STATE BAR OF MICHIGAN
BLS
BUSINESS LAW SECTION

The Michigan Business Law JOURNAL

Volume XXII
Issue 2
Summer 2002

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Published by THE BUSINESS LAW SECTION, State Bar of Michigan

The editorial staff of the *Michigan Business Law Journal* welcomes suggested topics of general interest to the Section members, which may be the subject of future articles. Proposed topics may be submitted through the Publications Director, Robert T. Wilson, The Michigan Business Law Journal, 150 W. Jefferson, Suite 900, Detroit, Michigan 48226-4430, 248-258-1616, or through Daniel D. Kopka, Senior Publications Attorney, Institute of Continuing Legal Education, 1020 Greene Street, Ann Arbor, Michigan, 48109-1444, 734-936-3432.

MISSION STATEMENT

The mission of the Business Law Section is to foster the highest quality of professionalism and practice in business law and enhance the legislative and regulatory environment for conducting business in Michigan.

To fulfill this mission, the Section (a) provides a forum to facilitate service and commitment and to promote ethical conduct and collegiality within the practice; (b) expands the resources of business lawyers by providing educational, networking, and mentoring opportunities; and (c) reviews and promotes improvements to business legislation and regulations.

The *Michigan Business Law Journal* (ISSN 0899-9651) is published three times per year by the Business Law Section, State Bar of Michigan, 150 W. Jefferson, Suite 900, Detroit, Michigan.
Postmaster: Send address changes to Twila Willard, State Bar of Michigan, 306 Townsend Street, Lansing, Michigan 48933-2083.

BUSINESS LAW SECTION

STATE BAR OF MICHIGAN

July 2002

Dear Business Law Section Members:

Once again, it is with a sense of great pride that we distribute this issue of *The Michigan Business Law Journal*. This publication contains extremely well written materials of importance to business law practitioners. We are, as always, grateful for the dedication of the authors, and for the continued top level work of Robert Wilson, our Section's Director of Publications, and our partner in the publication, ICLE.

I would also like to take this opportunity to announce an exciting new program--The Business Boot Camp--which is cosponsored by the Business Law Section and Young Lawyers Section of the State Bar. This exciting program, organized by ICLE, is designed to provide some "basic training" for newer business attorneys, and will feature practical nuts and bolts advice taught by experts. Information on this new endeavor can be found on ICLE's website at www.icle.org/products/seminar. This is an opportunity that should not be missed!

The Business Law Section offers significant benefits to its members, this *Journal* being but one. One important goal of the Section is to broaden active participation by business lawyers from all geographic areas of Michigan. If you are a Section member but have not yet become active in Section work, any of the Section's officers would love to have a chance to discuss how you could actively participate in building the best bar organization possible to support Michigan's business practitioners. We would like to extend a special invitation to younger members of the bar, who might not be aware of the opportunities available to them. We have a number of active Committees always looking for "new blood." Participation in Section activities can be very rewarding, both professionally and personally.

We look forward to seeing as many of you as possible at our Annual Meeting in September. And invite a friend or colleague with you!

Respectfully,

Tracy T. Larsen
Chairman, Business Law Section

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DID YOU KNOW? by Eric I. Lark & Kevin T. Block

Recent Amendments to the Michigan Mold Lien Act

Introduction

Public Act 17 of 2002, effective March 1, 2002, provides moldbuilders with a lien for the amount owed them for the fabrication, repair, or modification of dies, molds, or forms. This Public Act (hereinafter the Amendment) revises and supplements the existing Michigan mold and die lien law codified at MCL 445.611 et seq. (the Act). Legislative history reveals that the Amendment was adopted to address complaints by moldbuilders that the prior law did not sufficiently protect their interest in molds they fabricated when the molders or customers to whom they sold failed to pay their bills, filed bankruptcy, or otherwise became defunct.[1]

Parties Impacted by the Amendment

Based on the Amendment's definitional standards, it will impact numerous parties involved in the manufacture and use of molds, dies, and forms in the fabrication of plastic parts. The Amendment adds the term *moldbuilder*, defined as "a person who fabricates, casts, or otherwise makes, repairs, or modifies a die, mold, or form for use in the manufacture, assembly, or fabrication of plastic parts."[2] The definition of *customer* under the Act was not revised and continues to include "a person who causes a molder to use a die, mold, or form to manufacture, assemble, or fabricate a plastic product."[3] The Act likewise continues to define a *molder* as "a person who uses a die, mold, or form to manufacture, assemble, or fabricate plastic parts."[4]

Applying the Act's definitions, in the typical transaction the moldbuilder will fabricate the mold and then sell it to the molder (who often is a supplier to an original equipment manufacturer). The customer is usually an original equipment manufacturer who ultimately takes title to the mold from its supplier after parts have been produced by the mold and are tested to verify compliance with appropriate standards. It is the molder, however, and not the customer, who typically retains possession of the molds.

Shortcomings of the Mold Lien Act Prior to Amendment

The Amendment addresses two shortfalls of the former Act. First, the lien was formerly dependent upon possession.[5] From the moldbuilder's standpoint, this was problematic because the moldbuilder does not, in the normal course of business, retain possession of the molds it fabricates or works on. The moldbuilder typically delivers the molds to the molder. Second, there was some ambiguity in the Act as to whether a moldbuilder even had the *right* to assert a lien. While the former definition of *molder* under the Act included a person who made the mold, the lien was based on the amount the customer owed the molder for *plastic fabrication* work performed with the mold.[6] The ambiguity arose because, despite being included in the former definition of molder, the moldbuilder does not typically perform plastic fabrication work with the mold and therefore, at least on the face of the Act, was not able to assert a lien on the mold.[7]

> *Under the amended Act, the moldbuilder's lien attaches when the molder or customer receives actual or constructive notice of the lien.*

Mechanics of the Moldbuilder's Lien

To establish its lien under the Act as amended, the moldbuilder must do two things. First, the moldbuilder must permanently (through a placard or the like) record its name, street address, city, and state on the mold that it fabricates, repairs, or modifies. Second, it must file a financing statement with the Secretary of State.[8] While the Act does not specify what information must be included in the financing statement, an analogy can be made to lessors who file informational financing statements with respect to leased goods.

Under the amended Act, the moldbuilder's lien attaches when the molder or customer receives actual or constructive notice of the lien.[9] Section 9(3) of the Act now provides that actual and constructive notice of the moldbuilder's lien occurs when the required information is recorded on the mold and the moldbuilder files its financing statement.

The moldbuilder's lien remains valid until the earlier of (1) payment to the moldbuilder of the amount owed by the customer or molder, (2) termination of the financing statement, or (3) the customer's receipt of a "verified statement" from the molder that the molder has paid the amount for which the lien is claimed.[10] While the first two methods by which a moldbuilder's lien is terminated are logical, the third method, pursuant to which a "verified statement" is delivered, is troubling. First, it is unclear what purpose a verified statement serves in this context; had the molder paid the moldbuilder for the mold, the moldbuilder's lien would already be extinguished. Moreover, it is unusual for a party against whom a lien is placed to be able to unilaterally discharge the lien.[11] The Amendment's drafters may have inserted this provision to protect customers of the molders on the basis that the customers are good-faith purchasers in the ordinary course of business.

Enforcement of the Moldbuilder's Lien

Section 10 of the amended Act requires that a moldbuilder seeking to enforce a lien give written notice to the customer and the molder indicating that a lien is claimed, providing the amount the moldbuilder is owed,

and making a demand for payment. If the moldbuilder does not receive payment within 90 days of delivering the notice to the customer and the molder, the moldbuilder has the right to possess the mold and may enforce the right to possession by judgment, foreclosure, or any available judicial procedure. Section 10a allows the moldbuilder to also take possession of the mold, provided it can be done without a breach of the peace, and thereafter sell the mold (die or form) in a public auction. Before selling the mold, the moldbuilder must give the customer, molder, and other parties with a security interest in the mold 60 days notice of the sale together with other relevant information relating to the mold and sale.

Priority

Section 9(6) of the Act, as amended, provides that the "priority of a lien created under this act on the same die, mold, or form shall be determined by the time the lien attaches. The first lien to attach shall have priority over liens that attach subsequent to the first lien." This section makes it clear that between two competing moldbuilders' liens, the first to attach prevails. However, this section raises the issue of whether a moldbuilder's lien or a previously perfected security interest covering the mold as collateral would have priority.

In a companion Act, the Michigan legislature amended MCL 440.9201, which in part provides that transactions within Article 9 are subject to any applicable rule of law that establishes a different rule. The Act, as amended, is now included in the list of laws that establish a different rule. MCL 440.9201 further provides that in the case of a conflict between Article 9 and a rule of law, statute, or regulation, it is the rule of law, statute, or regulation that controls. While one could argue that because the Act "controls," the moldbuilder's lien has priority; the *priority* determination is not plain on the face of the Act or Article 9. Furthermore, if priority was established by MCL 440.9201, it would render redundant MCL 440.9333, which establishes priority (over Article 9 security interests) for liens created by law that are dependent on possession (the liens based on possession are already listed in 440.9201). Before the Amendment, a lien under the Act was dependent on possession and thus would have had priority pursuant to MCL 440.9333. Now, under the Act as amended, the moldbuilder's lien is not dependent on possession; thus MCL 440.9333 no longer applies and the priority of the lien is unclear.

To avoid a priority conflict with a competing Article 9 creditor, the moldbuilder, in addition to establishing a lien, may want to consider obtaining a purchase money security interest in the molds. The purchase money security interest should protect the moldbuilder from competing creditors. Likewise, the moldbuilder's lien should protect against the customers who could be buyers in the ordinary course and therefore take the molds free of an Article 9 security interest.

Conclusion

The recent Amendment to the Act provides additional protection to the moldbuilder not formerly available due to the possession requirement. Beyond creating a lien and the right to repossess the mold, the Amendment allows the moldbuilder to be a secured creditor in bankruptcy and to use the mold as collateral for its own borrowings, regardless of physical possession of the mold. However, a moldbuilder's lien appears to be subject to two potential shortfalls: first, the molder can potentially unilaterally discharge the lien by delivering a verified statement to the customer; and second, the Amendment fails to clearly establish priority between a moldbuilder asserting a lien and a competing Article 9 security interest.

NOTES

1. House Legislative Analysis, HB 4812, November 27, 2001.
2. 2002 PA 17, §1(b).
3. MCL 445.611(a).
4. MCL 445.611(b).
5. MCL 445.618.
6. MCL 445.618.
7. Some parties successfully argued that when the entire Act was read together, including §445.618(a), which provided that "notice [of the lien] shall state that the lien is claimed for the amount due for plastic fabrication work *or for making or improving the die, mold, or form. . . .*" (emphasis added), the Act also provided moldbuilders with a lien.
8. 2002 PA 17, §9.
9. 2002 PA 17, §9(4).
10. 2002 PA 17, §9(5).
11. The practitioner may consider requiring the molder to give a representation that it will not provide such a verified statement unless the verified statement is acknowledged by the moldbuilder. This mechanism, however, may provide little comfort if the molder is willing to provide a false verified statement.

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TAX MATTERS by Paul L. B. McKenney

Whose House Is It Anyway?

Introduction

Since the 1983 decision of the U.S. Supreme Court in *United States* v *Rodgers*, 461 US 677 (1983), a number of questions have arisen concerning the fate of Michigan real property held as tenancy by the entireties when only one of the two spouses is indebted to the Internal Revenue Service. On April 17, 2002, the day after the federal form 1040 for Michigan filers was due, the U. S. Supreme Court answered some of these questions. Taken as a whole, the taxpayer is now in a far more tenuous position than before the Court's decision in *United States* v *Craft*, No 00-1831, 2002 US Lexis 2790 (Apr 17, 2002).

The U.S. Supreme Court's Review of Michigan Property Law

The facts in *Craft* were garden variety—we have all seen similar stories on numerous occasions. One spouse, here the husband, was indebted to the IRS. However, the wife was not liable. Mr. Craft owed income taxes; in other cases, large federal tax debts commonly arise from unpaid employment taxes assessed against a "responsible person" of a failed business. The IRS filed a federal tax lien and a question arose regarding the Crafts' residence. Like 99 percent of all Michigan couples, their home was owned as tenancy by the entireties, a medieval form of ownership adopted by the Michigan Supreme Court in the nineteenth century. It was Michigan hornbook law that a creditor of one spouse could not attack tenancy by the entireties property. Since the U.S. Supreme Court's 1983 *Rodgers* opinion involving Texas community property, there have been serious questions whether this theory was still valid in tenancy by the entirety jurisdictions.

After the federal tax lien was filed, Mr. Craft executed a quitclaim deed purporting to convey his interest in the property to his wife for $1. A few years later, the Crafts sought to sell the house. The buyer and, more importantly, the buyer's lender and the title company required a release of the IRS lien against just Mr. Craft. A deal was cut whereby Mrs. Craft received one-half of the equity and the balance was held in escrow pending a judicial resolution of the federal tax lien matter. The U.S. Supreme Court, after two centuries of deference to state property law, held that the federal tax lien statute, IRC 6321, reached the husband's rights in entireties property:

> We conclude that the husband's rights in the entireties property fall within this broad statutory language. Michigan law grants a tenant by the entirety some of the most essential property rights: the right to use the property, to receive income produced by it, and to exclude others from it . . . . These rights alone may be sufficient to subject the husband's interest in the entireties property to the federal tax lien.[1]

Taken as a whole, the taxpayer is now in a far more tenuous position than before the Court's decision.

How does one value these rights? The Supreme Court remanded the case to the Sixth Circuit Court of Appeals for determination. Three justices dissented.

What Does *Craft* Mean to Your Clients?

The IRS has informally indicated that in a situation where only one spouse is liable and there is tenancy by the entireties property, it will seek 50% of the equity if the ages of the spouses are relatively equal. Age is important because there is an automatic survivorship feature with tenancy by the entireties property. For example, for a June/December marriage with a resultant great disparity in ages, the actuarial interest of the younger spouse would be more valuable. It should be noted that years ago the IRS adopted gender-neutral actuarial tables that increased the percentage interest of the male and decreased that of the female—the prior tables had generally assumed about a four-year-longer life span for women.

Common Hypotheticals

- Example 1: The client is in the entireties home, only one spouse is liable to the IRS, and a federal tax lien is filed. Hopefully the clients enjoy and can afford the residence because, if and when they sell it, in addition to the usual participants at the closing, a representative of the IRS Collection Division will also be there with a release to be exchanged for certified funds. Otherwise, the house is, as a practical matter, unsaleable.

- Example 2: One spouse is liable, the house is owned as a tenancy by the entireties, and no lien has been filed yet. The operative word here is "yet." Post-*Craft*, the government has informally indicated that it will no longer refrain from filing federal liens in such situations. It will then, in most cases, simply wait for the couple to sell the house, at which point the title company effectively becomes the de facto assistant to the Collection Division.

