturday, April 3 to 5, 2003. As experienced Committee members are well aware, Subcommittee meetings are where most of the program and publication ideas of the Committee originate, so if you have an idea for a program, would like to write an article (or even a book), or just want to get involved, check the schedule for these meetings, stop by, and let us hear from you! Subcommittee Chairs are listed on the Business and Corporate Litigation Committee web page at http://www.abanet.org/buslaw/bclit/home.html. Please feel free to contact any of them, or me, by e-mail before, during, or after the Spring Meeting to learn how you can become involved.

We also plan to have some fun as a Committee at the Spring Meeting, and there will be a Committee dinner, which is open to all, on Thursday, April 3, 2003, at a location to be determined but certain to be delightful. Recent venues have included Locke-Ober’s in Boston and the Old Ebbitt Grill in Washington, D.C.
Publications and Other Projects

Our Committee continues to serve as a valuable resource to the Section of Business Law, and indeed, the entire ABA, in connection with the ABA’s effort to comment on proposed rules promulgated pursuant to the Sarbanes-Oxley Act, the House of Delegates’ review of proposals with implications for business lawyers and business litigators, and other matters. In late 2002, Stephen D. Poss took the lead in our Committee’s participation in the ABA’s comments on the SEC’s proposed rules on attorney conduct pursuant to Sarbanes-Oxley Act Section 307. In addition, we presented comments to the Business Law Section Council on House of Delegates proposals concerning the adoption of a standardized citation form for legal authorities, guidelines prepared by the ABA’s Criminal Law Section on collateral administrative sanctions associated with criminal convictions, and the Civil Rights Tax Relief Act.

On the publications front, our Committee continues to be well represented in Section publications by the second annual book edition of the Annual Review of Developments in Business and Corporate Litigation, a joint effort of all of our Subcommittees and the Section Publications Board. The depth and breadth of this publication is remarkable, and at some 885 pages addressing nineteen subjects from Alternative Dispute Resolution Law to Securities Litigation, it is a splendid reference for the generalist and expert alike. If you are looking for a handy desk reference on a wide range of topics, you should definitely consider this volume for your bookshelf. One recent reviewer described the book this way:

“Like the 2001 edition, the latest volume, comprised of 885 pages, will prove useful to the generalist and the specialist alike, as well as to the litigator and non-litigator. It is a must have for any serious corporate and business law practitioner.”

New Jersey Lawyer (December 2002) at 68 (emphasis added).

Thanks are due to Heidi Staudenmaier, chair of the Publications Subcommittee, for her tireless efforts in compiling the Review of Developments, and to all of the authors, too numerous to list here, for their contributions to this work.

We look forward to seeing you in Los Angeles in April!

ABA Spring Meeting  
Section of Business Law  
Business and Corporate Litigation Committee  
April 3-6, 2003  
Los Angeles, California  
TENTATIVE SCHEDULE – SUBJECT TO CHANGE

Business and Corporate Litigation

Administrative Committees  
Friday 4/4/2003 1:00PM - 2:00PM  
Century Plaza Hotel  
Directors Dining Room, Mezzanine Level

Alternative Dispute Resolution  
Friday 4/4/2003 11:00AM - 12:00PM  
Century Plaza Hotel  
Encino Room, California Level

Antitrust and Trade Litigation  
Thursday 4/3/2003 9:00AM - 10:30AM  
Century Plaza Hotel  
Directors Dining Room, Mezzanine Level
Appellate Litigation
Thursday 4/3/2003 1:00PM - 2:00PM
Century Plaza Hotel
Directors Dining Room, Mezzanine Level

Business and Corporate Litigation
Friday 4/4/2003 8:00AM - 8:15AM
Century Plaza Hotel
Olympic II, Plaza Level

Business Courts
Thursday 4/3/2003 9:00AM - 10:00AM
Century Plaza Hotel
Governors Dining Room, Mezzanine Level

Business Torts
Thursday 4/3/2003 1:00PM - 2:00PM
Century Plaza Hotel
Governors Dining Room, Mezzanine Level

Class and Derivative Actions
Thursday 4/3/2003 9:00AM - 10:30AM
Century Plaza Hotel
Governors Boardroom, Mezzanine Level

Committee Forum: Finding the Hidden IP Claims in Business Disputes
Friday 4/4/2003 8:15AM - 10:00AM
Century Plaza Hotel
Olympic II, Plaza Level

Corporate Counseling & Litigation
Friday 4/4/2003 1:00PM - 2:00PM
Century Plaza Hotel
Encino Room, California Level

Criminal and Enforcement Litigation
Friday 4/4/2003 11:00AM - 12:00PM
Century Plaza Hotel
Directors Dining Room, Mezzanine Level

Employment Litigation
Friday 4/4/2003 4:00PM - 5:00PM
Century Plaza Hotel
Governors Dining Room, Mezzanine Level

Environmental Litigation
Saturday 4/5/2003 10:00AM - 11:00AM
Century Plaza Hotel
Governors Boardroom, Mezzanine Level

ERISA and Pension Litigation
Friday 4/4/2003 4:00PM - 5:00PM
Century Plaza Hotel
Senators Dining Room, Mezzanine Level

Indemnification & Insurance
Friday 4/4/2003 1:00PM - 2:00PM
Century Plaza Hotel
Malibu Room, California Level

Intellectual Property
Saturday 4/5/2003 10:00AM - 11:30AM
Century Plaza Hotel
Governors Boardroom, Mezzanine Level

Joint Meeting: Bankruptcy Litigation
Thursday 4/3/2003 1:00PM - 2:30PM
Century Plaza Hotel
Olympic II, Plaza Level

Partnerships & Alternative Business Entities
Friday 4/4/2003 3:30PM - 4:30PM
Century Plaza Hotel
Constellation I, Plaza Level

Pro Bono
Thursday 4/3/2003 9:00AM - 10:30AM
Century Plaza Hotel
Brentwood, California Level

Program: 2002 Review of Developments in Business and Corporate Litigation
Thursday 4/3/2003 2:00PM - 5:00PM
Century Plaza Hotel
Westside Room, Plaza Level
Every lawyer fears the unintentional disclosure of privileged documents to the opposing side. Imagine you are sitting at your computer drafting a summary of a privileged discussion. As you attach the summary to an email, a phone call interrupts you. After the phone call, you come back to your computer with the intention of sending the message to your client. You type in the email address, send the message and then realize that you just sent this privileged document to the opposing counsel instead of your client.

Now, suppose you are part of a complex, document-intensive litigation involving millions of dollars in damages. You have spent weeks reviewing documents and preparing a collection of documents to disclose to your opponent. Before you produce the box of documents pursuant to your discovery demands, your secretary innocently files a privileged document in the box. After the box is delivered to opposing counsel, your secretary mentions to you that she filed this document in the box that had been sitting by your desk earlier that morning.

Each of these scenarios represents a situation that breeds stress and anxiety in every litigator. Depending on the jurisdiction in which you practice, the above scenarios could have a serious effect on the outcome of your case.

Typically, courts addressing the issue of inadvertent disclosure of privileged documents have adopted one of three main approaches to determining whether the disclosure constitutes a waiver of privilege. The best way to avoid finding yourself in one of the above situations is to develop thorough procedures for document management. However, should you ever face a situation where an inadvertent disclosure of a privileged document occurs, it is important that you are familiar with the approach employed by your jurisdiction.¹

Resolving the Inadvertent Disclosure of Privileged Documents.