- Example 3: Will the IRS "levy" on a house owned as a tenancy by the entireties where only one spouse has federal tax liabilities? "Levy" is the polite tax term for "foreclose and kick them out." The answer to this question has not yet been administratively determined by the IRS. There are certainly some political and practical problems with adopting that policy. However, the U.S. Supreme Court in *Rodgers* allowed a levy and the nonliable spouse was

therefore uprooted. The nonliable spouse's "complete compensation" for her losing the house was her actuarial interest in the property. As Justice Brennan, author of the majority *Rodgers* opinion noted, "we are not blind to the fact that in practical terms financial compensation may not always be a completely adequate substitute for a roof over one's head."[2] The Court limited its ruling, noting that the levy authority in IRC 7403 "does not require a district court to authorize a forced sale under absolutely all circumstances. Some limited room is left in the statute for the exercise of reasoned discretion."[3]

Justices Rehnquist, O'Connor, and Stevens were among the *Rodgers* dissenters. Justice O'Connor wrote the majority opinion in *Craft* in which Chief Justice Rehnquist joined and Justice Stevens dissented together with Justices Scalia and Thomas.

NOTES

1. *United States v Craft*, No 00-1831, 2002 US Lexis 2790, *18 (Apr 17, 2002).
2. *United States v Rodgers*, 461 US 677, 703 (1983).
3. *Id.* at *HN23.

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 by Michael S. Khoury & Jeremy D. Bisdorf

Anatomy of Cybersquatting and Domain Name Trademark Actions

Introduction

This column will address two recent cases involving cybersquatting actions under the federal statutes that allow trademark holders to recover a domain name from another person who registered the name that uses the mark. The article will also discuss some strategic considerations in bringing or defending such an action.

Having a recognizable or easy-to-remember Internet address can be a valuable business asset. For a business that has established goodwill in a recognizable trademark, the first choice for a URL address is frequently *http://www.inserttrademarkhere.com*. Unfortunately for some trademark holders, someone else may have already registered this domain name or any variety of common misspellings of the trademark. The purposes may be completely innocent but may also be an attempt to get the attention of a potential customer of a competitor or to entice others who may want to access the trademark owner's site. These entities, or others registering a domain name to try to sell the domain name to the trademark owner for some inflated price, are easy targets for actions under the Anticybersquatting Consumer Protection Act (ACPA).[1] That is the subject of the first case. The second case is a pure trademark case involving domain names.

The ACPA

The ACPA requires a plaintiff to prove three elements to be successful in a "cybersquatting" action:

(1) that the defendant has registered, trafficked in, or used a domain name;
(2) that the domain name is identical or confusingly similar to the mark of the plaintiff (if the mark is famous, then "or dilutive of" is also added to this element); and
(3) that the defendant had a bad faith intent to profit from the use of the domain name.[2]

Whether or not a defendant has registered or trafficked in a domain name can usually be proven without much difficulty.[3] Similarly, whether the domain name is "confusingly similar" to the plaintiff's mark can be determined by using trademark legal standards that have been established through prior case law. However, interpreting what is meant by "bad faith intent to profit" is not a simple task.

The ACPA lists nine nonexhaustive factors that may be considered when determining whether "bad faith intent to profit" exists. These factors are:

(1) the trademark or other intellectual property rights of the plaintiff in the domain name;
(2) the extent to which the domain name consists of the legal name of the defendant or a name that is otherwise commonly used to identify the defendant;
(3) the defendant's prior use, if any, of the domain name in connection with the bona fide offering of any goods or services;
(4) the defendant's bona fide noncommercial or fair use of the mark in a site accessible under the domain name;
(5) the defendant's intent to divert consumers from the plaintiff's online location to a site accessible under the domain name that could harm the goodwill represented by the mark, either for commercial gain or with the intent to tarnish or disparage the mark, by creating a likelihood of confusion as to the source, sponsorship, affiliation, or endorsement of the site;
(6) the defendant's offer to transfer, sell, or otherwise assign the domain name to the plaintiff or any third party for financial gain without having used, or having an intent to use, the domain name in the bona fide offering of any goods or services, or the defendant's prior conduct indicating a pattern of such conduct;
(7) the defendant's provision of material and misleading false contact information when applying for the registration of the domain name, the defendant's intentional failure to maintain accurate contact information, or the defendant's prior conduct indicating a pattern of such conduct;
(8) the defendant's registration or acquisition of multiple domain names which the person knows are identical or confusingly similar to marks of others that are distinctive at the time of registration of such domain names, or dilutive of famous marks of others that are famous at the time of registration of such domain names, without regard to the goods or services of the parties; and
(9) the extent to which the mark is distinctive or famous.[4]

The first four factors can indicate that the defendant had some rights to use the name independent from the plaintiff and did not have a bad faith intent to profit from the plaintiff's mark. The remaining factors may reveal a bad faith intent to profit. As the list is nonexhaustive, a court is free to hear additional evidence from both the plaintiff and the defendant that could show the presence or absence of a bad faith intent to profit. A defendant can also avoid liability by convincing the court that they believed and had reasonable grounds to believe that their use of the domain name was a fair use or otherwise lawful.[5]

Actions under the ACPA are particularly appealing to plaintiffs because statutory damages can be awarded to a successful plaintiff whether or not actual damages can be shown.[6] However, if actual damages can be shown, then they may be

awarded instead of statutory damages.[7] The court also has the authority to require the domain name to be transferred and to award attorney's fees to the plaintiff.[8] No provision of the ACPA specifically permits defendants in unsuccessful ACPA actions to collect their attorney's fees.

The ACPA in Action

Bad faith can be a critical element in an ACPA action. One the one hand, both Congress and the courts have indicated that marks may be used in domain names by nonowners for purposes of comparative advertising, comment, criticism, parody, and news reporting, etc. Even when done for profit, the bad faith requirements of the ACPA are not necessarily met.[9] On the other hand, even in situations when the defendant asserts that the domain name was registered with one of these acceptable intents, a plaintiff is still given the opportunity to press a claim forward in an attempt to show that other motives played a factor in the registration. Defendants in an ACPA action will find it difficult to quickly dispose of a claim against them, especially if they rely on the fact that the complaint may have been weak in indicating the presence of a bad faith intent to profit or if they feel they are protected by the ACPA safe harbor. Two recent Michigan cases help to illustrate the potential complications of bringing a claim under the ACPA.

An example of a defendant who was unsuccessful in quickly disposing of a complaint with a 12(b)(6) motion appears in *Ford Motor Co v Great Domains.com, Inc*, 177 F Supp 2d 635 (ED Mich 2001). In *Great Domains*, Ford Motor Company sued the defendants, who had registered domain names containing Ford Motor Company trademarks, for violation of the ACPA, with claims for trademark infringement, unfair competition, and trademark dilution. The court granted each defendant's 12(b)(6) motion to dismiss the complaint for failure to state a claim but made an exception for the ACPA actions that were brought against the individual defendants.

The court ruled that a claim for trademark dilution, trademark infringement, or unfair competition involving the use of a trademark in a domain name requires an allegation of "use of a trademark in connection with goods or services, which, in the cybersquatting context, generally will require evidence that the domain was used to host a website from which goods or services have been offered over the Internet."[10] However, the court then went on to state that an action brought pursuant to the ACPA could not be dismissed so easily. The court concluded that if the allegations constituted a prima facie case of "intent to profit," the element of bad faith generally would not come into play until at least the summary judgment stage.[11]

This ruling may have seemed harsh to one of the individual defendants in *Great Domains*. That individual had apparently registered the name *www.jaguarcenter.com* to assist a friend of his daughter who had done research about jaguar cats and wanted to publicize issues concerning their preservation.[12] However, he was unsuccessful in having the claim dismissed. The court ruled that because his domain name "was posted for sale through Great Domains," there were sufficient facts alleged to let the case proceed to discovery.[13] This gives Ford the opportunity to test the defendant's story and to attempt to prove that it is not to be believed. However, an individual can be forced to defend his or her actions and assume expensive attorney's fees in situations where the conduct may have been entirely legal. The rules of economics here tend to favor the entity with the deeper pockets. It may simply be less expensive for a defendant to give up a name rather than to defend an action.

Domain names are awarded on a first-come first-served basis. Blatant attempts to squat on a domain name with a registered trademark solely to obtain large payments from the trademark owner should certainly be prevented by the law. However, the act of registering a trademark does not remove the trademarked word from all associations with other unrelated topics. The cost of proving this though can frequently be too much to bear for individual domain name registrants and the costs of letting others register domain names that incorporate a business's trademark are frequently too high for a business to let such registrations go unchecked.

The ACPA provides plaintiffs with a strong tool to leverage against potential defendants who register domain names that contain marks commonly associated with the plaintiff. The ACPA is extremely effective in preventing individuals from reserving commonly used trademarks and attempting to resell these domain names to the trademark owner. However, the ACPA may be too strong in some situations. It can be difficult and expensive to defend uses that perhaps should be permitted by the law.

The Uninvited Internet Visitors

Ford Motor Company had another action before the same court, but came away with a ruling that might surprise some. An individual registered the name *www.f***generalmotors.com*. Instead of linking to a site that criticized General Motors, however, the URL automatically linked Internet travelers to *www.ford.com*, the Ford Motor Company site. Ford Motor, despite the added traffic to its site, was not pleased, and sued the holder of the domain name for various trademark claims under the Lanham Act. Ford lost its motion for an injunction, however.[14]

Ford's view was that its mark was being disparaged by implicit association with the profanity directed at its cross-town competitor. Ford lost its claim that the linking to its site without permission constituted a dilution because the URL in question did not incorporate Ford's trademark. The court found that "[t]rademark law does not permit [Ford] to enjoin persons from linking to its homepage simply because it does not like the domain name or other content of the linking webpage."[15]

Ford had similar problems with its claims of infringement and unfair competition. Because Ford could not show that the defendant had used the mark for its own commercial benefit in connection with the sale of

goods or services, those claims failed as well. The court ruled that Ford had no remedy under the Lanham Act. Ford appealed the ruling to the Sixth Circuit but, according to the defendant's Web site, dismissed the appeal in late June 2002. At press time, the offending Web site is still operating and there is no information about any intended actions by General Motors.

NOTES

1. 15 USC 1125(d).
2. 15 USC 1125(d).
3. In cases where the domain name registrant is at issue, a plaintiff may pursue an in rem action against the domain name itself. 15 USC 1125(d)(2).
4. 15 USC 1125(d)(1)(B)(i). *See also Ford Motor Co v GreatDomains.com, Inc*, 177 F Supp 2d 635, 642 (ED Mich 2001).
5. 15 USC 1125(d)(1)(B)(ii).
6. 15 USC 1117(d). Statutory damages can range between $1,000 and $100,000 per domain name.
7. 15 USC 1117(a). The damages include defendant's profits, damages sustained by the plaintiff and the costs of the action.
8. 15 USC 1125(d)(1)(c).
9. *Ford Motor Co v Great Domains.com, Inc*, 177 F Supp 2d 635, 642 (ED Mich 2001).
10. *Id.* at 655.
11. *Id.* at 643.
12. *Id.* at 644.
13. *Id.*
14. *Ford Motor Co v 2600 Enters*, 177 F Supp 2d 661 (ED Mich 2001).
15. *Id.* at 664.

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Avoiding the Pitfalls of Insolvency Liability: Directors' and Officers' Fiduciary Duties to Creditors When the Company Is Insolvent or in the Vicinity of Insolvency

by Scott M. DeWolf

Introduction

Enron's dramatic collapse thrust issues relating to corporate directors' and officers' execution of their fiduciary duties, as well as the role of retained professionals assisting them in their efforts, to the forefront of our legal and popular culture. While there are many more chapters to be written on the Enron story, and the full extent of any changes precipitated by Enron's collapse to our corporate governance system and the law of director and officer liability will not be known for many years, one thing appears certain: the role of the directors and officers in a company's failure, and whether they faithfully executed their fiduciary obligations, will be the subject of increased scrutiny for the foreseeable future.

One can see evidence of this increased scrutiny in the recent fee application of Skadden, Arps, Slate, Meagher & Flom LLP in the K-Mart bankruptcy. In their fee application, the lawyers seek payment for nearly 8,000 hours of interviews with 125 current and former K-Mart employees and for time spent combing through nearly 700,000 pages of documents while investigating possible wrongdoing by current and former directors and officers.

While Enron provides a case study in what appears to be a complete failure of the corporate governance system, the current economic downturn presents a related challenge and potential pitfall for corporate directors and officers trying to faithfully execute their fiduciary duties while their company experiences financial difficulty. The challenge and potential pitfall involves the extent of the fiduciary duties owed to the company's creditors when the company is insolvent or in the "vicinity of insolvency."[1] Directors and officers managing companies during such troubled financial times risk substantial liability if they do not realize that they owe a fiduciary duty to the company's creditors. *And, yes, directors do owe creditors a fiduciary duty in these circumstances.*

This article briefly outlines this timely issue for directors and officers as well as for business lawyers advising their clients during times of financial crisis. Understanding the extent of fiduciary duties owed to a company's creditors when the company is insolvent or in the vicinity of insolvency is a complex issue. This article highlights four areas of concern: (1) when fiduciary duties shift to creditors, (2) how fiduciary duties shift to creditors, (3) what the applicable tests for insolvency are, and (4) what is the nature and extent of the liability that directors risk by failing to fulfill their fiduciary duties to the company's creditors.

From the outset it should be noted that there is no Michigan case directly on point. Michigan courts, however, routinely follow Delaware decisions in the area of corporate law.[2] Since Delaware has well-developed case law in this area, Michigan practitioners are well-advised to become familiar with this line of cases because this issue may soon, given the current economic and social environment, be squarely before a Michigan court.

Fiduciary Duties to Creditors: Do They Really Exist?

While lawyers as well as nonlawyer directors may be shaking their collective heads in disbelief that fiduciary duties to a company's creditors exist, this is, in fact, the case. The disbelief certainly arises from the general rules both lawyers and nonlawyer directors can, and do, routinely recite. These well-known rules include the following: "directors and officers are fiduciaries who owe a strict duty of good faith to the corporation which they serve"[3] and directors and officers owe their fiduciary duty to the shareholders to maximize value and allow them the greatest return on their investment.[4] Moreover, the Michigan Business Corporation Act has codified a director's standard of care in discharging his or her fiduciary duties. A director or officer must discharge his or her duties in good faith, with the care that an ordinarily

prudent person would exercise in similar circumstances, and in a manner he or she reasonably believes to be in the best interest of the corporation.[5]

It seems implausible then that corporate directors and officers could owe a fiduciary duty to the company's creditors given the above-referenced general rules and the general debtor-creditor relationship. Generally, any duties owed to creditors by the company are governed by the contracts between the company and the creditor as well as state debtor-creditor law. Indeed, the creditors' interests are often adverse to the company and its shareholders. Succinctly, the creditors want to make sure they are paid in accordance with the terms of their contracts with the company. Thus, they want the company to minimize risk and assure that they are paid for the goods and /or services they provided. Shareholders, on the other hand, want the company to aggressively pursue its business strategy and maximize shareholder value.

All of the above, however, assumes one thing to be true: that the company is solvent. In other words, the company is able to pay its debts as they become due or its assets exceed its liabilities. Once a company is unable to pay its debts as they become due or its liabilities exceed its assets, the rules change. Once a company is insolvent or in the vicinity of insolvency, the fiduciary duties of the directors and officers shift from the company and its shareholders to the company's creditors.[6]

Credit Lyonnais and Its Progeny: Directors' Shifting Fiduciary Duties—When, Why, and the Extent of the Shift

In one of the seminal opinions on this topic, the Delaware Court of Chancery addressed when and why the fiduciary duties of corporate directors and officers shift from the company and its shareholders to the creditors in *Credit Lyonnais Bank Nederland, NV v Pathe Communications Corp*.[7] Subsequent cases have given guidance on the extent of the shift in fiduciary duties from the company and its shareholders to its creditors.

In *Credit Lyonnais*, Chancellor Allen explained the inherent tension that arises between the stockholders of a corporation and its creditors as the company reaches the vicinity of insolvency. As the residual interest holders, the creditors have an incentive to reduce risk as the company nears insolvency. Stockholders, on the other hand, are the beneficiaries of any gains above the point of solvency. Thus, they have a divergent incentive to maximize the value of the corporate enterprise regardless of the risks of pushing the company deeper into insolvency.[8] As the company reaches the vicinity of insolvency, the directors and officers owe a fiduciary duty to the corporate enterprise and "the community of interests that the corporation represents, stockholders as well as creditors."[9]

In a now famous footnote, Chancellor Allen provided the following illustration of how examining the shareholder interests alone leads to a different result than considering the interest of creditors:

> The possibility of insolvency can do curious things to incentives, exposing creditors to risks of opportunistic behavior and creating complexities for directors. Consider, for example, a solvent corporation having a single asset, a judgment for $51 million against a solvent debtor. The judgment is on appeal and thus subject to modification or reversal. Assume that the only liabilities of the company are to bondholders in the amount of $12 million.
>
> Assume that the array of probable outcomes of the appeal is as follows

	Expected Value
25% chance of affirmance ($ 51mm)	$12.75
70% chance of modification ($ 4mm)	$2.8
5% chance of reversal ($ 0)	$0
Expected Value of Judgment on Appeal	$15.55

> Thus, the best evaluation is that the current value of the equity is $3.55 million ($15.55 million expected value of judgment on appeal—$12 million liability to bondholders). Now assume an offer to settle at $12.5 million (also consider one at $17.5 million). By what standard do the directors of the company evaluate the fairness of these offers? The creditors of this solvent company would be in favor of accepting either a $12.5 million offer or a $17.5 million offer. In either event they will avoid the 75% risk of insolvency and default. The stockholders, however, will plainly be opposed to acceptance of a $12.5 million settlement (under which they get practically nothing). More importantly, they very well may be opposed to acceptance of the $17.5

Once a company is insolvent or in the vicinity of insolvency, the fiduciary duties of the directors and officers shift from the company and its shareholders to the creditors.

> million offer under which the residual value of the corporation would increase from $3.5 to $5.5 million. This is so because the litigation alternative, with its 25% probability of a $39 million outcome to them ($51 million—$12 million=$39 million) has an expected value to the residual risk bearer of $9.75 million ($39 million x 25% chance of affirmance), substantially greater than the $5.5 million available to them in the settlement. While in fact the stockholders' preference would reflect their appetite for risk, it is possible (and with diversified shareholders likely) that shareholders would prefer rejection of both settlement offers.
>
> But if we consider the community of interests that the corporation represents it seems apparent that one should in this hypothetical accept the best settlement offer available providing it is greater than $15.55 million, and one below that amount should be rejected. But that result will not be reached by a director who thinks he owes duties directly to shareholders only. It will be reached by directors who are capable of conceiving of the corporation as a legal and economic entity. Such directors will recognize that in managing the business affairs of a solvent corporation in the vicinity of insolvency, circumstances may arise when the right (both the efficient and the fair) course to follow for the corporation may diverge from the choice that the stockholders (or the creditors, or the employees, or any single group interested in the corporation) would make if given the opportunity to act. [10]

. . . the most prudent course of action for directors of companies in the vicinity of insolvency is to at least consider the interests of creditors and not solely the interests of the shareholders.

Admittedly, Chancellor Allen's decision is ambiguous in that it gives directors little guidance as to what constitutes the vicinity of insolvency. Similarly, the extent of the shift of duties to creditors when a company is in the vicinity of insolvency is unclear. Given the ambiguity, the most prudent course of action for directors of companies in the vicinity of insolvency is to at least consider the interests of creditors and not solely the interests of the shareholders. The directors should engage in analysis similar to that of Chancellor Allen in footnote 55 to be sure their conduct is not unduly risky and accords proper weight to the interests of the corporate enterprise itself and the "community of interests that the corporation represents"—stockholders as well as creditors.

While the extent of directors' fiduciary duties to creditors in the vicinity of insolvency may be unclear, subsequent decisions leave no doubt about the extent of directors' fiduciary duties to the creditors once the company is insolvent as well as when those duties arise. First, in *Geyer v Ingersoll Publications Co,*[11] the defendants contended that no fiduciary duty to creditors existed absent the institution of a statutory insolvency proceeding (i.e., bankruptcy). The court resoundingly rejected this argument and held that it was "insolvency in fact rather than insolvency due to a statutory filing . . . [that] determin[es] when a fiduciary duty to creditors arises."[12] After *Geyer*, the courts have made it abundantly clear that once the corporation reaches the point of insolvency, the directors' and officers' fiduciary obligations wholly shift to the creditors so as to "maximize the value of the assets for payment of the unsecured creditors."[13]

Insolvency: How Is It Defined?

Since corporate directors' fiduciary duties shift to the creditors when the company is insolvent or in the vicinity of insolvency, the definition of insolvency is crucial. There are two principal definitions used in determining whether a company is insolvent and the directors' fiduciary duties have shifted to the company's creditors.

A company is insolvent when "the sum of such entity's debts is greater than all such entity's property, at a fair valuation."[14] This is the Bankruptcy Code's definition of insolvency and is essentially synonymous with the "balance sheet" test, which states that a company is insolvent when total liabilities exceed total assets. The other principal test that is used in the Uniform Fraudulent Transfer Act, often referred to as the "equitable insolvency test" or "cash-flow test," states that a company is insolvent if it "is generally not paying [its] debts as they become due."[15] Courts have used both tests to determine whether fiduciary duties have shifted to creditors; however, the most recent Delaware decisions have applied the equitable insolvency test to declare that a company is insolvent and that the fiduciary duties have shifted to the creditors.[16]

Insolvency Liability: the Nature, Extent, and Potential Lack of Protection from Such Liability

As illustrated in Chancellor Allen's footnote,

the interests of creditors and shareholders substantially diverge when a company is insolvent or in the vicinity of insolvency. Assuming the company is insolvent or in the vicinity of insolvency, directors adhering to the traditional rules in executing their fiduciary obligations risk substantial liability if the company ultimately fails. Several areas are especially problematic for directors in companies that are insolvent or operating in the vicinity of insolvency. While these examples are not exhaustive, they are common scenarios that directors and officers face in times of financial crisis.

If there are offers to purchase the company, assets, or divisions, the offers require special attention from the directors and officers. Offers that during otherwise stable financial times would ordinarily be rejected should not be summarily dismissed. Instead, the directors should look at each offer very closely giving due consideration to the interests of the company's creditors. If such offers would render the company solvent or pay off the majority of the creditors and lessen the damages that creditors would suffer if the company were forced into bankruptcy, great care should be taken before such offers are rejected.

Another area fraught with peril is approving transactions that leave the company with an unreasonably small capital base. This is especially true when the company is in the vicinity of insolvency. If the directors and officers approve a transaction that is unduly risky and it results in the creditors being harmed as a result when the company fails, the directors and officers may be held liable for breach of fiduciary duty to the creditors.

All transactions with control persons also require special attention. Such transactions should be closely scrutinized to be certain that the control persons are not gaining an unfair advantage over the community of corporate interests, including those of the company's creditors.

If the directors fail to consider the creditors' interests in the vicinity of insolvency, or when the company is actually insolvent and they fail to act in the creditors' best interests, the directors are subject to liability for the damages suffered by the creditors when the company fails. If the directors take actions that result in the company going further into debt, they can be held liable under what is known as the deepening insolvency theory of liability.[17] Once the company is in the zone of insolvency and the fiduciary duties have expanded to include the creditors, the directors can be liable under the deepening insolvency theory for all damages flowing from indebtedness to creditors.

Directors and officers and their counsel should also be aware that at least two recent decisions have held that exculpatory provisions in the company's articles of incorporation[18] do not exculpate a director from liability for an alleged breach of fiduciary duty to the company's creditors.[19] Briefly, these courts have reasoned that the exculpation clause in the articles of incorporation only shields directors and officers from liability to the corporation or its shareholders, not to its creditors who were not parties to the contract.[20]

Conclusion

Directors and officers serving during times of financial crisis must be cognizant that their fiduciary duties can shift from the company and its shareholders to the company's creditors when the company is insolvent or in the vicinity of insolvency. Directors and officers must understand that their fiduciary duties can be owed not only to the company and its shareholders, but also to the company's creditors. During such times, the directors and officers must proceed with care and adjust their decision-making calculus to include the interests of the company's creditors. Failure to do so may subject the company's directors and officers to substantial future liability for breach of fiduciary duty if the company ultimately declares bankruptcy or fails.

Directors and officers and their counsel should also be aware that at least two recent decisions have held that exculpatory provisions in the company's articles of incorporation do not exculpate a director from liability for an alleged breach of fiduciary duty to the company's creditors.

NOTES

1. *Credit Lyonnais Bank Nederland, NV v Pathe Communications Corp*, 1991 Del Ch Lexis 215, at *108 n. 55 (Del Ch 1991).
2. *See, e.g., In re Consumers Power Co Derivative Litigation*, 132 FRD 455, 461 (ED Mich 1990), *Priddy v Edelman*, 883 F2d 438, 443-44 (CA 6 1989); and *Russ v Federal Mogul Corp*, 112 Mich App 449, 455 n 1; 316 NW2d 454 (1982).
3. *Production Finishing Corporation v Shields*, 158 Mich App 479, 486; 405 NW2d 171 (1987); *Salvador v Connor*, 87 Mich App 664, 675; 276 NW2d 458 (1978).
4. *Salvador v Connor*, 87 Mich App 664, 675; 276 NW2d 458 (1978).
5. MCL 450.1541a; *see also Camden v Kaufmann*, 240 Mich App 389, 394; 613 NW2d 335 (2000).
6. *See In re High Strength Steel, Inc*, 269 BR 560, 569 (Bankr D Del 2001); *Geyer v Ingersoll Publications Co*, 621 A2d 784, 790 (Del Ch 1992); and *Credit Lyonnais Bank Nederland, NV v Pathe Communications Corp*, 1991 Del Ch Lexis 215 (Del Ch 1991).
7. *Supra* note 1.
8. *Id.*
9. *Id.*
10. *Id.*
11. *Geyer v Ingersoll Publications Co*, 621 A2d 784 (Del Ch 1992).

12. *Id.* at 787.

13. *In re High Strength Steel, Inc*, 269 BR 560, 569 (Bankr D Del 2001) (recognizing under Delaware law "once a corporation becomes insolvent, its officers and directors owe unsecured creditors a fiduciary duty.").

14. 11 USC 101(32)(A).

15. MCL 566.32(1) and (2). *See also* the Michigan Business Corporation Act's insolvency test for corporate distributions (MCL 450.1345).

16. *See, e.g., LaSalle National Bank v Perelman*, 82 F Supp 2d 279, 290 (D Del 2000) (citing *Odyssey Partners LP v Fleming Companies, Inc*, 735 A2d 386, 417 (Del Ch 1999)).

17. *See, e.g., Schacht v Brown*, 711 F2d 1343, 1347-48 (CA 7 1982), *cert denied*, 464 US 1002 (1983) (finding injury when corporation "fraudulently continued in business past its point of insolvency"); *Hannover Corp of Am v Beckner*, 211 BR 849, 854-55 (MD La 1997) ("[A] corporation can suffer injury from fraudulently extended life, dissipation of assets, or increased insolvency."); *Allard v Arthur Andersen & Co*, 924 F Supp 488, 494 (SDNY 1996) ("Because courts have permitted recovery under the 'deepening insolvency' theory, [defendant] is not entitled to summary judgment as to whatever portion of the claim for relief presents damages flowing from indebtedness to trade creditors."); *In re Gouirian Holdings, Inc*, 165 BR 104, 107 (EDNY 1994) (denying motion to dismiss claims brought by creditors' committee, finding it possible that "under some set of facts two years of negligently prepared financial statements could have been a substantial cause of [the debtor] incurring unmanageable debt and filing for bankruptcy protection.").

18. *See* MCL 450.1209(1)(c) (providing: "The articles of incorporation may contain any provision not inconsistent with this act or another statute of this state including any of the following: (c) A provision eliminating or limiting a director's liability to the corporation or its shareholders for money damages for any action taken or any failure to take any action as a director, except liability for the following: (i) the amount of a financial benefit received by a director to which he or she is not entitled; (ii) intentional infliction of harm on the corporation or the shareholders; (iii) a violation of section 551 [MCL 450.1551]; (iv) an intentional criminal act.

19. *Pereira v Cogan*, 2001 US Dist Lexis 2461 at *32-35 (SDNY 2001); *In re Ben Franklin Stores*, 2000 US Dist Lexis 276 (ND Ill 2000) (applying Delaware law).

20. *Id.*

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Commercial Dispute Resolution: New Horizons

by Jon H. Kingsepp & Mary C. Dirkes

Introduction

Commercial litigation generally involves disputes arising from contractual or business relationships. In days long past, commercial litigation cases were resolved by bitter combat in the courtroom. The toll, particularly as the stakes became higher, was exorbitant on lawyer and client energy. The unknown risks increased as did the expenses incurred. As cases became more complex, required interim relief, or involved international relationships, the tools traditionally used to resolve commercial disputes became increasingly archaic and ineffective, failing to meet the expectations and demands of the client.

In today's marketplace, a drawn-out legal battle can damage a business, destroying critical business relationships and overshadowing a company's operations and its business goals and objectives. Even if a company ultimately prevails, the cost of doing so can prove insurmountable.

These litigation shortfalls dictate more imaginative and innovative measures from the legal community. Alternative measures began in English law as early as 1698.[1] Here in the United States, however, the development of nontraditional resolution measures did not begin to take on recognition until 1926 with the adoption of the dispute resolution techniques in the Railway Labor Act.[2] Since then, alternative dispute resolution has been met with increasing approval and usage, particularly in the past several years. Indeed, many states are considering adopting the Uniform Mediation Act.[3] The Michigan Supreme Court recently adopted a court rule regarding nonbinding alternative dispute resolution, effective August 1, 2000.[4] Moreover, Michigan also recently created a cyber court with its own unique rules of procedure to streamline cases and achieve quick results.[5]

The panoply of legislation and dispute resolution alternatives available offers the legal and business community new methods and opportunities to resolve commercial disputes without resorting to traditional courtroom litigation, thereby providing many advantages to the client. With the advent of this new age of alternative dispute resolution, the lawyer's role has necessarily enlarged. In addition to the traditional role of advocate, the lawyer must evaluate the client's needs and expectations, and, using creativity, imagination, and experience, develop an alternative dispute resolution method that, when appropriate, will settle the commercial conflict both expeditiously and effectively.