The reasoning behind finding a waiver of the attorney-client privilege is becoming clearer as the courts address the issue with increasing frequency. Typically, courts follow one of three tests to determine whether inadvertent disclosure waives the privilege. The first approach is the traditional or strict approach, which holds that an inadvertent disclosure always constitutes a waiver of privilege.² At the other...
extreme is the second approach, often referred to as the “no waiver” approach or “subjective intent test.” This approach holds that an inadvertent disclosure does not constitute a waiver of privilege without extreme negligence.3

Somewhere in between the two extremes lies the third approach, referred to as the “skeptical balancing test” or Hydraflow test.4 The skeptical balancing test gives the court discretion in determining whether the inadvertent disclosure results in a waiver. In using such discretion, the court may consider that lawyers are humans and make mistakes just like everyone else—especially during a complex and burdensome discovery process.

The Strict Approach.

Courts subscribing to the objective test emphasize the importance of creating a strong incentive for careful document management.5 Clients and attorneys are accountable for negligence in handling privileged and confidential matters.6 Under the traditional approach, any document produced, whether or not production was intentional, loses its privileged status.7 This automatic waiver applies unless the court finds that the responsible attorney took all possible precautions to prevent the disclosure.8 Adding to the harshness of this approach, once a waiver has been determined, the scope of the waiver extends to all other communications that concern the subject matter of the inadvertently produced documents.9

Many jurisdictions have declined to adopt this unforgiving test. The strict approach lacks flexibility and drastically intrudes on the attorney-client relationship. This approach discourages clients from completely confiding in their attorney for fear that an inadvertent disclosure of a privileged document will waive their privilege.10 In an effort to gain certainty of results, the purpose behind the attorney-client privilege is lost.

The landmark decision illustrating the application of the strict approach is In re Sealed Case from the District of Columbia Circuit.11 There, a company refused to disclose six privileged documents after a memo was disclosed to a Defense Contract Audit Agency (“DCAA”) auditor and a subpoena had been issued by the grand jury.12 The company claimed the disclosure to the DCAA auditor was a “bureaucratic error” and was inadvertent.13 The court said that “if a client wishes to preserve the privilege, it must treat the confidentiality of attorney-client communications like jewels—if not crown jewels.”14 The court ultimately held, albeit a harsh result, that the disclosure of a single memorandum constituted a waiver of the privilege and the scope of the waiver “extends to all other communications relating to the same subject matter.”15

The Subjective Intent Approach.

The subjective intent approach places value on the importance and sanctity of the attorney-client privilege. If an inadvertent disclosure of privileged information occurs, the privilege survives.16 Jurisdictions following this test refuse to find waiver absent a knowing and intentional relinquishment of the attorney-client privilege.17 These jurisdictions believe that finding a waiver when the client is not aware of the disclosure would serve to punish the innocent. Such a result works against the notion of protecting the client’s interests.

Notwithstanding, this lenient test receives plenty of criticism. The “no waiver” approach provides a blanket of protection to inadvertently-disclosed documents, thus leaving little incentive for attorneys to diligently review materials in advance of production.18 The test also ignores something core to the concept of the attorney-client privilege – confidentiality. Confidentiality is impossible to restore after the disclosure of the privileged documents and “under this test, the lack of confidentiality becomes meaningless so long as it occurred inadvertently.”19

In Mendenhall v. Barber-Greene Co., the court found that the client’s welfare demands that more than negligence be required for a waiver of privilege to occur.20 In that case, the attorney had failed to remove privileged documents before disclosing patent applications in a patent infringement action.21 The court found that “a communication is
The court found that negligence is not enough to waive the attorney-client privilege because the client's welfare is paramount. The Skeptical Balancing Test.

Among courts recently addressing the issue of inadvertent disclosure, the most popular approach is the skeptical balancing test. This test takes the circumstances of each case and examines them against five factors to determine whether waiver of the attorney-client privilege has occurred. The five factors are: (1) reasonableness of precautions taken to prevent inadvertent disclosure; (2) the time taken to rectify the error; (3) the scope of discovery; (4) the extent of disclosure; and (5) the overriding issues of justice and fairness.

The policy considerations behind such a balancing test include striking a fair balance between protecting the attorney-client privilege and allowing for waiver of the privilege in appropriate circumstances. By avoiding an “all-or-nothing” approach, the balancing test accounts for errors sure to occur in the context of complex litigation – even when the most diligent practices are used. The skeptical balancing approach earned its name because there are limits to how far courts should go in allowing carelessness in the disclosure of privileged documents.

The Fourth Circuit has found that a waiver through an inadvertent disclosure of privileged documents constitutes a waiver to the entire subject matter of the disclosed communication. In F.C. Cycles International v. Fila Sport, the court reached this conclusion after applying the five-factor test. The defendant admitted to the disclosure of a privileged document, but failed to seek return of the document and did not try to limit the use of the document during the remaining litigation. The court found that the defendant had made little effort to maintain the confidentiality of this document. Therefore, it was reasonable to infer that there was no intent to keep the document privileged. This lack of effort translated into a voluntary waiver, in the court's view, and the waiver applied to the entire subject matter of the disclosed document.

Ethical Concerns in Handling Inadvertently Disclosed Privileged Documents.

Whichever test is used, attorneys face the ethical question of what action to take if they receive privileged documents or communications from opposing counsel. In August of 2002, Model Rule of Professional Conduct 4.4(b) was adopted by the American Bar Association's ("ABA") House of Delegates, as proposed by the ABA Ethics 2000 Commission. This new Model Rule states that "[a] lawyer who receives a document relating to the representation of the lawyer's client and knows or reasonably should know that the document was inadvertently sent shall promptly notify the sender." The new rule only requires that the receiving attorney notify the sender; it does not require the return of the document.

The comments to new Model Rule 4.4 explain that the next step is to determine whether the disclosure has waived the privileged status of the document. The comments also note that, while a lawyer is not obligated by law to return a document unread if he or she has notice that it was sent inadvertently, the decision to do so voluntarily is a "matter of professional judgment ordinarily reserved to the lawyer." Prior to approval of new Model Rule 4.4(b), the American Bar Association had published general guidelines for the treatment of inadvertently disclosed materials in Formal Opinion 92-368. That opinion directs attorneys to review materials only to the extent necessary to determine whether the documents are privileged, and if so, to contact opposing counsel immediately to seek further direction. The parties can discuss a course of action and, if necessary, go to the court for guidance.

The California Court of Appeals followed the ABA's reasoning in a 1999 decision. There, the court denied the imposition of sanctions on an attorney refusing to return obviously privileged documents because the state had not formally
adopted a position on ethical conduct in the circumstance of inadvertent disclosure. The court then chose to formally examine the ethical issue and define the response required of California attorneys. Specifically, the court held that a lawyer who receives materials that appear to be privileged and confidential, and it is reasonably apparent that the disclosure was inadvertent, must refrain from further examining the materials and immediately contact the sender.

The State Bar of Arizona Board of Governors has approved a proposal to incorporate a modified version of ABA Model Rule 4.4(b) into the Arizona Rules of Professional Conduct. The new proposed Arizona rule goes somewhat further than the ABA rule. Specifically, new ER 4.4 provides:

(a) In representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass, delay or burden any other person, or use methods of obtaining evidence that violate the legal rights of such a person.

(b) A lawyer who receives a document and knows or reasonably should know that the document was inadvertently sent shall promptly notify the sender and preserve the status quo for a reasonable period of time in order to permit the sender to take protective measures.

The last phrase of ER 4.4 subsection (b) ["... and preserve the status quo ..."] is not included in the new ABA Model Rule 4.4.

Conclusion.

Each jurisdiction approaches the issue of inadvertent disclosure of privileged documents from a different angle. For example, Arizona's new proposed ER 4.4 specifies that when a lawyer receives an inadvertent communication, the lawyer has a duty to: (1) stop reading the document; (2) make no use of the document; and (3) immediately notify the sender so that person can take protective measures.

As technology continues to expand in use and popularity, the risk of inadvertent disclosure of privileged materials grows. Electronic mail and facsimile communication are helpful in making work quicker and easier, while also making an inadvertent disclosure a little more probable if the proper care is not used. The best course is to establish a procedure at the commencement of litigation ensuring that adequate precautions are in place governing the disclosure of documents. The more careful and thorough the procedure for producing documents, the lesser the possibility of an inadvertent disclosure.

If an inadvertent disclosure occurs, the attorney should take efforts to correct the disclosure immediately. A good record of the precautions and procedures used to prevent a disclosure is essential in establishing that a waiver did not occur. The most important thing you can do, however, is be careful, thorough and prepared before disclosing documents.

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2 In re Sealed Case, 877 F.2d 976, 980 (D.C. Cir. 1989).


5 In re Sealed, 877 F.2d at 980.

7 Id., see, e.g., FDIC v. Singh, 140 F.R.D. 252, 253 (D. Me. 1992) (applying the strict applicability rule because “[o]ne cannot ‘unring’ a bell”); Underwater Storage, Inc. v. United States Rubber Co., 314 F. Supp. 546 (D.C. Cir. 1970) (holding that once a document is produced for inspection, the confidentiality is breached and the privilege is lost).

8 Id., see, e.g., United States v. De la Jara, 973 F.2d 746, 750 (9th Cir. 1992) (“When the disclosure is involuntary, we will find the privilege preserved if the privilege holder has made efforts ‘reasonably designed’ to protect and preserve the privilege”).

9 Id. at 980-81.

10 Gray v. Bicknell, 86 F.3d 1472, 1483 (8th Cir. 1996) (stating that if inadvertent disclosure waives privilege for all related matters, then client will be hesitant to enlighten attorney).

11 877 F.2d 976 (D.C. Cir. 1989).

12 Id. at 979.

13 Id. at 980.

14 Id.

15 Id. at 980-81 (quoting In re Sealed Case, 676 F.2d 793, 809 (D.C. Cir. 1982)).

16 Mendenhall, 531 F. Supp. at 955.

17 Id. (“[W]aiver imports the intentional relinquishment or abandonment of a known right. Inadvertent production is the antithesis of that concept.”); See also, Trilogy Communications, Inc. v. Excom Realty, Inc., 652 A.2d 1273, 1276 (N.J. Super. Ct. App. Div. 1994) (“To hold that the inadvertent production of a privileged document is a waiver of the lawyer-client privilege would render nugatory [New Jersey’s] strong public policy favoring the confidentiality of lawyer-client communications embodied in statute, rules of evidence, rules of professional ethics, and case law.”); Georgetown Manor, Inc. v. Ethan Allen, Inc., 753 F. Supp. 936, 938 (S.D. Fla. 1991) (concurring with the Mendenhall court, that inadvertent production is the antithesis of intentional relinquishment); Leibel v. General Motors Corp., 646 N.W.2d 179, 186 (Mich. Ct. App. 2002) (for a valid waiver to exist there must be “an intentional, voluntary act” and therefore the privilege continues after an inadvertent disclosure).

18 Gray v. Bicknell, 86 F.3d 1472, 1483 (8th Cir. 1996).

19 Id.

20 Mendenhall, 531 F. Supp. at 955.

21 Id. at 952.

22 Id. at 955.

23 Id.


25 Gray, 86 F.3d at 1484.

26 Hydraflo, 145 F.R.D. at 637.

27 Gray, 86 F.3d at 1484.

28 Id.

29 Simon Property Group, 194 F.R.D. at 648 n.2.


31 Id.

32 Id. at 75.

33 Id. at 80.

34 MODEL RULES OF PROF’L CONDUCT R. 4.4(b) (2002).


39 Id.
The proposed comment to Arizona ER 4.4 is as follows:

[1] Responsibility to a client requires a lawyer to subordinate the interest of others to those of the client, but that responsibility does not imply that a lawyer may disregard the rights of others. It is impracticable to catalogue all such rights, but they include legal restrictions on methods of obtaining evidence from others and unwarranted intrusions into privileged relationships, such as the client-lawyer relationship.

[2] Paragraph (b) recognizes that lawyers sometimes receive documents that were mistakenly sent or produced by opposing parties or their lawyers. If a lawyer knows or reasonably should know that a document was sent inadvertently, then this Rule requires the lawyer to stop reading the document, to make no use of the document, and to promptly notify the sender in order to permit that person to take protective measures. Whether the lawyer is required to take additional steps, such as returning the original document, is a matter of law beyond the scope of these Rules, as is the question of whether the privileged status of a document has been waived. Similarly, this Rule does not address the legal duties of a lawyer who receives a document that the lawyer knows or reasonably should know may have been wrongfully obtained by the sending person. For purposes of this Rule, “document” includes e-mail or other electronic modes of transmission subject to being read or put into readable form.

[3] Some lawyers may choose to return a document unread, for example, when the lawyer learns before receiving the document that it was inadvertently sent to the wrong address. Where a lawyer is not required by applicable law to do so, the decision to voluntarily return such a document is a matter of professional judgment ordinarily reserved to the lawyer. See ERs 1.2 and 1.4.

DRAFTING TECHNOLOGY LICENSES IN A DOWN MARKET – PROTECTING LICENSES FROM THE BANKRUPTCY OR BUSINESS FAILURE OF LICENSORS

by Philip S. Warden

The following article discusses issues concerning the protection of software licenses in the event of the bankruptcy or business failure of the software licensor.

Licensor Bankruptcy Basics.

Types of Possible Licensor Bankruptcy.

Chapter 11. If a company files a petition under Chapter 11 of the Bankruptcy Code the business remains in operation, controlled by its officers as a “debtor-in-possession.” The goal of Chapter 11 is to reorganize the business and continue operating. Upon a motion of a creditor, the Court may convert a Chapter 11 case to one under Chapter 7 on the basis that the debtor-in-possession is unable or unlikely to effectuate a reorganization plan or that the business is continuing to lose its value and such losses are prejudicial to creditors. 11 U.S.C. § 1112(b)(2). Start-up corporations don’t often file under Chapter 11, as, the company has generally used its financing, and is not generating any positive cash flow. Such a company is generally not capable of proposing a feasible plan of reorganization because it has no way to cover its current and expected costs and pay its creditors. In a Chapter 11 reorganization, cash and cash flow is king.

“Liquidating 11.” This is not a formal category, but a company may file a plan under Chapter 11 to remain in control of the liquidation process. A technology license would likely be assumed and sold, if the license has prospective value, or rejected, if there is no current realizable value, or if the Debtor is unable to provide required services to support an assumed license.

Chapter 7. If a company files a petition under Chapter 7, all of the assets are transferred to the control of a trustee. Of course, this discussion
refers to corporate bankruptcies unless expressly stated otherwise. Bankruptcies filed by individuals can involve different issues that are not addressed here. "Section" refers to the Bankruptcy Code (11 U.S.C.) Except in unusual circumstances, the business will shut down immediately. (Occasionally, if the value of the business would decline significantly if it ceased operation, a trustee may obtain an order allowing the continued operation of the business. 11 U.S.C. § 721. This is the exception rather than the rule.) The trustee's primary jobs are to collect all of the assets, sell them for the highest value, determine the priority and validity of creditors' claims, and distribute the proceeds accordingly. The trustee is also responsible for investigating the financial affairs of the Debtor, and may set aside preferential or fraudulent transfers (discussed below), or certain types of liens. See 11 U.S.C. § 704 (describing duties of the trustee); 11 U.S.C. § 544 (describing trustee's Avoidance Powers).