This article identifies several key factors to consider when contemplating alternative dispute resolution and the different alternatives available. This article also addresses the problem of obtaining an unwilling opponent's consent to the dispute resolution process and suggests how to avoid this problem from reoccurring.

The considerations and issues raised in this article generally apply no matter the size of the case or the specific facts involved. Certain concerns or issues discussed, however, may be magnified depending on the particular circumstances.

The Client's Expectation

Perhaps the single most important factor to consider when weighing alternatives to traditional litigation is the client's expectation. In the commercial world of the twenty-first century, clients expect their legal counsel to resolve commercial disputes promptly and efficiently. Not surprisingly, clients are more interested in conducting their business than spending time in lawyers' offices or courtrooms. In most business disputes, clients now seek solutions that focus as much on underlying commercial concerns as on truth or rights. Speed and cost are often the paramount concerns.[6] If the legal profession fails to deliver timely results, clients will look elsewhere for assistance, even outside the legal profession.

To avoid such a result, it is incumbent upon the lawyer to be cognizant of the client's business and expectations. This entails not only familiarity with the client and the client's business, but also an awareness of the dispute's impact throughout the client's organization, the dislocation of the client's resources, and the client's interest in continuing a business relationship that may

be jeopardized by lengthy and combative litigation. Armed with this knowledge, the lawyer can begin the analysis necessary to devise the appropriate dispute resolution strategy. These strategies vary from case to case depending on both the particular facts underlying the dispute and the client's interests, needs, and expectations. Consequently, counsel should thoroughly analyze each new case and make decisions concerning the most suitable forum and method for resolving the issues, preferably before the parties ever set foot in the courtroom.

The Strategy Analysis

The strategy analysis developed by Daniel A. Bent is one of the most informative evaluation techniques.[7] This analysis has several components and is a valuable tool for lawyers in developing the appropriate response to a client dispute. The strategy analysis identifies numerous considerations worthy of inclusion in an initial analysis, many of which are set forth below. These are the hidden costs of litigation that ought to be analyzed with the client and minimized, if not completely eliminated.

We now are in a different age; client expectations and demands are much greater than they were when traditional litigation was the only method available to resolve a dispute.

- **Decision Costs.** These are the out-of-pocket costs that a client might expend throughout the traditional litigation process, beginning with the filing of the lawsuit, continuing through discovery, and culminating in a trial by either a judge or a jury.
- **Distraction Costs.** These are the unknown and unpredictable costs that may result from the attention of the client's personnel being diverted from the normal day-to-day business activities to the litigation's impact on their particular business.
- **Self-Education Costs.** These costs come from the time that the client and attorney must spend developing information necessary from the standpoint of the opponent's presentation.
- **Emotional Wear and Tear Costs.** Any client, no matter how familiar with litigation, will experience recurrring emotional anxiety and distress that necessarily results from protracted and combative litigation.
- **Lost Opportunity Costs.** These are the unknown costs that result from the allocation of time and effort spent by the client and the client's personnel on the pending litigation.
- **Business Relationship Costs.** Litigation may have detrimental consequences beyond the immediate issues between the particular parties involved. The litigation may establish a precedent having wide-ranging consequences within the trade or market at issue.
- **Pending Litigation Costs.** These are impact costs that may arise with respect to the client's financing or investment needs during the course of litigation.
- **Gamesmanship Costs.** These costs may be incurred when the opposition uses the litigation to the detriment of the client.
- **Risk of Loss Costs.** No one can predict with absolute certainty how a court or jury will rule. Thus, the client essentially must rely on the judgment of the lawyer as well as on the integrity of the legal system. Oftentimes this presents a substantial risk to the client and to the continued viability of the client's business.
- **Public Record Costs.** A negative decision may impact the client's ability to attract future business. Once made public, the decision is a matter of record that cannot be erased.

These are just a few of the many costs and implications that must be considered when deciding whether to pursue litigation. Many of these costs can be greatly reduced, if not completely avoided, by carefully developing an alternative to traditional litigation. We now are in a different age; client expectations and demands are much greater than they were when traditional litigation was the only method available to resolve a dispute. Today's goal is to avoid litigation in a case that could be a lawyer's delight but a client's nightmare.

Assuming the analysis of the client's expectations and business dictates a resolution apart from traditional litigation, the lawyer's next step is to select between the many alternative dispute resolution methods available. To do so, the lawyer must thoroughly understand the available options.

The Alternatives

There are several alternatives available that might be more suitable than traditional litigation. Most of these alternatives require the intervention of a third party who presumably is independent and trained in the dispute resolution process. In Michigan, the traditional alternative dispute resolution approach has been statutory arbitration as set forth in MCL 600.5001–600.5035.[8] Other options are available, however, including (1) mediation under MCR 2.411, (2) case evaluation under MCR 2.403, (3) conciliation, (4) early neutral evaluation (ENE), (5) mini trials, (6) med arbitration, (7) fact finding, (8)

interest-based mediation, and (9) adjudication. Some of the more pertinent dispute resolution methods for commercial disputes are discussed briefly below:

1. MCR 2.411 mediation is a nonevaluative and nonjudgmental process whereby a neutral third party facilitates dialogue between the parties working toward their own settlement of the dispute.
2. MCR 2.403 case evaluation is a process in which a fact/legal analysis or summary is submitted to a panel of three attorneys who then place a numerical value on the claim presented.
3. Arbitration involves the presentation of facts and law and witnesses to a panel of one or more individuals, which, after hearing the evidence, issues a binding decision.
4. Med arbitration is a process in which the dispute initially is submitted to mediation; however, if some or all of the issues are not resolved, the mediator becomes an arbitrator and renders a binding decision on the remaining issues.
5. Interest-based mediation is a process by which the parties look to the existence and preservation of relationships or the restructuring of a relationship that may be affected by the dispute between the parties.

Alternative dispute resolution methods, such as those described above, enable counsel and clients to select a method that may resolve a dispute expeditiously and effectively. Consequently, counsel should always assist a client in evaluating alternative dispute resolution methods in connection with the facts surrounding the particular dispute. As previously indicated, this evaluation is client-based and depends on the existence and continuation of an ongoing relationship and on the impact on the industry or the client's business, along with other related considerations. The importance of a dialogue between counsel and client identifying the alternative best suited for their particular dispute cannot be overemphasized.

Consideration also should be given to the use of an "expert" who may be familiar with the industry in which the dispute arises and who has gained respect or stature within that industry. It is not uncommon in alternative dispute resolution matters to utilize accountants or other experts when advising the client with respect to the strategy that ought to be taken in resolving a dispute. These same experts might be called on again during whichever alternative dispute resolution process is selected to further assist the parties in resolving their dispute.

Despite the alternatives available, there are instances when alternative dispute resolution simply is not possible. More often than not, this occurs when the animosity between the parties is too great or the differences between the parties are too large. Even in these situations, however, counsel should remember that when a dispute initially arises, both parties largely stand on equal footing. Both parties face the risks associated with litigation, both parties will incur legal fees, and both parties will be inconvenienced. Being on a level playing field at the outset should encourage both parties with experienced counsel to engage in an initial dialogue on whether the dispute can be resolved short of litigation.

Assuming the dispute cannot be voluntarily resolved without litigation, counsel may insist on alternative dispute resolution under the new Michigan Court Rules. Courts now are empowered to mandate the implementation of alternative dispute resolution, although many jurists still prefer that the parties reach their own agreement.

Being on a level playing field at the outset should encourage both parties with experienced counsel to engage in an initial dialogue on whether the dispute can be resolved short of litigation.

Procedural Considerations Common to Each Method

Regardless of the alternative dispute resolution method selected, there are significant preliminary procedural questions to be identified and resolved. Addressing these procedural issues at the outset will avoid subsequent litigation that may obliterate any advantages gained from alternative dispute resolution.

How should the procedure be formalized—by court order or by a negotiated agreement? What issues are to be presented for resolution? What is the time frame in which the dispute should be presented? How will the facts and legal issues be presented? Who is to be involved? To what extent will counsel disclosures be protected from public disclosure or from subsequent discovery should the alternative dispute resolution mechanism fail? To what extent is the arbitrator/facilitator/mediator protected from being a witness? How secure from discovery are any notes taken during the proceeding? To what extent can shared documents be used in subsequent discovery proceedings? How can an informal settlement reached between the parties be enforced if someone subsequently rescinds the agreement?

These are but a few examples of the procedural issues requiring careful consideration when selecting an alternative dispute

resolution mechanism. Once agreed upon, these issues should be memorialized in writing to avoid later disputes.

Persuading the Recalcitrant Opponent

Since many alternative dispute resolution processes are relatively new, there are still those who emphatically insist that their clients deserve their "day in court." Attorneys, by their training, should appreciate that their true value lies in problem solving and persuasion. These traits can be effectively utilized in dispelling the notion that a trial is the only recourse available in a commercial dispute. In addition, any alternative dispute resolution proposals should be communicated to the client, who may independently appreciate that a "day in court" can in fact be an unpleasant experience. Communications to opposing counsel, therefore, should be made under the assumption that the communication will be repeated verbatim to the opposing party. Carefully structuring a proposal for consideration by opposing counsel as an alternative to litigation and as a cost-saving measure for both parties can be invaluable in persuading counsel, and more importantly, the opposing party, to accept the alternative dispute resolution method proposed.

Another alternative, which at times can be more effective, is to request a pretrial or dispute resolution conference with the particular judge assigned to the case (assuming a lawsuit has been filed). By involving the court, one essentially enlists judicial support for the notion of alternative dispute resolution, a notion in which most courts strongly believe. Opposing counsel and parties may be more inclined to accept an alternative dispute resolution method should the court suggest that an alternative be utilized rather than spending money in protracted discovery matters and motions before the court. Additionally, while the case initially may not settle, once these discussions are held with the court, the parties may be more inclined to continue settlement discussions while the case proceeds than they otherwise would have been. Moreover, the client will appreciate the effort to minimize costs while effectively trying to resolve the dispute.

Lawyers must resist the temptation to insist upon traditional courtroom litigation without exploring potentially less expensive alternatives.

Agreement to Resolve Disputes

Most lawyers practicing in the commercial arena are familiar with contractual arbitration clauses. For example, the construction industry for years has relied on arbitration of construction-related disputes. Some practitioners have noted, however, that arbitration can itself be protracted and expensive, and therefore may no longer be as attractive as it once was, particularly in light of the current array of other alternative dispute resolution methods available. Unquestionably, arbitration has its place in the appropriate fact setting. However, the time may have come when lawyers should insist that their clients, in their written agreements, provide for dispute resolution clauses that require the consideration and implementation of the *other* alternatives that might be more cost effective. Such provisions should require one or another form of mediation or conciliation as a precondition to a full-blown lawsuit or arbitration hearing.

Conclusion

Alternative dispute resolution in the commercial litigation context can be a new adventure for clients and counsel. While some parts of the country have utilized dispute resolution measures for many years, the new court rules in Michigan now essentially require all counsel to consider effective alternatives that may benefit the client. Lawyers must resist the temptation to insist upon traditional courtroom litigation without exploring potentially less expensive alternatives.

Obviously, there are matters that will never be resolved outside of the traditional courtroom setting and this article does not intend to suggest that alternative dispute resolution is the preferred choice in all cases. Instead, each case must be analyzed individually and evaluated based on the unique factual circumstances, as well as the client's needs, expectations, and past experiences. In addition, one must consider the judicial attitude toward alternative dispute resolution, as well as the court's docket and other related matters.

A lawyer's value is demonstrated in many ways, including the recognition of less-expensive problem-solving measures. The suggestion has been made through corporate surveys that corporations are more satisfied with mediation than litigation or arbitration. Consequently, mediation or other forms of dispute resolution must be considered for the client's benefit. If a client can avoid protracted litigation at the suggestion or behest of counsel, the client certainly will remember that counsel in future matters and may even recommend that counsel to other business associates. In short, an efficient and effective alternative dispute reso-

lution process can produce a win-win situation for both the client and counsel. The process cannot succeed, however, without careful and deliberate evaluation and implementation.

Because alternative dispute resolution remains relatively new, there are several issues yet to be litigated regarding the process. Some of these issues have been mentioned herein—the definitive outcomes of which are reserved for future discussion. For the time being, however, a cautious and careful lawyer will include the client in the entire dispute resolution analysis and will ensure that, once agreed upon, an alternative dispute resolution method is formalized either by court order or by written agreement.

NOTES

1. *See* Glasner, *Contract Disputes: The Role of ADR*, 55 Dispute Resolution Journal 3, August 2000, at 50.
2. 45 USC 154, 155.
3. National Conference of Commissioners on Uniform State Laws (NCC USL Uniform Mediation Act Approved August 2001).
4. MCR 2.410.
5. 2001 PA 262.
6. Picker, *ADR New Challenges and Roles and New Opportunities*, 56 Dispute Resolution Journal 20, (February/April 2001).
7. Bent, *United States: Game Theory Explaining How Mediation Can Thump Litigation (Mediation has edge over litigation in resolving business disputes)*, Mondag Business Briefing (June 11, 2001), Business and Management Practices (2002).
8. Such statutory arbitration is governed by MCR 3.602.

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Employer Beware, What You Don't Know Can Hurt You: E-mail Monitoring and Privacy Issues in the Private Sector Workplace

by Janet M. Ziulkowski

Introduction

With the increasing number of businesses using e-mail, employers are forced to balance the individual employee's privacy interests in e-mail communications with the potential threat this essential communication tool poses to employers. Not surprisingly, many employers find this to be a difficult proposition.

Some employers have discovered, to their regret, that the inappropriate use of e-mail and the Internet by employees can create corporate liability and cause litigation or can provide evidence that exacerbates litigation. Evidence of sexual, racial, or other forms of harassment and discrimination are found in employees' e-mail and used against the employer in litigation on a daily basis. To minimize liability for harassment, employers are becoming proactive, establishing policies regulating the use of their electronic communication systems, including policies for monitoring company-provided e-mail.

When evaluating whether to monitor e-mail, employers are faced with a difficult dilemma. An employer that does not monitor employee e-mail runs the risk of liability stemming from unauthorized transmission of harassing or discriminating material circulated via the company's e-mail system. On the other hand, an employer that does monitor e-mail faces potential liability for violating an employee's privacy rights. To avoid liability for employee misuse of company e-mail systems and for violating an employee's privacy interests in electronic communications, employers must familiarize themselves with the Electronic Communications Privacy Act (ECPA)[1] and develop and consistently enforce an effective company e-mail policy.

The Electronic Communications Privacy Act

When the government is the employer, employees have certain protections through federal and state constitutions; however, this is generally not the case in the private sector workplace. Congress responded to this lack of protection for private sector employees by enacting the ECPA, which limits an employer's right to monitor its employees' communications.

Specifically, the ECPA imposes criminal and civil liability upon anyone who (1) "intentionally intercepts, endeavors to intercept, or procures any other person to intercept or endeavor to intercept, any wire, oral, or electronic communication"[2] or (2) "uses or discloses to any other person the contents of any electronic communication while knowing or having reason to know that the information was obtained through the illegal interception of electronic communication."[3] Along with actual damages, the ECPA provides for punitive damages in appropriate cases.[4] The ECPA also provides for equitable relief[5] along with attorney's fees and costs.[6] Finally, an employer who violates the ECPA can be subject to criminal charges.[7]

Employers seeking to avoid liability under the ECPA for unauthorized access or interception of employee e-mail while still monitoring their employees' electronic communications may rely on three exceptions to the ECPA: (1) prior consent, (2) business use, and (3) system provider.

Consent

Actual or implied consent may be sufficient to shield the employer from liability. The ECPA expressly allows the interception of electronic communication when "one of the parties to the communication has given prior consent."[8] When monitoring e-mail, express consent provides the employer with the strongest protection. However, implied consent can also prevent or limit employer liability.

Ordinary Course of Business

Absent express or implied consent, employers may still intercept electronic communications if it is done in the ordinary course of business.[9] "'Ordinary course of business' is not defined in the [ECPA], but it generally requires that the use be (1) for a legitimate business purpose, (2) routine and (3) with notice."[10] This exception allows the employer to intercept, use, or disclose a com-

munication if the interception involved use of equipment or facilities furnished by the provider of the electronic communication service.[11]

Service Provider Exception

The service provider exception exempts system providers from general ECPA prohibitions on access and disclosure of electronic communications. The ECPA provides the following:

> It shall not be unlawful under this chapter for an operator of a switchboard, or an officer, employee, or agent of a provider of wire or electronic communication service, whose facilities are used in the transmission of a wire or electronic communication, to intercept, disclose, or use that communication in the normal course of his employment while engaged in any activity which is a necessary incident to the rendition of his service or to the protection of the rights or property of the provider of that service.[12]

This exception has not been tested by the courts. However, commentators have speculated that providers such as "CompuServe or MCI Mail, would most likely be included as 'providers,' while employers who subscribe to these networks for e-mail service may possibly be included as 'agents.'"[13] With the uncertainty of this exception, employers would be better advised to utilize either the consent or business-use exceptions.[14]

Creating an Effective Electronic Communications Policy

Many companies have a written e-mail and Internet policy, particularly those that rely heavily on electronic communications to operate their businesses. Yet oftentimes, those policies are incomplete, inadequate, and inconsistently enforced, thereby giving rise to possible employer liability from both internal and external claimants. In light of the ECPA and its uncertainty and severe penalties, it is imperative that employers create, implement, and consistently enforce electronic communication policies. These policies should provide clear and detailed guidelines for how company e-mail systems are to be regulated in the workplace. When drafting an electronic communication policy, there are some fundamental elements an employer must incorporate to adequately protect the company.

Statement of Business Purpose

The employer should identify the technology, systems, and equipment that are covered by the company's electronic communication policy. It should expressly state that all such systems and equipment are owned by the company and that their use is limited to business purposes only. If the employer makes exceptions, they must be clearly defined. If the company allows incidental personal use, the policy should emphasize that it must be minimal and must not interfere with business operations or systems. The policy should also state that solicitation for any purpose will not be tolerated. This provision is particularly important in the context of limiting union organization drives.

Scope of Use

The policy should define permitted and unauthorized uses. For example, there should be clear and unambiguous language prohibiting company e-mail from being used for unlawful, harassing, or discriminatory activities. The employer should make it clear that broadcasting of messages contrary to the company's best interest is prohibited and any unauthorized uses that are material violations of the policy must be reported to management.

Notification that Privacy Should Not Be Expected

The policy should expressly state that all communications may be monitored by the employer, and therefore, employees should not expect privacy when using company-owned systems and equipment. Employees should also be notified that all information created on company systems and equipment belongs to the employer.

Employee Obligations Regarding Proprietary Information

The policy should define confidential company information and prohibit its unauthorized transmission. This section should include a caution against inadvertent transmission and provide examples such as the use of e-mail distribution lists.

State How Policy Will Be Enforced

Employees should also be made aware that they may be subject to personal liability for violating the policy as well as other measures: "The seriousness with which the employer views violations of this policy should be reinforced with a recitation that violations <u>will</u> result in discipline up to and including termination."[15]

Some employers have discovered, to their regret, that the inappropriate use of e-mail and the Internet by employees can create corporate liability and cause litigation or can provide evidence that exacerbates litigation.

Employer's Right to Monitor

A provision should be included expressly reserving the employer's right to review, audit, intercept, access and disclose any business or personal messages created, sent, or received on the company's systems and equipment. To assure legal sufficiency, this section should also include a clear unambiguous statement that the employer *will* monitor the employees' e-mail.

Acknowledgment and Consent to Monitoring

One of the most important provisions of the policy is the employee acknowledgment and consent to monitoring. Employers should require every employee to sign the policy acknowledging that he or she has read the company's electronic communication policy, agrees to adhere to it, and consents to the employer's monitoring of his or her e-mail.

In addition to a signed acknowledgment, employers should obtain consent each time the employee accesses the computer system by having the Intranet provider place a message on the computer that is activated when an employee logs on. The warning message could state that "[Company] computing and communication resources are provided for business-related purposes. [Company] will monitor system use and inappropriate activity will subject users to appropriate disciplinary action, which may include termination."[16] The notice should ask the employee to acknowledge that he or she agrees to the terms of the policy before logging onto the system. Employers can also post notices throughout the workplace advising employees that e-mail and Internet use are not private and may be monitored. This negates any assertion that the employee had an expectation of privacy.

The previous list is by no means meant to be exhaustive. It is merely a starting point for creating an effective electronic communications policy. Once a company determines its individual needs, it can incorporate these suggestions into its own policy. In addition, employers should familiarize themselves with the ECPA to prevent inadvertent violations that could subject them to both civil and criminal liability. However, no policy, no matter how well drafted, is going to be effective unless it is uniformly distributed to the employees and consistently enforced.

NOTES

1. 18 USC 2510 et seq.
2. 18 USC 2511(1)(a).
3. Rice, *Hi-Tech Harassment: How to Address Hostile Workplace Claims Based on E-mail and Internet Usage,* ABA Annual Meeting (2001) (citing 18 USC 2511(1)(c) and (d)).
4. 18 USC 2520(b)(2).
5. 18 USC 2520(b)(1).
6. 18 USC 2520(b)(3).
7. 18 USC 2511(4).
8. 18 USC 2511(2)(d).
9. 18 USC 2510(5)(a).
10. *Adams v City of Battle Creek,* 250 F3d 980 (6th Cir 2001).
11. 18 USC 2510(4) and (5)(a).
12. 18 USC 2511(2)(a)(i).
13. Donbrow, *Electronic Communications and the Law: Help or Hindrance to Telecommunication?*, 50 Fed Comm LJ 685, 697 (1998) citing Lee, *Watch Your E-Mai! Employee E-mail Monitoring and Privacy Law in the Age of the "Electronic Sweatshop"*, 28 J Marshall L Rev 139, 156 (1994).
14. White, *E-mail@work.com: Employer Monitoring of Employee E-Mail,* 48 Ala L Rev 1079, 1089 (1997) citing Morris, *E-mail Communications: The Next Employment Law Nightmare,* HR Advisor, at 15 (July-Aug 1995).
15. Rice, *supra* note 3, at 15.
16. Rogers, *You Got Mail But Your Employer Does Too: Electronic Communication and Privacy in the 21st Century Workplace,* 5.1 J Tech L & Pol'y 1 (Spring 2000).

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Electronic Discovery in Commercial Litigation

by Amy K. Hunt

Introduction

It would be the exceptional case today that does not involve some type of electronic discovery. Both the Federal Rules of Civil Procedure and the Michigan Court Rules make electronic information fair game and require that such information be produced in a usable format—either electronically or in hard copy. This access to information is both a blessing and a burden for all involved. While many litigators rejoice in finding that one ill-advised and ill-worded e-mail that makes the case, they are also dispirited by the task of reading through thousands of pages of e-mail, as is often the case even when steps are taken to narrow the universe of relevant communications.

Despite the burden and cost, electronic discovery is important because electronic information is one of the most powerful forms of information. While memories of events may fade or shift in favor of present circumstances, contemporaneous e-mail communications regarding the subject matter of the litigation can reveal (or at least seem to reveal) the true nature of the matter at hand or the parties' true intent. E-mail communications may also reveal when a company or individual first had notice of a particular problem, which may be relevant to determining whether the client has a statute of limitations defense. More subtly, e-mail communications can often convey the culture of a company and the personalities of its individuals, information that is usually not available to outside counsel.

Electronic information is more than just the details revealed in e-mails. Over half of all business documents are never printed. If the dispute involves an agreement, that agreement's electronic trail, captured by a word-processing program, can reveal points of contention and can shed light on the intentions of the parties. In addition, production of a company's financial information in computer-readable format, including sales and marketing data, can facilitate data manipulation and ease damages calculation.

Electronic discovery is the subject of an ever-increasing number of articles and scholarship; entire continuing legal education conferences focus solely on the topic. The intent of this article is to give the business lawyer a brief overview of what is happening today in commercial litigation as well as to highlight areas of concern that should be addressed by clients.

What Can Be Discovered?

Relevant Information

Generally speaking, both the federal and state discovery rules are broadly worded to permit discovery of virtually anything that is relevant to the subject matter of the dispute.[1] Most judges tend to be permissive in their discovery rulings, applying limits only to the most over-reaching of requests.

The definition of *document*—as in request for production of documents—includes electronic data.[2] Discoverable electronic information includes, but is not limited to the following:

- Voice mail messages and files (including backups)
- E-mail messages and files (including back-ups and deleted e-mails)
- Data files
- Program files
- Backup and archival tapes
- Temporary files
- System history files
- Web site information stored in textual, graphical, or audio format
- Web site log files
- Cache files (which can reveal Internet activity)
- Cookies (containing user information collected by Web site operators)[3]

Because *document* is broadly defined, when the client receives a document request in the context of litigation, the client should produce not only available hard copies of responsive documents, but should also evaluate whether electronic data exists that is responsive to the request. A lawyer must become familiar with the client's information services department, with how data is maintained, and with the company's archiving and back-up procedures. No lawyer should overlook the client's use of personal digital assistants (PDAs) such as Palm Pilots or Blackberries, which invariably contain rele-

vant and responsive information, or employees' home computers, to the extent that they may contain business-related materials.

Drafts

If the dispute involves a contract of any sort and there are questions of interpretation, the existence of drafts can be a significant source of helpful information. In this respect, clients and lawyers should be aware that, in addition to the text of the document, a document file can also contain embedded data or metadata, such as "the date the document was created, the identity of the author, the identity of subsequent editors, the distribution route for the document, or the history of editorial changes."[4] If opposing counsel has requested only the electronic document, steps can be taken to convert the document to a pdf or tif format to limit the availability of embedded data and prevent inadvertent disclosure of privileged information.

If the dispute involves a contract of any sort and there are questions of interpretation, the existence of drafts can be a significant source of helpful information.

Deleted Information

Much is said and written today about the difficulty in truly deleting electronic information. In the case of e-mail, for instance, one user's attempt to delete an e-mail may not actually result in deletion of that e-mail because it may also exist on a file server, in the files of the sender, in the files of individuals to whom it was forwarded, or in backup files. Even data that exists in only one place and is deleted may under some circumstances be recovered by computer forensic experts who specialize in the recovery of deleted data. Finally, deleted information may exist on tape backups and in archives.

Background on the Client's Information Technology Capabilities and Practices

In listing witnesses with knowledge of relevant facts either as part of Rule 26 disclosures or in response to an interrogatory request, the lawyer should identify the client's management information system managers.[5] It is becoming more common for opposing counsel to seek information from these managers before serving document requests. By taking this preliminary step, the lawyer seeking documents can frame requests in such a way as to obtain precisely the information required in the format required.

Even if the opposing party does not identify an information systems person, counsel may simply issue a 30(b)(6) deposition notice, asking the opposing party to designate a person able to testify to the following matters:

1. A complete description of all internal electronic mail and/or intranet communication systems in use at [company name] during the time period _____ to the present.
2. The record retention policies of [company name] for both hard copy documents and information stored in electronic format in effect at [company name] during the time period _____ to the present.
3. All protocols and/or policies in place at [company name] during the time period _____ to the present for creating and/or retaining backup tapes or other archive copies of electronic information or data, as well as the current location and custodian of all such backups and/or other archive materials.
4. A description of the operating platforms in use at [company name] during the time period _____ to the present (i.e., Novell, Windows NT, DOS, etc.).
5. An identification and brief description of all word-processing, spreadsheet, and database programs in use by [company name] during the time period _____ to the present.

Protecting the Privilege and Protecting Confidentiality

There is nothing particularly unique in the e-discovery context about protecting the confidentiality of privileged or other sensitive documents. For instance, if the client is producing marketing data, that data will likely be produced subject to a protective order, the terms of which usually are agreed upon by the parties and may even include "attorney's eyes only" provisions if the litigation is between competitors. That said, lawyers producing copious amounts of electronic data, including e-mails, must conduct a careful review to ensure privileged documents are not inadvertently produced. It is also generally advisable to address the problem up front by negotiating a procedure with opposing counsel for dealing with the inadvertent production of privileged information.

Producing the Data

Electronic data must be produced in a reasonably usable form.[6] Of course, not all parties want everything in printed, hard copy form. In some cases, especially when the data concerns financial or sales-type information, electronic production is preferred in order to give the requesting party the flexibility to manipulate the data. There are a number of outside services that specialize in

assisting with the production of electronic information. In the context of e-mail, for instance, outside consultants work with the raw data to eliminate system files, explode attachments, and minimize duplication. In a large case, the cost of these services is amply justified by the time saved in document review.

Another aspect of the production problem is access—who should retrieve the data and who is permitted access to the data? At least one court has used the rule permitting "entry upon designated land or other property" as a justification for compelling a responding party to submit its system to "inspection" by the requesting party so that party may retrieve the requested documents.[7] Often the parties can come to an agreement that the opposing party's expert may conduct an on-site inspection and retrieve the data. If the data is housed on a desktop computer, it is not uncommon to require the opposing party to produce the computer—or at least its hard drive—for inspection and review.

Planning for the Future

Given the likelihood that your client's computer information will be discoverable if your client is involved in litigation, it is important to plan ahead and implement policies and procedures that minimize the risk of electronic data becoming the source of damaging evidence. Policies should cover such topics as document retention, and e-mail, Internet, and voice mail use. Once promulgated, these policies must be diligently implemented and enforced.

Document retention policy: The vast majority of corporate clients have document retention policies geared towards industry or other regulatory requirements that plainly apply to paper documents. Document retention policies, however, need to reflect the fact that *document* is a broad term that includes electronic data. Retention periods for electronic data may be significantly shorter than for paper documents.[8] Backup and archiving policies are also a type of electronic document retention that should be specifically addressed by the client's information system personnel.

E-mail policy:[9] A client's e-mail policy should make it clear that: (1) the e-mail system—including messages composed, sent, or received—is company property; (2) employees should not consider their e-mail communications private or confidential; (3) the company retains a right to monitor, review, audit, intercept, access, delete, and disclose all messages created, received or sent; (4) employees should not use e-mail in a manner that would violate defamation laws and should avoid casual or humorous messages that may be misconstrued if taken out of context; and (5) employees should not use the e-mail system to create offensive or disruptive messages, including messages that contain sexual implication or image, racial slurs, gender-specific comments, or any other comment that offensively addresses someone's age, sexual orientation, religious or political beliefs, national origin, or disabilities.