Property of the Bankruptcy Estate. In any bankruptcy case, a new entity, the bankruptcy estate, is created upon the court granting relief to the Debtor, and all of the assets of the Debtor (with some exceptions for individuals) are transferred into the estate. 11 U.S.C. § 541. The bankruptcy estate here is referred to as the "Estate," and the bankrupt entity, whether the debtor-in-possession of a Chapter 11 or a Chapter 7 debtor is referred to as the "Debtor." The assets of a bankruptcy estate, or "Property of the Estate" is defined very broadly in section 541 of the Code. It includes, with minor exceptions, "all legal or equitable interests of the Debtor in property as of the commencement of the case." Estate property includes all of the Debtor’s contract rights, and intellectual property rights. See generally Dailey v. Smith, 684 N.E.2d 991, 993, 292 Ill. App. 3d 22, 24 (Ill. App. Ct. 1997); Matter of Plunkett, 23 B.R. 392, 393-394 (Bankr. E.D. Wis. 1982); H.R. REP. NO. 95-595, at 175-176 (1977). In bankruptcies of technology companies, particularly in Chapter 7, intellectual property rights are often the only valuable assets.

Assignment for the benefit of creditors. A common law device (the statutory assignment was repealed in California in 1980) in which the assets are "assigned" to an assignee fiduciary, who then liquidates them, and thereafter distributes the proceeds to creditors. An assignee has some of the rights of a trustee in bankruptcy, but does not have, e.g., the power to assume and assign.

Liquidation under California Corporations Code § 1800. California Corporations Code section 1800 authorizes a petition in voluntary dissolution if a sufficient number of shareholders or person authorized by the Articles of Incorporation seek liquidation.

Abandonment of business. This is a not uncommon result for many technology licensors. The business is simply closed, there is no formal liquidation, there is a "walk away." This creates a problematic situation for a licensee; some modicum of protection is available a Service Agreement and software license agreement. The Service Agreement should include at least the following (executory issues and terms:

(a) any future modifications or customizations to the software by the licensor after the initial delivery;

(b) any services to be provided by the licensor, such as installation, implementation, training, and consulting services and the costs for such services, and an agreement that such services are not part of any license;

(c) acceptance testing of the software;

(d) support of the software, with licensor to provide updates and enhancements to the software and to resolve errors on a tiered prioritization approach;

(e) licensor’s warranty obligations with regard to the software and any services provided;

(f) licensor’s indemnification obligations with respect to intellectual property or other agreed upon claims
(g) confidentiality obligations; and

(h) updating of any source code and associated documentation deposited under a technology escrow agreement.

In the event that licensee does not obtain an up-front license to the source code version of the software (as is recommended), the parties need to separately and concurrently execute a Source Code Escrow Agreement. The Source Code Escrow Agreement should include certain release conditions upon which the source code would be released to licensee. Those release conditions should include breach of either the Software License Agreement or the Services Agreement, or occurrence of a pre-defined bankruptcy event. The Services Agreement should also contain a requirement that the licensor update the deposited materials soon after the licensor releases new versions of the licensed software.

If the licensee will be also licensing any of the licensor’s trademarks, the parties should also separately and concurrently execute a trademark license agreement. Note that section 365(n) which references the Section 101(35)(A) definition of “intellectual property” does not include trademarks.

A security interest in the technology would also be useful (see discussion in Section C).

Automatic Stay.

Section 362. The automatic stay, set forth in section 362 of the Bankruptcy Code, is the core protection provided to a bankruptcy debtor. It occurs “automatically” upon the filing of a “petition for relief.” Section 362 prohibits anyone from, among other things:

- Bringing an action or continuing any suit against the Debtor that could have been brought before the bankruptcy case began;
- Taking any act to obtain possession of property of the estate or to exercise control over such property (but obtaining escrowed materials in a Source Code Escrow may be an exception, see section 365(n)(3));
- Creating, perfecting or enforcing any lien against the property of the estate; or
- Taking any action to collect or recover a claim against the Debtor that arose before the case began. This is not a complete list. If there is any question regarding a violation of the automatic stay, reference should be made to the Bankruptcy Code [hereinafter “Code”]. 11 U.S.C. § 362(a).

Violation of Stay. Generally, any act against the Debtor, including terminating a contract or license, taking assets, or otherwise taking an action adverse to a Debtor, will be a violation of the stay and should not be done without first obtaining an order from the bankruptcy court where the case was filed for relief from stay. Violations of the stay (and in particular, actions taken with knowledge of the bankruptcy) can result in serious repercussions. For example, in Computer Communications, Inc. v. Codex Corporation, 824 F.2d 725 (9th Cir. 1985), the Ninth Circuit upheld a $4,750,000 damages award against a company that terminated a contract to purchase computer equipment based on a bankruptcy-triggered clause without first obtaining relief from stay.

Relief from Stay. To obtain relief from stay, a party must either bring a motion before the court and obtain an order, or have the trustee or the debtor-in-possession sign a stipulation to an order which the bankruptcy judge must thereafter enter. In general, relief from stay will be granted for good cause shown, including the “lack of adequate protection of an interest in property” and the likelihood that no reorganization is possible, or that the asset involved is not critical to the prospects of reorganization.

Ipso Facto Clauses.

Automatic termination on bankruptcy or insolvency provisions in licenses and executory contracts and are not enforceable in a bankruptcy case against the Debtor. Section 365(e)(1) provides:

Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or
unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title; or

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

Technology licenses almost invariably contain such clauses (as does Exhibit B), but as provided in the Code, and in Computer Communications, Inc. v. Codex Corporation, supra, they do not work against Debtors.

Treatment of Licensees.

Treatment of Executory Contracts. Section 365 of the Code provides the terms under which a trustee or debtor-in-possession may assume or reject an executory contract. Generally, an executory contract is defined as one where the obligations of both the Debtor and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other. In re Robert L. Helms Const. & Devel. Co. Inc., 139 F.3d 702, 705 (9th Cir. 1998). It is well settled that a technology or software license constitutes an executory contract under section 365. See In re Select-A-Seat Corp., 625 F.2d 290 (9th Cir. 1980). Accord In re CFLC, Ins., 89 F.3d 673 (9th Cir. 1996).

Assuming an Executory Contract or License. Section 365(a) allows the trustee (or debtor-in-possession) to assume executory contracts. Subsection (b) requires that, if there has been a default in the contract, the trustee may not assume it unless the trustee cures the default or provides adequate assurance to the other party that the default will be promptly cured and the other party will be compensated for any actual financial loss resulting from the default. The trustee must also provide adequate assurance of future performance. If a licensor files Chapter 11, and seeks future royalties, it must assume the contract, assure the buyer of its future performance and continue to act as licensor. Contracts that are personal service contracts or contracts to make a loan, extend debt or debt financing or financial accommodation, or to issue a security of the debtor may not be assumed. Section 356(e). In the 9th Circuit, a non-exclusive patent license has been held to be personal and not assumable nor assignable (In re CLFC, supra).

Time to assume or reject.

Delay in assumption or rejection in Chapter 11. Often the mere delay of installation of a license can crucially impact the licensee’s business. In a Chapter 11 case, there is no specific deadline by which a Debtor must assume or reject an executory contract or license. A licensor that files Chapter 11 may simply suspend its performance while deciding what action to take. A Debtor can also enforce a contract in this interim period. Matter of Whitcomb & Keller Mortgage Co. Inc., 715 F.2d 375, 379 (7th Cir. 1983).