Voice mail policy: A client's voice mail policy should make it clear that: (1) the voice mail system is company property; (2) the company reserves the right to access the contents of voice mail communications when necessary for any business purpose; and (3) employees are prohibited from creating or maintaining offensive, demeaning, or disruptive messages.

Internet policy: A client's Internet policy should make it clear that : (1) employees' access to the Internet will be monitored; and (2) employees' use of the Internet should be consistent with the employer's policies regarding sexual harassment and offensive or disruptive communications.

Preserving Electronic Information When on Notice of a Claim

Finally, and perhaps most importantly, clients must also be advised of their obligation to maintain documents relevant to identified controversies.[10] This will require the client to adopt "protocols for exempting from destruction those records relevant to identified controversies."[11] Failure to do so may result in the imposition of significant discovery sanctions or the invocation of a presumption that the destroyed documents are unfavorable to the client's cause.[12]

Document retention policies . . . need to reflect the fact that document *is a broad term that includes electronic data.*

NOTES

1. As a technical matter, the federal rules are worded more narrowly than the state rules. *Compare* Fed R Civ P 26(b)(1) ("Parties may obtain discovery regarding any matter, not privileged, that is relevant to the claim or defense of any party.") *with* MCR 2.302(B)(1) ("Parties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action, whether it relates to the claim or defense of the party seeking discovery or to the claim or defense of another party."). In practice, however, this is a distinction without much of difference.

2. *See, e.g.*, Fed R Civ P 34(a) (a request for production of documents includes data compilations); *Simon Prop Group, LP v MySimon, Inc*, 194 FRD 639, 640 (SD Ind 2000) (holding that "computer records, including records that have been 'deleted,' are documents discoverable under Fed R Civ P 34"); *Playboy Enterprises v Welles*,

60 F Supp 2d 1050, 1053 (SD Cal 1999) (granting plaintiff access to defendant's hard drive in order to obtain deleted e-mails).

3. *Kleiner v Burns*, 2000 WL 1909470, at *4 (D Kan Dec 15, 2000).

4. Flynn & Finkelstein, *A Primer on "E-vide-n.c.e.", Litigation* 34, 36 (Winter 2002).

5. *See supra* note 4, at 35.

6. *See, e.g., Haworth, Inc v Herman Miller, Inc*, 162 FRD 289 (WD Mich 1995) ("Defendant, as the respondent to the discovery request, has the obligation in this case to translate the data on the electronic tape into a form usable by plaintiff.")

7. *See Strasser v Yalamanchi*, 669 So 2d 1142, 1145 (Fla Dist Ct App 1996).

8. *See, e.g., Samuels v Mitchell*, 1995 WL 936327, at *2 (ND Cal Jan 18, 1995) (approving 90-day e-mail retention policy).

9. *See* Janet M Ziulkowski's article on page 22 for further discussion of company e-mail policy.

10. *See, e.g., Shamis v Ambassador Factors Corp*, 34 F Supp 2d 879, 889 (SDNY 1999) (holding party under duty to preserve relevant electronic information when on notice of a claim).

11. Flynn & Finkelstein, *supra* note 4, at 37.

12. *See In re Prudential Ins Co of American Sales Practices Litig*, 169 FRD 598, 615 (DNJ 1997) (even in the absence of proof that Prudential intentionally intended to frustrate discovery, court sanctioned Prudential $1 million for "its haphazard and uncoordinated approach to document retention"); *Hamann v Ridge Tool Co*, 213 Mich App 252, 255 (1995) (stating spoliation standard).

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Technology: Is It All Good?

by William D. Girardot & Joseph A. Ahern

Introduction

One can scarcely pick up a legal magazine without running into a technology-related article of one sort or another. (This issue is certainly no exception.) Most of the articles address recent applications of the latest technology or show how one can increase productivity or eliminate staff by buying expensive law-office equipment. As this rush to a more hi-tech legal profession continues, rarely do we pause the discussion to consider whether these advances are good or bad for the profession.

This article attempts to examine both sides of the technological coin. The authors coexist in a Troy law firm attempting in its own way to adjust to the continuing developments in technology used by the legal profession.

Of Course Technology Is Good
by William D. Girardot

The tremendous impact of technology on the practice of law was vividly demonstrated in the aftermath of the terrorist attacks of September 11, 2001. With the immediate grounding of all commercial air traffic in America following the attacks and the inevitably slow restoration of public confidence in the safety of our aviation system following the resumption of flights, our society's reliance upon communication technology was tested as never before.

The nearly universal availability of Internet access, fax machines, and cell phones provided a critical element in sustaining the American economy in the days of uncertainty which followed September 11. With airplanes grounded, the safety of the entire American transportation system in doubt, and an economy poised on the brink of a recession, the business of America nevertheless proved its resiliency.

Indeed, only months from the date of the attacks, the nation's economy appears to be on the mend with many economists describing the 2001 recession as perhaps the most mild recession of the post–World War II era—even to the point that some now question whether we should label the economic slowdown of 2001 as a recession. Certainly, this economic recovery was made possible by the fortitude of the American people who demonstrated their ability to persevere in conducting their daily business activities in the face of grave peril.

The availability of hi-tech communication systems also contributed mightily to the rebound in America's economic fortunes. With universal Internet access, videoconferencing, and other communication systems, the adverse economic impact that might otherwise have flowed from the loss of the nation's air transport system was greatly reduced.

Adapting to wholly new realities, American business quickly concluded that much of its work, albeit not all, could continue without the benefit of face-to-face meetings afforded by airline travel. In fact, despite the resumption of public airline travel by the week following September 11, many businesses throughout the United States implemented self-imposed restrictions prohibiting airline travel for work-related concerns except in cases of utmost necessity. To fill the gap necessitated by these air travel limitations, businesses were able to rely upon the vast array of communications systems and devices that have become available within the last 20 years to keep pace with their business needs.

The legal field perhaps was more insulated from the disruptions that occurred post-September 11 than other businesses. Unlike other business endeavors, whose success or failure ultimately depends on the delivery of tangible products, the success of legal practitioners depends almost exclusively on the delivery of intangible services to their clients. It is the idea contained within a brief that adds value to clients' causes. Therefore, as long as lawyers throughout the United States were able to communicate the ideas underlying their client's causes, be it in a brief, a contract, or any other electronically renderable document, the business of law could proceed relatively unscathed by the events afflicting other portions of the nation's economy. Of course, since the legal profession, whether civil or criminal, mirrors American society as a whole, to the extent America was hurting, so America's lawyers inevitably felt a sting as well.

The technological improvements that have marked the practice of law since 1980 served the legal field well in the period fol-

lowing the terrorist attacks of September 11 and highlighted the profound change in the practice of law that has occurred in only the past quarter century or so. Beginning with the widespread use of the fax machine in the early 1980s, the practice of law has changed dramatically from preceding eras.

By today's standards, items like the fax machine hardly seem technological advancements. But with the advent of the fax machine (and the rise of overnight delivery companies such as FedEx and UPS), lawyers were no longer bound by the temporal restrictions imposed by the restraints of the traditional postal system. For instance, before the use of fax machines, a contract draft to be circulated among multiple parties would travel at the rate the post office provided if the parties were not located within driving distance of one another. This necessarily added days to the process of reviewing and revising draft documents.

With the fax machine, these time constraints changed almost overnight. No longer would the time for drafting a document from beginning to end be measured in weeks or months; instead, with the nearly instantaneous delivery possibilities afforded by fax machines, a lawyer's turnaround time for documents was compressed to hours if not minutes.

This trend was hastened by the rise of computers and word-processing systems, which made their appearance in the legal workplace in the mid-1980s. Just as fax machines reduced document delivery time, word processors facilitated a reduction in the time actually spent on document preparation. Indeed, with the spread of word processors, the typewriter became a relic of history in the same way that monastic scriveners of medieval times became a historical curiosity upon Gutenberg's invention of the printing press.

No longer bound by bottles upon bottles of correction fluid, ever-more sophisticated word-processing programs allow lawyers to substantially decrease the time necessary to physically prepare their documents while steadily increasing the quality of their work. Through the wonders of the backspace key, the cut and paste options, and the ability to merge, download, and import text, a document undergoing revision no longer has to be manually retyped from start to finish or suffer the indignity of being blotched hither and thither with whiteout. Instead, with a few deft keystrokes, a draft document may now be revised quickly and cleanly to obtain a final product in considerably less time than was permitted by a typewriter. In turn, having saved time in physically preparing a document, the drafting attorney is afforded more time to polish the substance of the document.

The development of CD-ROM law libraries and the access to vast amounts of legal material via the World Wide Web have in many instances transformed the capacity and speed of legal research.

Many law practices have obtained even greater efficiencies by relying upon the many technological improvements in legal research. The development of CD-ROM law libraries and the access to vast amounts of legal material via the World Wide Web have in many instances transformed the capacity and speed of legal research. Although these tools may not completely replace the traditional print library, few can argue that these technological research tools do not greatly expedite the tasks of a legal researcher. These developments combined with the abilities of computer platforms to integrate vast amounts of information have allowed complex document formation, from the drafted form and contract to the electronic form products available to lawyers.

More recent developments in technology have also served to increase the pace by which legal information is transferred. E-mail has allowed information to be transferred nearly instantaneously via the Internet. Documents, which just a few years back were transferred by fax, are now sent by e-mail, allowing the recipient to immediately review and directly revise the document at his or her desk without delay. Perhaps of even greater significance is the growing capability for filing pleadings and other forms with courts and agencies through electronic transfer. Although in the distinct minority, the paperless law office[1] has now become a reality and will likely become more common as comfort levels with this technological revolution rise.

Recent improvements in wireless technology have also been widely adopted by law practices across the country. Beginning with the widespread introduction of voice mail and fax machines in recent years, no lawyer has been too far away from matters at the office requiring immediate attention. Now, with cell phones and routine access to e-mails and the Web, a lawyer need rarely, if ever, be out of touch with his or her office. Without a doubt, wireless technology and remote access to the Web have tremendously increased lawyers' capability to remain in constant contact with their clients, their offices, and the tools of their trade, whether they are out of the office on a business trip or, perhaps regrettably, even on a vacation.

These developments in computers and

communication have certainly proven to be a boon for the practice of law, and in all likelihood, this trend will continue. For one, there is every reason to believe that videoconferencing will become even more prevalent, with video meetings, status conferences and the like becoming commonplace as the technology becomes more accessible. As demonstrated by the aftermath of September 11, with the use of videoconferencing, the lawyer's need for travel and all the attendant costs and time associated with travel may be substantially reduced.

Likewise, designers of wireless technology, which is perhaps still in its infancy, are now integrating its various forms into one unit combining the best of a cell phone and a portable digital assistant (PDA). Moreover, even as these improvements appear on the horizon, greater advances are developing in the area of Web access for wireless technology as Web browser software adapts to the growing demand for remote Internet access and instant communication.

All of these advances bode well for an attorney's ability to practice law more efficiently. With instantaneous communication, a lawyer's ability to quickly absorb and accurately convey his or her client's message will certainly continue to increase by leaps and bounds. Not only will this permit lawyers to perform their jobs better, but from the clients' perspective, it should reduce the attorney's fees as attorney travel and research time decrease.

Without minimizing the undesirable side effects that technology may bring to certain aspects of the practice of law (which are addressed in the accompanying section), few can deny that the implementation of the technological improvements of the last 20 years have allowed lawyers to better serve their clients. Although the resources available to lawyers through advanced office technology are no substitute for the exercise of a lawyer's knowledge and sound judgment, these technological advances allow lawyers to leverage their time and experience in ways never before possible.

Let's Not Be Too Sure About That

Joseph A. Ahern

While technology has been helpful in many ways to the profession of law, it has also negatively affected the practice. Much has been written lately about technology and the law. This fascination with technology should not be surprising. The last 150 years have seen an unrelenting explosion of technological advances and the pace of innovation seems to be accelerating. We seem to have an inexhaustible appetite for whatever is newer, better, more powerful, etc., as seen in the information revolution of the last ten years.

The practice of law, of course, has not been isolated from this phenomenon. When I started practicing law eighteen years ago at a small firm in Milwaukee, Wisconsin, I had no idea what a fax machine was. At that time, a fax machine was a luxury available only to the largest firms, which proudly advertised their Telecopier number across their letterhead. Eighteen years ago, an extensive brief was ten pages long, and if I asked my secretary to do more than two drafts, she knew lunch was on me the next day. My desk was free of any cathode ray tubes and my briefcase (sans my laptop) was about four pounds lighter than it is now.

Without question, technology has affected the practice of law. It has resulted in physical changes to my desk and greater demands on my time as my clients, opposing counsel, and the judiciary demand increasingly faster turnaround to their (frequently unreasonable) requests. My desk is getting more cluttered with my PC on one end and an ever-growing stack of inch-thick briefs on the other. It has been many moons since one of my fellow attorneys greeted me with a blank stare when I asked for their e-mail address. Obviously, technology, which has made these things possible, has had a profound impact on my own practice of law, as I am sure it has affected yours.

However, the question that I rarely see examined is whether these advances in technology have ***substantively*** affected the way we practice law. Certainly, the use of cell phones and PDAs is a formative change in the way we practice law, but do these changes affect the way we think and behave regarding the law?

It is my opinion that technology has negatively affected the legal profession. I believe that technology has affected the way lawyers think and argue as well as how they relate to other lawyers. In days past, clear and concise prose was esteemed and practiced by the legal profession; volume, rather than substance, now seems to carry the day. In days gone by, lawyers were traditionally viewed as helping to narrow and focus issues. Now it seems that the best lawyers are those who create the most issues. Finally, I believe that technological advances have contributed, at least in part, to the decline in the civility of lawyers.

Lest you think I am a Luddite, I do be-

In days past, clear and concise prose was esteemed and practiced by the legal profession; volume, rather than substance, now seems to carry the day.

lieve that technological advances have the promise of positively affecting the way we practice law. However, I believe the way many lawyers are currently implementing these technological improvements has not resulted in a positive gain for the profession.

Let me guide you through a short history lesson on the interaction of technology and the law to illustrate my point.

Technology and the Practice of Law Prior to 1850

When Abraham Lincoln began practicing law in 1837, the life of an American lawyer had remained unchanged for almost two centuries. Lincoln studied for the bar with the help of a few musty old legal tomes located at the law practice of his mentor. When Lincoln received his law license, he rode the circuit, travelling on horseback from town to town, often meeting clients for the first time on the courthouse steps. Communication between Lincoln and his clients was usually limited to person-to-person conferences and the exchange of letters. These letters were written in longhand using expensive ink, paper, and postage.

In colonial Boston, cases were heard at the bar for 150 years before a trial required more than one day for complete adjudication.

These constraints compelled early American lawyers to be concise in their writing and direct in their speech. Thomas Jefferson had captured the essence of the new democratic age and launched the independence of this nation in a document scarcely two pages long. Four score and seven years later, Abraham Lincoln described the grief of an entire people at Gettysburg in a mere 268 words.