Motion to set a time within which the debtor may assume or reject. The Code allows the debtor to assume or reject “an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before the confirmation of a plan ....” Section 365(d)(2). A licensee can bring a motion to request the Court to set a time for the Debtor to determine to assume or reject. Such a motion is substantially stronger if the license itself states that “time is of the essence” in contract performance. See Exhibit B. If the possible insolvency of a party to a license is an issue when the license is created, the other party should insist on language that specifies the time in which the contract would be assumed or rejected. While this may not be
specifically enforced by a Bankruptcy Court, it provides support for the motion.

Delay of assumption or rejection in Chapter 7. In a Chapter 7, such a delay is generally not an issue. A Chapter 7 trustee does not operate the business, and thus will have no reason to assume a license. Rejection is automatic 60 days after a trustee is appointed. Section 365(d). The licensee then is faced with the issues of rejection and determining the status of its rights. The only reason a Chapter 7 trustee would assume would be in connection with a sale.

Rejection and Effect on Non-Debtor.

Effect of rejection when the licensor is the Debtor. Section 365(g) provides that if a contract (license) is rejected (and has not been previously assumed) it constitutes a breach of the contract as of the date immediately before the filing of the bankruptcy petition. Therefore, if a licensor rejects a license, the licensee would have no future rights in the licensed technology upon the rejection of the license. That was the state of the law until the passage of section 365(n) in 1988. Furthermore, upon rejection, the Debtor would be free to sell the licensed technology to the highest bidder. See Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985).

Operation of 365(n).

E electing to retain the license. The essence of section 365(n) is that it allows the licensee of a rejected license to retain its rights under the license so long as the licensee continues making required payments. 11 U.S.C. § 365(n)(2)(B). The Ninth Circuit has read "royalty payments" broadly to mean all of the payment obligations to the licensor. Even payments that are intended in the contract as compensation for the licensor’s future services were deemed “royalties” for this purpose. In re Prize Frize, Inc., 32 F.3d 426 (9th Cir. 1994). In a technology license this means that the non-debtor licensee could have to pay all of the development, servicing, upgrading and “de-bugging” fees to preserve a license elected to be kept in place, under section 365(n), even though the Debtor is not doing any work. Further, section 365(n) only allows the licensee to retain these rights and technology "as such rights existed immediately before the case commenced." 11 U.S.C. § 365(n)(1)(B). Thus, if the Chapter 11 licensor continues to work on the licensed technology post-petition and then rejects the contract, section 365(n), arguably, would not give the licensee rights to that post-petition work under 365(n). See Bio Safe Int'l. Inc. v. Controlled Shredders, Inc. (In re Szombathy) 1996 WL 417121 (Bankruptcy N.D. Illinois 1996). The licensee making the section 365(n) election is not allowed to offset any post-petition damages against the royalty obligation. 11 U.S.C. § 365(n)(2)(C).

Restriction on assuming licenses. Section 365(n) only applies when the Debtor is licensor. The Debtor as licensor may not be able to assume a patent license at all. Section 365(c) provides that the trustee may not assume or assign any executory contract if applicable law excuses the non-debtor to such contract from accepting performance from other than the Debtor. If non-bankruptcy law prohibits the assignment of a contract without the other party’s permission, the Debtor may not be able to assume or assign it. There is currently a split in the circuits on how this section is applied. In the Ninth, Third, Fourth, and Eleventh Circuits, the courts apply the rule in a manner that prohibits both assumption and assignment. See, e.g., In re Catapult Entertainment, Inc., 165 F.3d 747, 750 (9th Cir. 1999), cert. dismissed, 120 S. Ct. 369 (1999). (Ninth Circuit holds non-exclusive license to a patent non-assumable by the debtor-in-possession.) In other courts, a debtor may be able to assume a patent or copyright license, but not assign it to a third person. See, e.g., In re: GP Express Airlines, Inc., 200 B.R. 222, 231-33 (Bankr. D. Neb. 1996). Trademark licenses apparently are not protected because they are not within the definition of “intellectual property” as defined in the Bankruptcy Code. See 11 U.S.C. § 101 (35A). It is important to note that offset rights are waived, if the § 365(n) election is made, but recoupment rights may not be.
Effect of Rejection. Rejection “denies the right of a contracting creditor [licensee] to require the [debtor] to specifically perform the then executory portions of the contract.” Leasing Service Corp. v. First Tenn Bank, 826 F.2d 434, 436 (6th Cir. 1986). Courts have recognized that rejection “is not the equivalent of rescission.” In re Murphy, 694 F.2d 172 (8th Cir. 1982).

Source Code escrows. The bankruptcy code, section 365(n)(3) specifically contemplates escrowing the technology pre-petition, such as source code, and allows access to it post-petition. Section 365(n)(3) provides:

(3) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, then on the written request of the licensee the trustee shall—

(B) not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including such embodiment) including any right to obtain such intellectual property (or such embodiment) including any right to obtain such intellectual property (or such embodiment) from another entity.

The material escrowed can include intellectual property and upgrades and modifications. It is not clear whether relief from the automatic stay is required to access the escrowed material. The safe way to proceed is to assume that relief should be sought; in the right circumstances relief can be sought on shortened time.

Extreme measures. Assignment of the technology and license back. If a licensee has sufficient leverage, it is possible to purchase outright the software or other technology, so the licensee becomes the owner which can then license back to the former licensor.

Supporting a troubled licensor.

Reasons to advance payment or lend money to a troubled licensor. Occasionally a licensee will be willing to accelerate its payments by providing a loan to the licensor in order to try to avoid the problems created by bankruptcy. This is an opportunity to adjust terms of the license to avoid some of the concerns described. Some of the reasons a company would be willing to undertake this additional risk are:

The Cost of finding an alternative source to complete the work. Often the cost in both lost time and development if the licensor fails is far greater than any possible claim that might be made in a bankruptcy estate. This can be even more pressing if the grant of license to the buyer is conditioned on the completion of the work.

Preserving the intellectual power of the relationship. Often the parties have created an effective relationship over several months of working together, and the knowledge level and skill of the troubled company’s employees would be difficult to replace.

Taking a security interest in the IP to protect the additional risk. If the licensee has leverage such that it can get a security interest in the intellectual property to secure the Debtor’s performance under the license, such a security interest gives rise to secured claims, which should be a disincentive to any rejection.

Securing completion of the work. Traditionally, security interests are given to secure the payment of money. A licensee can also take a security interest to secure the completion of the work. California’s commercial code states that a “[s]ecurity interest’ means an interest in personal property...that secures payment or performance of an obligation.” Cal. Com. Code § 1201(36)(a) (emphasis added).

Adjusting contract terms. If the cost to the licensee resulting from the license not being implemented is greater than the initial license fees, this limit should be adjusted. The parties could also agree to a sum for liquidated damages to cover the
cost of the delay to the licensee if the project fails; these damages should then be covered by the security interest. The timing of the transfer of rights in licensed technology should also be changed to address the problems discussed above. All of these changes must be analyzed for the risks of preference and fraudulent conveyance claims in bankruptcy, and the risk of an unenforceable penalty clause. One way to address such threats is to set out in recitals to the new agreement that the loan (or acceleration of payment) is made primarily to benefit the licensor, that the licensor cannot find adequate funding elsewhere, and that without the loan the licensor is likely to fail. This will support an argument that the Debtor is making a reasonable bargain. Recitals of fact are generally persuasive evidence. “The facts recited in a written instrument are conclusively presumed to be true as between the parties thereto” Cal. Evid. Code § 622. Of course, if the licensor is in bankruptcy within 90 days of the buyer perfecting its security interest, the agreement may be set aside. 11 U.S.C. § 547.

Basic due diligence. It is essential before relying on the failing company’s promise of security to run a basic security-interest check on its assets. If the licensee is taking a security interest in copyrights, it must research the Copyright Office to determine if any security interest in a registered copyright is recorded. For most other collateral the licensee should research the Secretary of State’s office in BOTH the state of the failing company’s business AND the state of its incorporation. (Article 9 of The Uniform Commercial Code, setting forth the rules of secured transactions has been significantly modified as of July 1, 2001. It has not yet been enacted in all states, which has created some inconsistent practices.) If large lenders have pre-existing blanket liens on all the licensor’s assets, a security interest may have little value.

**Perfecting a Security Interest in IP.**

Perfecting a security interest is essential. It is essential to **perfect** a security interest to prevent a trustee in bankruptcy avoiding the security interest as a “hypothetical lien creditor” under 11 U.S.C. § 544.

**Perfecting a security interest in copyrighted material.** To perfect a security interest in a registered copyright, record the security interest with the Copyright Office. *In re Peregrine Entertainment, Ltd.*, 116 B.R. 194 (Bankr. C.D. Cal. 1990); *In re AEG Acquisition Corp.*, 127 B.R. 34 (Bankr. C.D. Cal. 1991). Because of the recent trend of cases, also record a U.C.C.-1 in the borrower’s state of operation and its state of incorporation. *See, In re Cybermetic Services, Inc.*, 252 F.3d 1039 (9th Cir. 2001). If the copyright is not registered currently the secured creditor can require that the borrower register it so that the security interest may be recorded in the Copyright Office. *In re Avalon Software Inc.*, 209 B.R. 517 (Bankr. D. Ariz. 1997). This may be impractical in a license development context, as the work is in the process of being created. Requiring registration would also raise issues about confidentiality.

**Perfecting a security interest in a patent.** To perfect a security interest in an issued patent record a U.C.C.-1 in the state of operation and the state of incorporation. *In re Cybermetic, supra*, 1058 (Ninth Circuit held that neither 35 U.S.C. § 261 of the Patent Act nor Article 9 of the U.C.C., as adopted in California, requires the holder of a security interest in a patent to record it with the PTO to perfect the interest as against a subsequent lien creditor.

**Enforcing the Security Interest.**

**Relief from stay.** A creditor of a Debtor must obtain relief from stay to foreclose on its security interest. After relief is obtained, the creditor must comply with the rules of Article 9 of the U.C.C. regarding the disposition of collateral by a creditor after default. See, e.g., Cal. Com. Code §§ 9601-27. All references to the California Commercial Code are to the revised code effective on July 1, 2001.

**Sale of collateral.** The primary tool for foreclosing on a security interest is for the creditor to sell the collateral at a public or private foreclosure. Article 9 requires specific notice of the sale. It also requires that the sale be conducted in a commercially reasonable manner. *See, e.g., Cal. Com. Code § 9610(b).* In most cases of a partly-developed
product, the creditor in a license development relationship would want to avoid a noticed public sale, as it would disclose the developing product to the public (including any competitor). Also, it would be difficult to meet the "commercial reasonableness" requirements for the sale of an incomplete license.

Taking possession and ownership in satisfaction of a claim. The revised California Commercial Code section 9620 sets out the rules for a creditor to take possession and ownership of collateral in satisfaction of the debt. In order for a creditor to acquire the collateral as only partial satisfaction of the debt, the Debtor must agree to this form of foreclosure after the default. (The Debtor cannot waive this right before.) If acquisition is in full satisfaction to the debt, the creditor must follow certain conditions including notice rules, but does not have to obtain permission of the Debtor unless the Debtor objects. In a development context, the collateral may be unfinished work-product, which is of real value only to the creditor/licensee or its competitors. By having the status of a secured creditor (assuming the claim is valid and cannot be set aside as a preference or fraudulent transfer), the creditor can foreclose on its security interest by acquiring the collateral in satisfaction of the claim, and get possession of the work without having to pay a trustee. This also prevents its exposure to competitors.

Risks in Chapter 11 or 7.

Preferences. A bankruptcy trustee is given equitable powers to promote equality of distribution among creditors. Section 544 grants the trustee the rights and powers of a creditor who extended credit to the Debtor at the time of filing the petition and received a judicial lien on all applicable property. 11 U.S.C. § 544(a). As such, the trustee may set aside prebankruptcy transfers and security interests that had not been perfected as of the petition filing date. Collier on Bankruptcy ¶ 1.03[7][a] (15th ed. 1996). Generally, the trustee may set aside certain transfers (those which stem from a prior obligation and which put the transferee in a better position than it would have been if it had been paid through the estate) of the Debtor’s interests in property made within 90 days prior to the petition. 11 U.S.C. § 547(b). A grant of a security interest in personal property is considered a “transfer” within the meaning of section 547. In re Organic Conversion Corp., 259 B.R. 350, 355 (Bankr. D. Minn. 2001). A transfer made in settlement of a prior obligation, even when the parties execute a new agreement contemporaneously with the transfer, can also be viewed as a preference. See, e.g., In re Redway Cartage Co., 84 B.R. 459, 463 (Bankr. E.D. Mich. 1988). Therefore, it is important that in any renegotiated license work out environment the licensor is not merely making unilateral concessions in exchange for a verbal agreement to advance a payment.

Fraudulent Conveyances. One of the trustee’s duties is to examine the financial condition of the Debtor. This includes examining recent transfers for overreaching or “fraudulent conveyance.” A trustee will find a fraudulent conveyance if the Debtor transferred property for less than a “reasonably equivalent value” while the Debtor was insolvent. 11 U.S.C. § 548(a)(1)(B). The trustee will scrutinize any transfer that appears to have been made to limit the assets of the estate. In re SunSport, Inc., 260 B.R. 88, 115 (Bankr. E.D. Va. 2000). Therefore, if in a renegotiated license the licensee accelerated a payment by a month or two, and received in exchange adjusted IP transfers, an increase in liability limits, a liquidation damage clause, and a security interest, a trustee might successfully argue the transfer was for less than reasonably equivalent value. Careful drafting and restraint of overreaching are necessary to defend the transaction from the trustee’s scrutiny.

Protecting Confidential Information in Licensor’s Bankruptcy.

Confidentiality Terms. While confidentiality terms are usually included in licenses often it is done by a separate Non-Disclosure Agreement (“NDA”) entered into before the license is negotiated. When a company faces severe financial difficulty, however, the scene changes. In an effort to find an investor or
a buyer, the distressed licensor may disclose its records for due diligence, and once a bankruptcy is filed, disclosure is the rule, unless protective action is taken.

Conflicting Policies. The Supreme Court has described the basic rule of disclosure as “a general right [for the public] to inspect and copy public records and documents, including judicial records and documents.” Nixon v. Warner Communications, Inc., 435 U.S. 589, 597, 98 S. Ct. 1306, 1312, 55 L. Ed. 2d 570 (1978). This policy of open inspection helps the citizen “keep a watchful eye on the workings of public agencies.” Id. at 598. In the context of the Bankruptcy Code this right to open inspection was codified in 11 U.S.C. § 107(a), reflecting “Congress’s strong desire to preserve the public’s right of access to judicial records in bankruptcy proceedings.” In re Orion Pictures Corp., 21 F.3d 24, 26 (2d Cir. 1994). In part, this Congressional directive for open access flows from the nature of the bankruptcy process which is heavily dependent on creditor participation, and which requires full financial disclosure of Debtor’s affairs. In re 50-Off Stores, Inc., 213 B.R. 646, 654 (Bankr. W.D. Tex. 1997).