Similarly, dispute resolution was a much quicker endeavor than it is today. In his most famous case, Abraham Lincoln cleared Duff Armstrong of a murder charge in a short one-day trial. In colonial Boston, cases were heard at the bar for 150 years before a trial required more than one day for complete adjudication. It was not until 1770 and the trial of the nine soldiers charged in the Boston Massacre, that John Adams (barrister for the defendants) and his opponent Robert Paine were compelled to spend two entire days deciding the fate of these nine men (and 13 colonies).

Both Adams and Lincoln enjoyed respectful, if not warm, intercourse with their contemporaries in the law practice. Almost every attorney in Boston in the 1760s and in the Springfield area in the 1840s rode the circuit with their fellow lawyers and judges. These attorneys spent long days on horseback travelling from town to town. Virtually every night, Adams and Lincoln shared a bed with one of their travelling adversaries. The bar was small and it was difficult to avoid dealing with the same lawyer again and again. In these tight-knit legal communities, with the same lawyers trying cases against each other day after day, there was little room for the unkept promise or the broken bargain.

1850–1945

The period encompassing the second half of the nineteenth century and the first half of the twentieth century experienced an unparalleled explosion of technological advances. These advances, which were most pronounced in the areas of transportation and communication, are typically associated with the rise of the United States as the preeminent global economic power. However, the practice of law was also profoundly affected by these advances.

In 1850, the United States' railroad network was scarcely deserving of the name. It consisted of a crazy quilt of short lines, each with their own standard gauges and little, if any, ability to operate together. Nineteen years and a Civil War later, the blood and sweat of thousands of Irish and Chinese immigrants made possible the hammering home of the Golden Spike at Promontory Summit in Utah, signifying the joining of the Union Pacific and Central Pacific Railroads—the Transcontinental Railroad was a reality and the nation suddenly became much smaller.

Although the Transcontinental Railroad occurred four years after his untimely death, Abraham Lincoln still benefited from the improvement of the railway system in the old Northwest Territory prior to his presidency. Once confined to the area around Springfield, Lincoln was able to represent clients as far away as Chicago and Cincinnati. The emergence of regional rather than local law practices began to emerge.

In the areas of communication, the greatest innovations prior to 1945 were the telegraph and telephone. Instantaneous communication, once confined to the immediate vicinity of the speaker and listener, now took place between parties at the opposite end of town, the county, the state, and even the country. The ability to communicate with clients also led to the regionalization and nationalization of the law practice.

1945 to Present

The manufacturing and transportation revolutions that occurred prior to World War II paved the way for the information revolution. In the cold war era there was a demand

for better and faster machines that could aid the United States in its struggle with the Communist world. The enormous and expensive computers of the 1940s and 1950s grew ever smaller, cheaper, and faster. It was not until the 1970s, however, that these advances in technology became available to the law office.

Of all the developments in technology, word processing had one of the most immediate effects on the practice of law. The word processor placed the creation of voluminous documents and briefs within the reach of even the smallest law office. Although it may have leveled the playing field between various-sized law firms, the increased capability to pump out reams of paper via word processor also certainly lengthened the field. Previously, the ability to create mountains of paper was limited to the larger law firms. However, as the typewriter gave way to mag cards that in turn gave way to mainframes and now PCs, every lawyer obtained enormous word-processing capability.

Thirty years ago, every change to a brief or document meant a painstaking whiteout application or a complete retyping of the entire document. A lawyer's ability to refine his or her ideas was limited to the size and patience of his staff. Now, however, the ability to change documents has become infinitely more accessible. One would expect that this would result in more concise, better-drafted documents. The Law of Unintended Consequences, however, has dictated that precisely the opposite has happened. Many, if not most lawyers, now use the editing process as an addition process. Documents, instead of becoming more concise, become endless recapitulations of frequently unconnected ideas. With the cut and paste function, attorneys are able to collect snippets of their past works into a collage to address this week's issue. Although this method may meet with occasional success, more often it diffuses and confuses the work product.

This phenomenon is most pronounced in the transactional field. Contracts are growing longer. Of course, some of this increase should be attributed to the growing size and complexity of transactions themselves. However, I believe it is the ease of technology which has also added to these ever-growing documents. The "canned" portion of every contract seems to be growing longer and longer. Entire sections seem to be devoted to such topics as whether the headings of a section are intended to be substantive or descriptive—is there really a difference? I am aware that all these sections (even the one I just described) emanate from some prior real dispute. Lawyers are simply trying to cover every contingency and protect their clients from every possible harm. However, I believe the continual tacking on of contractual clauses to cover every potential contingency does not clarify the parties' intent. Rather, it provides fertile ground for the litigators after the deal is consummated.

The unfettered lengthening of documents has also affected the litigation field. One of the primary roles of a litigation attorney is to distill succinctly his or her client's position into a clear and concise argument. The word processor has had the opposite affect on the practice. When was the last time anyone saw a three-page brief, citing a few cases, that was centered on the central issue of the case? Instead, it appears that briefs nowadays go on for pages and pages accompanied by long string citations. It is not uncommon, for instance, in a motion for summary disposition to see FRCP 56 cited along with seven or eight cases reiterating that, yes, motions for summary judgment are granted only when there is no genuine issue of material fact. Why the eight cases? Because they're on the word processor. Has the proponent or his or her opponent read these cases? Do we expect that the judge will?

When was the last time anyone saw a three-page brief, citing a few cases, that was centered on the central issue of the case?

As most of the judiciary can attest, motion day is choking the courts with endless disputes on discovery, procedure, and virtually anything other than the substance of the case. Indeed, it appears to be a defense strategy to keep cases going as long as possible and to create as many issues as a fertile lawyer's mind can conceive of to gain some advantage over the opponent. Of course, two can play at this game in the war of the word processor and endless motion hearings can be the result.

The facsimile machine has also had a tremendous impact on the practice of law. The law by its very nature has always been contentious. Rarely has there ever been a trial where there was not a heated exchange or argument between battling attorneys. Inflamed passions are frequently encountered in face-to-face and even in telephone exchanges. However, until the advent of the fax machine, these emotional exchanges typically remained outside of the attorney's written product. Lawyers had time to reflect (and perhaps cool down) and measure their words in response to correspondence from the other side. A letter written at 1:00 could go through several revisions prior to its

posting at 5:00.

All this changed with the introduction of the fax machine. Where once our correspondence consisted of well-thought-out missives, they have now taken on the countenance of unguided missiles. I doubt that a single reader, at least once in his or her career, has not fired off a later-regretted, hastily drawn fax response to an adversary's communication (which was also probably faxed).

The fax machine has also created some new tactics for the enterprising litigator. It appears that many practitioners believe that the court rule's requirements regarding briefs do not apply to faxed supplements. It has become almost standard practice for attorneys to fax "supplemental materials" to the court on the afternoon (or even early evening) prior to a substantive hearing. I wonder how much additional billable time has been wasted on a Wednesday morning motion call in Oakland County as lawyers try to sort out whether the fax that was sent the day before at 4:59 p.m. and not placed on the opposing attorney's desk until Wednesday morning was actually received and should be considered by the court.

I feel most attorneys share my belief that there has been a breakdown in interlawyer relations over the past two decades. This behavior has been institutionalized to the point where there are (not a few) seminars that deal specifically with the "bad faith litigator." Is this a result of more "bad" people being admitted to the profession? Perhaps. But perchance it is also a result of the stress created as the ever-increasing pace of technology forces new demands on the individual lawyers. Or perhaps it is the result of greater depersonalization of the practice. As I mentioned earlier, attorneys in Abraham Lincoln's day were forced to get along because of their close personal proximity as they rode circuit. Now, this personal contact is lost as we communicate with each other primarily via telephone and, even more impersonally, by e-mail. E-mail is worse because it removes the ability of the receiver to ascertain contextual clues to statements that would otherwise be discernible by hearing the inflection placed upon words in a sentence or via body language. This, combined with the informality adopted by most e-mail users, has certainly led to some very great disagreements when statements are taken out of the intended context.

In sum, technology seems to hold (and I believe the previous section argued) great promise in our profession. However, I believe technology does not lead to an automatic gain for the profession; I believe it is the profession which must use the technology in a responsible way to better itself and, ultimately, the clients it serves.

NOTES

1. *See* Stephen M. Landau's article on page 35 for a view of the paperless office.

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The Paperless Office: How I Went into Semiretirement

by Stephen M. Landau

Introduction

It is now possible to have constant access to our client files (whether we are in the office, at home, or on the road), to secure the content of those files, and to store them indefinitely without cost (and without filling our garages or basements), saving money along the way. The purpose of this article is to outline how to go paperless and gain these advantages.

You Can Eliminate All the Paper—Ethically and Responsibly

The first step in going paperless is to develop a sensible record retention policy that allows the elimination of clutter in a manner consistent with the ethical guidelines provided by the State Bar of Michigan Committee on Professional and Judicial Ethics. Those guidelines emanate from a group of formal ethics opinions[1] and essentially provide the following principles:

- Attorneys have two forms of paper in their possession. On the one hand, there are "funds and other property in which a client . . . has an interest."[2] Common examples of such property include a title abstract or other documents provided to the attorney by the client for use in a transaction and photographs or other documents that are personal to the client but are provided to the attorney for use as evidence in a case. On the other hand, there is the balance of clutter attorneys accumulate, including "pleadings and other documents that are wholly available as permanent records of the presiding court," attorney work product (including research, memoranda, and other paper generated by the attorney), and internal bookkeeping, billing, and accounting records.
- Clients have a right to the return of the property in which they have an interest. Attorneys "own" all other records in their possession, although the client has the right to access the materials that properly comprise the representation file.[3] Attorneys may charge a reasonable fee to find and /or copy the materials they own.[4]
- Retention of a document "depends on the content of the record, not on whether the record is maintained on paper, tape or computer disk . . . ."[5] Original documents must be retained in an original format only if (a) they are personal to the client, (b) they are not available as part of the public record, or (c) retention in any other form would not be in the "best interests of the client" (as determined by the "best judgment" of the lawyer).[6]
- As an alternative to forever storing those few documents that must be retained in their original form, lawyers may (a) reach an agreement with the client, either at the outset of the representation (perhaps as part of a standard retention agreement) or at its conclusion; or (b) thereafter make a reasonable attempt to locate the client through notice to the client's last known address, wait a reasonable period, and then dispose of the materials.[7]

Organizing the Paperless Office

A paperless office differs from a conventional office in that everything is viewed on a computer monitor rather than on paper. Otherwise, it can be organized in an identical fashion to the traditional office. For instance, just as paper files are divided into correspondence, drafts, executed documents, or pleadings, discovery, and briefs, so can electronic files be organized in an identical fashion. Instead of keeping files and documents in an old wooden desk, they are kept on a computer desktop.

The Equipment List

Going paperless takes less equipment than you might think. This is the minimum equipment list for your paperless office: one server with built-in tape backup; one laptop computer per attorney plus at least one extra laptop for the office; a suitable number of printers at the office, one of which is color; two fireproof vaults or safes, one at the office and one off-site; a firewall and a virtual personal network (VPN); a T1 phone line at the office for Internet access; and a cable modem or other high-speed Internet access device at home for each attorney.[8]

The Tangible Benefits of Conversion

In a recent article by Marcia L. Proctor entitled "Are You Prepared?," the author addressed the dilemma faced by attorneys living in the world of paper.[9] Fire, disaster, computer crashes, and the like imperil records. None of these problems exists in the properly structured paperless office. Because all computers in the office and out of the office are networked, each computer itself constitutes a backup of all data. In the paperless office, all documents generated *and* received from others are maintained on the computer system and, therefore, are backed up. The two fireproof vaults or safes mentioned earlier constitute your further security. Daily backup tapes and laptops left at the office are stored in the vault at the office when not in use. The second vault, kept off-site (at your residence), stores duplicate backup tapes. You have now protected clients' records and the core of your practice from any reasonable catastrophe. You should also have greater control of your practice's information management system—you are no longer a slave to that task.

Fire, disaster, computer crashes, and the like imperil records. None of these problems exist in the properly structured paperless office.

The Intangible Benefits: Increased Productivity Is the First Advantage of Going Paperless

Our computer system was set up to provide maximum ease of use. We expected that with familiarity we would also become increasingly productive. While this did occur, we experienced unexpected benefits: a state of semiretirement.

The freedom that computers provided gave us these unexpected benefits. With all the hardware and software properly installed, whether we are at the office, at home, or at any other location where high-speed Internet access is available, we can access files and work exactly as if we were in the office. In fact, with a wireless local access network (LAN), connection to the office network is possible within approximately 300 feet of a cable modem. In other words, while others are driving to the office in rush hour, we can be working on the deck out back. Or if the weather is inclement—except for office conferences or court appearances—there is no need to go to the office at all.

Unless an appearance in court is required, we no longer drive during rush hour. We may leave the office before evening rush hour and still work at home later. We need not go to the office on a weekend or have to pack a briefcase and concern ourselves with any of the following: Should we take the entire file? What if we forget part of the file? What if we lose part of the file or it gets hopelessly disorganized? What if someone else needs to look at the file while we have it?

Conclusion

The system described confirms the three primary benefits of the paperless office:

(1) Financial Savings—you can gain increased productivity per attorney: time saved commuting; reduction of support staff; substantial decreases in postage expense and supplies, and a decrease in active file storage costs and closed file storage costs.

(2) Access to Files—as long as you have a computer with you and have a high-speed Internet connection available, all of your files and all of the contents of each file are available at any time.

(3) Increased Security—modern laptops can now be alphanumerically coded with hard drive passwords. This simply means that without the password, no one, within reason, can break into your laptop or off-site computer system. If your laptop is lost or stolen, the data on the hard drive is genuinely inaccessible to anyone, and thus, you have vouchsafed your clients' confidences while having substantially reduced your costs of operation.

When you add up all of these benefits and add the conveniences they yield, the result is tantamount to semiretirement.

NOTES

1. There are three major formal ethics opinions that deal with the ownership, retention, and destruction of file materials. In formal opinion R-5 (12/15/89), the State Bar Board of Commissioners noted that all law firms, including solo practices, are "obligated to have a record retention policy or plan in order to meet ethical obligations" and set forth the components of a record retention policy. Two years later, in R-12 (9/27/91), the Committee revisited the issue of retention and also set forth guidelines for the proper disposition of representation files and for saving files on microfilm. Finally, in R-19 (8/4/200), the Committee dispelled prior notions regarding ownership of and access to client files. *See generally* Allen, "Ownership of Lawyer's Files About Client Representations: Who Gets the Original? Who Pays for the Copies?" 79 MI Bar Jnl 1062 (2000).

2. MRPC 1.15.

3. R-19. Allen, *supra* note 1 at 1063, summarizes the differentiation under the heading: "It is the Lawyer or Law Firm Which is Entitled to the Original, Physical Materials in the File, Unless the Client Has a Special Need or a Pre-existing Proprietary Right in the Original."

4. R-19 summarizes the ownership /access issue as follows:

In conclusion, the ownership of the physical materials composing the lawyer's or law firm's file is to be distinguished from access to the information contained in them. The client's right is, in general, one of access, not custody or possession. Thus, it is properly the client who should bear the cost of copying and delivering copies of the file records.