In the context of bankruptcy, Congress has created an exception to this general right of inspection. Section 107(b)(1) provides that, upon request, the court shall “protect an entity with respect to a trade secret or confidential research, development, or commercial information.” 11 U.S.C. § 107(b)(1). Unlike the similar Federal Rule of Civil Procedure 26(c)(7), the movant does not have to show “good cause” for the requested protection. Therefore, while it is possible to protect confidential information in the bankruptcy context, it requires prompt action by the non-debtor.

Contract Terms and General Diligence. If insolvency is a possible risk, the Services Agreement should specifically provide that the terms are confidential to avoid disclosure to a competitor that might look to buy the licensor.

Contract terms also should require that all confidential documents be marked as such, and oral communications be followed up with a written notice of confidentiality typically pursuant to an NDA. This helps to assure clear records of confidentiality, reminds the parties to respect the confidentiality of the information, and will support a claim that the material is entitled to be protected.

In order to protect information in bankruptcy, the licensee must be able to identify the confidential information. This requires that from the beginning of a relationship, in addition to marking or otherwise being able to identify as confidential information, a licensee should maintain a record of information it has disclosed. Note that the Service Agreement should contain confidentiality provisions so as to limit the argument that the Software License Agreement.

Protective Orders and Other Actions in Bankruptcy by a Licensee. Immediately upon learning of the other party’s bankruptcy, the licensee should inform Debtor’s counsel of the nature of the licensee’s confidential information and request cooperation in protecting it. If Debtor’s counsel is less than cooperative, or if the information is particularly sensitive, the licensee should obtain a protective order from the court under section 107, as described above. The order may protect “trade secrets” or “confidential research, development or commercial information.” The information does not have to be a trade secret to be entitled to be protected, but the claiming party does have to be able to establish that it is confidential. In re Orion Pictures Corp., 21 F.3d 24, 27 (2d Cir. 1994); In re Handy Andy Home Improvement Centers Inc., 199 B.R. 376 (Bankr. N.D. Ill. 1996).

Usually a Bankruptcy Court will respect well-documented diligent requests for a protective order. Judges have little patience, however, for poorly documented, last-minute requests for protection or inspection. This is particularly true when the resulting delay will create an expense for the estate.

Prompt action is particularly important when a company files Chapter 7. The trustee must vacate leased premises to avoid incurring rental obligations
and will generally only retain documents and data that have some foreseeable value to the estate. (A trustee will occasionally serve a “Notice of Proposed Abandonment of Property and Records” to announce the intended disposal of records.) The trustee will also sell computers “as is,” including all the data that may be stored on their drives. A trustee will usually agree to a reasonable request to recover confidential information if the party can establish it is entitled to it (and offers to pay the cost of such recovery).

In addition to obtaining a protective order, the licensee may attend the Meeting of Creditors, held under 11 U.S.C. § 341, to inquire if the licensor is complying with the terms of the protective order. The licensee should also file a Request for Special Notice with the Court and serve it on the Debtor and the Debtor’s service list, so that it is informed of the status of the case.

Philip S. Warden is a partner at Pillsbury Winthrop, LLP in San Francisco. This article was part of a presentation by Mr. Warden at the 8th Annual Institute for Intellectual Property Law. As a part of his presentation, Mr. Warden provided examples of a Service Agreement, Software License Agreement and Source Code Escrow Agreement, each of which is designed to address the issues raised in the article. Due to the format of the Network, these documents were not included with the article. They, however, can be obtained from Mr. Warden, who can be reached by phone at (415) 983-7260, or by e-mail at warden-ps@pillsburywinthrop.com.

"THE FIRST THING WE DO …"

by Elizabeth S. Stong

In preparing to write this quarter’s Letter from the Chair, your chair considered the importance of the intertwined topics of ethics and professionalism, and that often-quoted line from Shakespeare, “The first thing we do, let’s kill all the lawyers … “ On tee-shirts and coffee mugs, it has been offered for years as a criticism of lawyers, and a not-too-gentle suggestion that maybe the world would be better off without us. More recently, it has been suggested by speakers and writers, including bar association columnists, that in fact, Shakespeare was praising lawyers, and that the quote, in full, stated in substance that for if a society wished to live in a world of tyranny, where individual rights could not be protected, then, “the first thing we do, let’s kill all the lawyers …”

Eager to identify the source of this second, much more attractive, interpretation, your chair tracked down the citation, pulled a copy of Henry VI Part II from the shelf, and saw the following at Act IV, Scene Two. The quote appears in a scene with Jack Cade, “a rebel,” and two followers of Cade, Smith “the weaver,” and Dick “the butcher.”

Smith: [Aside] He need not fear the sword; for his coat is of proof.
Dick: [Aside] But methinks he should stand in fear of fire, being burnt i’ the hand for stealing of sheep.
Cade: Be brave, then; for your captain is brave, and vows reformation. There shall be in England seven halfpenny loaves sold for a penny: the three-hooped pot; shall have ten hoops and I will make it felony to drink small beer: all the realm shall be in common; and in Cheapside shall my palfrey go to grass: and when I am king, as king I will be,--
All: God save your majesty!
Cade: I thank you, good people: there shall be no money; all shall eat and drink on my score; and I will apparel them all in one livery, that they may agree like brothers and worship me their lord.
Dick: The first thing we do, let’s kill all the lawyers.
Cade: Nay, that I mean to do. Is not this a lamentable thing, that of the skin of an innocent lamb should be made parchment? that parchment, being scribbled o’er, should undo a man? Some say the bee stings: but I say, ’tis the bee’s wax; for I did but seal once to a thing, and I was never mine own man since. How now! who’s there?

Several meanings to this complex text are suggested by commentators. Inquiries via e-mail to several learned colleagues led to two professors, who offered their thoughts on the passage and suggest that neither the tee-shirt and coffee-mug anti-lawyer analysis, nor the legal profession’s pro-lawyer interpretation, captures all of the Bard’s intent. Prof. Dennis Reid of Vassar College observed:

“It seems to me … that Cade is using the same form of speech given to Falstaff in the tavern scene with Hal, in Henry IV Part 1, in which Falstaff proclaims what he would do if he were a more powerful man. The intent is to kill the lawyers as the comment about beeswax is that its sting lasts longer as it seals proclamations, the word of the law. Also it reads that the lawyer is the element separating the serf from the aristocracy, so … Shakespeare is arguing that the lawyers are protecting the oppressed. … More than chronicling a ‘history,’ Shakespeare was commenting on the present.

“Cade wants to become a member of the ruling class and he will do whatever he wants to circumvent the rules that are stopping him from his goal, which means skirting the laws of the land. This is anarchy -- Shakespeare wasn’t an anarchist. …

“Cade is a tyrant; therefore he is without ethics, and has no moral compass. So Shakespeare is arguing that we should not kill all the lawyers. Now the ambiguity comes because the people in the pit -- the rabble -- watching the play would cheer at this because they would identify with Cade. This is where Shakespeare’s power comes through. Once they start to see what Cade is really like, and what happens to him, then they will have reason to pause.”

Prof. Ira Bloomgarden of John Jay College of Criminal Justice, part of the City University of New York, commented:

“As always with Shakespeare there is ambiguity. Shakespeare, as all middle class and above Englishmen feared and detested the lower classes -- this scene involves Jack Cade’s Rebellion, an eruption of the peasantry. Jack and his gang are bad guys, as far as Shakespeare is concerned; a bunch of low lifes who ‘don’t know their place.’ Therefore, their cry for the heads of the legal profession could be interpreted as a defense of lawyers, since obviously what the bad guys hate must be good, right?

“Unfortunately, not quite. Shakespeare villains often have truth at least partially on their side -- they are not simple ‘black hats,’ so the argument that the rabble have this aim doesn’t necessarily mean that lawyers are the lifeblood of the nation. (Pause for several minutes of bitter laughter).

“One could also interpret this as an explanation of why the masses are rebelling -- they’ve been skinned by the parchment of legal documents that deprive them of what little they have.

“Henry VI plays are about the breakdown of English society after the untimely death of Henry V. Part of that breakdown is surely a peasant revolt, but another cause, in Shakespeare’s view, could be the loss of ethics among lawyers who, instead of pursuing justice, are corrupted to take advantage of the poor.
“Clearly Shakespeare doesn’t like lawyers as much as he likes legitimate kings, dashing adventurers, intelligent comedians, smart women, and tough, loyal soldiers.

“So there are varying ways to read this.”

Varying ways, indeed! At a minimum, the next time you see a tee-shirt or coffee mug that says, “The first thing we do, let’s kill all the lawyers …,” remember that one of the points Shakespeare may have had in mind was that when lawyers lose sight of their mission to pursue justice, they do so at their peril.

Elizabeth S. Stong is a partner with Willkie Farr & Gallagher in New York.

SUBCOMMITTEE REPORTS

ALTERNATIVE DISPUTE RESOLUTION SUBCOMMITTEE

by Michael J. Crane

Asbestos-related litigation is a fixture on many judicial dockets throughout the country. It presents significant judicial and business challenges that are not abating with time. Along with the Business Law Section’s ADR Committee, our subcommittee will be co-sponsoring what promises to be an interesting program at the Spring Meeting in Los Angeles. The program is titled, “Xtreme Litigation: Asbestos Claims Test the Legal System.” It will address the expanding world of asbestos-related litigation that has involved over 6,000 companies and brought about several dozen bankruptcy filings. A panel, moderated by our sub-committee’s vice chair Abigail Pessen, will address the possible ADR, judicial and legislative solutions to this problem. The program will take place on Saturday, April 5, from 8:00 AM to 10:00 AM and we hope that you will attend what will be an interesting discussion.

BANKRUPTCY LITIGATION SUBCOMMITTEE

by William K. Zewadski and Philip S. Warden

On behalf of the Bankruptcy Litigation Committee, Bill Zewadski gave an "Early Bird Bankruptcy Update" Report to the New York meeting of the full committee December 13, 2002. He highlighted the astonishing new records of bankruptcy filings, and the Third Circuit Cybergenics decision of November 18, 2002, vacating the panel opinion pending hearing en banc which questioned whether a creditors’ committee could bring fraudulent transfer claims. He then made fearless predictions about the coming year in bankruptcy, with even higher numbers of filings of bankruptcy cases, the possible passage of a modified version of the long-proposed bankruptcy legislation along the lines of the Conference Committee report (without the abortion language), and likely new decisional bombshells from the Supreme Court.

The next program of the Subcommittee will be at the Los Angeles Spring Meeting, at 1 PM Thursday, April 3, 2003, and anyone wanting to participate or just to join the committee, should write Bill Zewadski, z@trenam.com, or call (813) 227-7484. We hope to see you all then.

INDEMNIFICATION AND INSURANCE SUBCOMMITTEE

by William D. Johnson

During the upcoming Business Law Section Spring Meeting in Los Angeles, members of the Indemnification and Insurance Subcommittee will participate as authors and panelists in connection with the annual "Review of Developments in Business
and Corporate Litigation" program. The (always-popular) program will take place on Thursday, April 3, from 2:00 p.m. to 5:00 p.m.

Also during the Spring Meeting, members of the Subcommittee will again meet jointly with members of the Corporate Counseling and Litigation Subcommittee. The joint meeting will take place on Friday, April 4, from 1:00 p.m. to 2:00 p.m. As before, we will share with one another case law, legislative, rule-making, and "practice pointer" updates, and we will discuss the current state of the D&O market. Please join us!

The Indemnification and Insurance Subcommittee always welcomes new members. If you have any questions, please contact subcommittee chair Bill Johnston at wjohnston@ycst.com or subcommittee vice chair Mike Gassman at michael.gassman@dbr.com.

PUBLICATIONS SUBCOMMITTEE

by Heidi M. Staudenmaier

The Publications Subcommittee is busy at work on the 2003 edition of "Annual Review of Developments in Business and Corporate Litigation". This publication will be based on the seminar materials developed for the Committee’s traditional program at the Section's Spring Meeting which entails a comprehensive update of business litigation issues.


The 2003 Annual Review will represent the third year for the publication. Although the 2003 chapters are already in progress, if anyone would like to become involved in the effort for 2004, please let me know.

ANNUAL REVIEW OF DEVELOPMENTS IN BUSINESS AND CORPORATE LITIGATION

The 2002 Edition of a time-saving Guide summarizing legal developments on Business and Corporate Litigation issues is available. By the Committee, the Annual Review of Developments, brings together thorough summaries of recent cases, legislation, trends and developments in business litigation topics. Experts with in-depth litigation experiences address key concerns such as What issues did the Supreme Court address in deciding a key securities arbitration case last year?; and What are the latest developments in intellectual property law? New topics addressed in the 2002 Edition include Antitrust Litigation, Criminal and Enforcement Litigation, ERISA, and Securities Arbitration. This reference will keep you current with annual updates.

A necessary reference for every business litigator.

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* Intellectual Property Law
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* Table of Cases

To order this publication, click http://www.abanet.org/buslaw/catalog/r5070397.html or call (800)-285-2221. 2002, 7 x 10, 904 pages, Paperback. $99.95 (Section member price); $119.95 (Regular price); Product Code: 5070397.

Overnight delivery is available for an additional cost when orders are placed before 2:00 p.m. Central Time. Please ask the service representative for details when you place your order.

**AUTHOR! AUTHOR! – “BUSINESS LAW TODAY” ARTICLES REQUEST**

*by Francis G.X. Pileggi*

“Business Law Today” is the national magazine of the Section of Business Law of the American Bar Association. The magazine is published six times a year as a membership benefit for approximately 60,000 Section members. “Business Law Today” is a magazine, not a law review. We are looking for articles that are enjoyable to read. We publish basic articles directed to business lawyers unfamiliar with a substantive area as well as articles on technical legal issues, but the presentation should be direct and comprehensible.

Articles run around 2,000 to 3,000 words. Manuscripts must not have been published previously. However, seminar materials that have been revamped into simple, readable articles are acceptable. Additionally, any articles previously published in an ABA newsletter (such as Network) or firm newsletters are acceptable. The complete author guidelines are available through the Business Law Section's Website, www.abanet.org/buslaw/blt-guidelines.html, or Heidi M. Staudenmaier directly at “Business Law Today,” Editor-in-Chief, Snell & Wilmer, Phoenix, (602) 382-6366, hstaudenmaier@swlaw.com.
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I, ____________________________________________, hereby apply for membership in the ABA Section of Business Law (formerly Section of Corporation, Banking and Business Law) and enclose $45.00 as my annual membership dues for the year 2002-2003. I understand that Section dues include $20 for a basic subscription to The Business Lawyer for 1 year and $14 for a basic subscription to Business Law Today for 1 year; these subscription charges are not deductible from the dues, and additional subscriptions are not available at these rates.

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