5. R-5. Presumably, this applies with equal force to material stored on a CD-Rom, zip disk, or next format for electronic storage.

6. R-12.

7. R-5.

8. These are my suggestions and should not be considered exclusive:

Server—one Dell 2500 for offices of 1 to 25 attorneys.

Laptops—Dell refurbished, available from dell.com.

Firewalls—Sonicwall.

Printers—for black and white, the HP 4100; for color, the Tektronix Phaser.

Scanners—for 1 to 5 attorneys, the HP3100 C; for 6 or more, the HP 9100 C.

Service and Support—24/7 service agreements on all hardware and a very good tech support company.

9. Proctor, *Are You Prepared?* 21 MI Bus LJ 1, at 7 (Fall 2001).

Stephen M. Landau, of Stephen M. Landau, PC, Bingham Farms, practices in the areas of complex business litigation, commercial torts, and construction litigation. He is a member of the Real Property, Business Law, and Probate and Estate Planning Sections of the State Bar of Michigan. He is a mediator with the complex civil and commercial panels for Oakland County Circuit Court and a mediator for the commercial panel of Wayne County Circuit Court. He has published numerous articles and lectured to several professional groups.

Case Digests

Prepared by Abigail H. G. Ohl, Esq.

Labor and Employment Law—Racial Discrimination—Hostile Work Environment—Statutory Limitations Periods

Nat'l RR Passenger Corp v Morgan, 122 S Ct 2061 (2002). Title VII of the Civil Rights Act of 1964 requires a plaintiff to file an employment discrimination charge with the EEOC either 180 or 300 days after an alleged unlawful employment practice took place. Morgan, a black male, filed a charge of discrimination and retaliation with the EEOC against petitioner National Railroad Passenger Corporation (Amtrak), alleging that he had been subjected to discrete discriminatory and retaliatory acts and had experienced a racially hostile work environment throughout his employment. The district court granted petitioner partial summary judgment because some of the allegedly discriminatory acts occurred outside of the 300-day filing period. The Ninth Circuit reversed, holding that a plaintiff may sue on claims that ordinarily would be time-barred if they either are "sufficiently related" to incidents that fall within the statutory period or are part of a systematic policy or practice of discrimination that took place, at least in part, within the period. The Supreme Court affirmed in part and reversed in part, holding that a Title VII plaintiff raising claims of discrete discriminatory or retaliatory acts must file his charge within the appropriate 180- or 300-day period, but a charge alleging a hostile work environment will not be time-barred if all acts constituting the claim are part of the same unlawful practice and at least one act falls within the filing period. In neither instance is a court precluded from applying equitable doctrines that may toll or limit the time period.

Labor and Employment Law—Disabilities Discrimination—Reasonable Accommodation

US Airways, Inc v Barnett, 122 S Ct 1516 (2002). The Americans with Disabilities Act of 1990 (ADA) prohibits an employer from discriminating against an individual with a disability who, with reasonable accommodation, can perform a job's essential functions, unless the employer can prove that the accommodation would impose an undue hardship on its business operations. Barnett injured his back while working as a cargo handler and moved to a less physically demanding position in the mailroom. Barnett later lost the mailroom position to a more senior coworker under US Air's established seniority system. Barnett sued US Air under the ADA, alleging that US Air's decision not to make an exception to its seniority system amounted to a failure to reasonably accommodate his disability. The district court rejected Barnett's argument, ruling that requiring US Air to override its seniority rules constituted an undue hardship and granted summary judgment to US Air. The Ninth Circuit reversed, holding that the existence of a seniority system was only one factor in the undue-hardship analysis, and that a case-by-case fact-intensive analysis was necessary to establish whether any particular assignment would amount to an undue hardship. The Supreme Court vacated and remanded, holding that an employer's showing that a requested accommodation conflicts with seniority rules ordinarily is sufficient to prove, as a matter of law, that an "accommodation" is not "reasonable" under the Americans with Disabilities Act. However, the employee remains free to present evidence of special circumstances that make a seniority-rule exception reasonable in the particular case.

Labor and Employment Law—Disabilities Discrimination—Defenses and Exceptions

Chevron USA, Inc v Echazabal, No 00-1406, 2002 US LEXIS 1202 (June 10, 2002). Echazabal worked for independent contractors at a Chevron oil refinery until Chevron refused to hire him because its doctors said continued exposure to refinery toxins would worsen Echazabal's liver condition. The contractor laid off Echazabal after Chevron asked it to reassign him to a job with no toxins exposure or remove him from the refinery. Echazabal filed suit, claiming, among other things, that Chevron's actions violated the ADA. Chevron defended under an EEOC regulation permitting the defense that a worker's disability on the job would pose a direct threat to his health. The district court granted Chevron summary judgment, but the Ninth Circuit reversed, finding that the regulation exceeded the scope of permissible rule making under the ADA. The Supreme Court reversed, holding that the EEOC regulation does not exceed the scope of permissible rulemaking under the ADA and that an employer is not required to employ someone who has a disability that would pose a direct threat to his or her own health.

Taxation-—General Sales Tax Act—Michigan Use Tax Act

General Motors Corp v Dep't of Treasury, No 116984, 2002 Mich LEXIS 1042 (June 4, 2002). Purchasers of new GM vehicles receive a "goodwill" adjustment policy, under which GM, at its discretion, will pay for replacement parts after the limited warranty period has expired. Following an audit, defendant assessed use taxes on replacement parts provided under the goodwill policy. On appeal, the court of claims granted summary disposition to the defendant. The court of appeals affirmed, concluding that because GM dealers were not obligated to provide goodwill adjustments to all customers, the value of the goodwill program was not included in the gross proceeds arising from retail sales of its vehicles.

On appeal, the supreme court held that because the goodwill adjustment policy allows customers to seek redress of vehicle defects is included in the vehicles' retail price, and is purchased at the time of retail sale, it is part of the consideration flowing to customers when they purchase a vehicle that is taxed under the General Sales Tax Act. Since replacement parts provided under the goodwill program are subject to the sales tax at the time of retail sale, they are exempt from the use tax under MCL 205.94(1)(a).

Michigan Uniform Partnership Act—General Partnerships—Creation and Elements

Byker v Mannes, 465 Mich 637, 641 NW2d 210 (2002). In 1985, the parties went into business together, sharing equally in the commissions, financing fees, and termination costs related to the business entities that they created. The parties' business relationship began to suffer after a marina in which they had invested started losing money. Eventually, defendant stopped contributing money to the parties' enterprises while plaintiff continued to make loan payments, to incur accounting fees, and to enter into loans for the business. After unsuccessfully seeking reimbursement from defendant, plaintiff brought suit for the recovery of the money on the ground that the parties had entered into a partnership. The trial court determined that the parties had created a general partnership, even if this was not their subjective intent. The supreme court affirmed.

The supreme court held that in determining whether a partnership exists, the focus is not on whether the individuals subjectively intended to form a partnership; that is, it is unimportant whether the parties would have labeled themselves "partners." Rather, the focus is on whether individuals intended to jointly carry on a business for profit within the meaning of the Michigan Uniform Partnership Act, MCL 449.1 et seq. (the Act), regardless of whether they subjectively intended to form a partnership. The court noted that the Act contains no language requiring a subjective intent to create a partnership; in fact, subjective intent is not among the items to be considered on a list entitled "Rules for determining existence of a partnership," MCL 449.7. The supreme court also determined that the court of appeals' analysis of prior Michigan case law overemphasized the relative significance of the absence of subjective intent in ascertaining whether a legal partnership existed.

Business and Employment Torts—Unfair Business Practices—Interference with Contract

CMI Int'l, Inc, v Intermet Int'l Corp, No 225585, 2002 Mich App LEXIS 650 (Mich Ct App April 30, 2002). During negotiations for Intermet to acquire CMI, Intermet signed a confidentiality agreement, executed on March 31, 1998 (the March agreement), which prohibited Intermet from hiring any CMI managerial, sales, or technical employees without CMI's consent. When negotiations failed, CMI turned to the auction process; CMI required any auction participant (including Intermet) to sign a standard confidentiality agreement that prohibited soliciting its employees for one year without CMI's consent but did not address hiring of CMI employees. Intermet signed the agreement on July 23, 1998 (the July agreement). Hayes Lemmerz International, Inc. (Hayes) eventually purchased CMI. Hayes demoted one of CMI's key employees (Ruff), who later contacted Intermet. Intermet hired Ruff and Ruff resigned from CMI. The trial court dismissed all of CMI's claims against defendants; on appeal, CMI challenged the dismissal of the claims involving breach of the March agreement with Intermet and trade secret misappropriation.

The court upheld all of the trial court's rulings. It agreed with the trial court that the March agreement in fact was superseded by the July agreement, of which plaintiff could not establish breach; that agreement only prohibited soliciting of CMI employees, and Intermet did not solicit Ruff. On the tortious interference with contractual relations claim, CMI failed to sufficiently demonstrate that by seeking new employment with Intermet, Ruff unjustifiably instigated a breach of contract. On the trade secret misappropriation claim (actually a claim of threatened misappropriation), CMI offered no evidence of duplicity by Ruff or Intermet and failed to even suggest a specific trade secret that defendants were likely to misappropriate.

Taxation—Single Business Tax Act—"Definition of Royalty"

Columbia Assoc, LP v Dep't of Treasury, Nos 222513, 235810, 2002 Mich App LEXIS 594 (April 19, 2002). Plaintiff cable operators entered into affiliation agreements with several satellite networks, under which plaintiffs paid affiliation fees to the networks in exchange for programming packages that plaintiffs distributed through their cable television systems. Defendant, through a written, internal policy statement, declared that the affiliation fees are "rents" not "royalties" under the SBTA, and that payments plaintiffs made under network affiliation agreements had to be added back to their tax bases. With respect to plaintiff Columbia (docket number 222513), the court affirmed the tax tribunal's ruling that affirmed the deficiency assessment against Columbia. With respect to plaintiff Four Flags (docket number 235810), the court reversed a judgment by the court of claims that ordered defendant to refund to plaintiff single business tax that it had paid under protest.

The court held that the network affiliation fees were royalties under the SBTA and were required to be added to plaintiffs' tax bases. Citing *Mobil Oil Corp v Dep't of Treasury*, 422 Mich 473, 484-485, 373 NW2d 730 (1985), the court pointed out that the fees fit *Mobil Oil*'s definition of a royalty. The three key manifestations of a royalty include the following: (1) a payment, (2) the form of the product itself or proceeds from selling the product, and (3) something made in consideration for the use of the property. The court found that the fees clearly fit this definition.

Michigan Antitrust Reform Act—Noncompetition Agreements—Enforceability

Bristol Window & Door, Inc v Hoogenstyn, Nos 226114, 226138, 226139, 2002 Mich App LEXIS 465 (March 22, 2002). Plaintiff sells residential homeowners various home-improvement products including windows, doors, and siding. Defendants worked for plaintiff as independent contractors until they began establishing a competing home-improvement business. Plaintiff brought claims of trade secret misappropriation and breach of a covenant not to compete; defendants counterclaimed that the non-

competition agreements constituted unreasonable restraints of trade, in violation of the Michigan Antitrust Reform Act (MARA; MCL 445.771 et seq.).

The court held that the trial court erred in construing Sections 2 and 4a of the MARA as a prohibition against all noncompetition agreements except those between employers and employees. The trial court also erred in failing to apply the common-law rule of reason embodied within Section 2 of the MARA when ruling on the enforceability of the noncompetition agreement between plaintiff employer and defendant independent contractors.

Business and Employment Torts—Deceit and Fraud—Statute of Limitations—Discovery Rule

Boyle v General Motors Corp, No 225536, 2002 Mich App LEXIS 464 (March 22, 2002). Plaintiff Pat Boyle wanted to buy an existing Chevrolet dealership, for which defendant set the capitalization requirement at $350,000. Plaintiff raised the required funds and took over the dealership. When plaintiff later sought to sell the dealership because of financial difficulties, she submitted a proposed sales agreement to defendants for their approval. Defendants told plaintiff that "the rent factor in the agreement with [the purchaser] was not in accordance with its accepted rent factor formula." Relying on this statement, plaintiff did not sell the dealership and later went out of business. Plaintiff later learned that defendants had told the dealership's former owner that "it was easier for General Motors to let Pat Boyle buy a dealership and watch her fail than it would have been to prevent her from buying a dealership." Plaintiff also learned that the dealership was woefully undercapitalized and doomed to fail, and that the rent factor in the proposed sales agreement was within GMC's rent factor formula. Defendants argued that plaintiffs' fraud claims (based on the $350,000 capitalization requirement and the statement regarding the rent factor formula) were time-barred as they occurred in 1988 and 1991 and plaintiff did not file suit until 1999. Plaintiff argued that the discovery rule should apply, and as the fraud was not discovered until 1995, her claims were not time-barred. The trial court ruled for the defendants, finding that it was bound by *stare decisis* to follow *Thatcher v Detroit Trust Co*, 288 Mich 410, 285 NW 2 (1939) (discovery rule only applies to fraud action if defendant concealed cause of action).

The court of appeals reversed, holding that that the discovery rule applies to fraud actions. In asserting that plaintiff's claim was time-barred, GMC relied on two cases in which the supreme court did not apply the discovery rule to fraud actions. The court dismissed the significance of these cases as they predated the adoption of the discovery rule in Michigan. Also, the court noted that in *Williams v Polgar*, 391 Mich 6, 25 n18, 215 NW2d 149 (1975), which concerned negligent misrepresentation, the supreme court quoted with approval an Idaho decision in which the court emphasized the unjustness of not applying the discovery rule to fraud cases. In addition, the court discussed *Fagerberg v LeBlanc*, 164 Mich App 349, 416 NW2d 438 (1987), which quoted *Williams* and concluded that the discovery rule applies in actions for fraud.

Taxation—Administration and Procedure—Definition of "Filing"

Florida Leasco, LLC v Dep't of Treasury, No 225119, 2002 Mich App LEXIS 42 (January 15, 2002). Although the tax tribunal dismissed petitioner's appeal as untimely because it was sent by certified mail upon, but received one day after, the 35-day deadline set by MCL 205.22(1), the legislature intended that filing would be effective, in any event, upon either a certified mailing or actual delivery of a petition to the tribunal. Because appellant sent its petition by certified mail within the 35-day statutory deadline, the tax tribunal had jurisdiction over the appeal.

Index of Articles

(Vol XVI and succeeding issues)

Correction

In the Spring 2002 issue of the *Michigan Business Law Journal*, there is a production error in the article by Michael K. Molitor entitled "Some Planning Ideas to Help Resolve Deadlocks in Closely Held Corporations," which begins on page 14.

In the lower left column on page 17, the last two sentences of the last full paragraph should have been deleted. This paragraph should have then been combined with the next. Following is a corrected version of the paragraph:

> To be enforceable under Section 488, the agreement must meet two conditions. First, the agreement must be set forth in the articles or bylaws and be approved by all persons who are shareholders at the time of the agreement, or be set forth in a written agreement signed by all of the persons who are shareholders at the time of the agreement and "made known" to the corporation. Second, the agreement can be subject to amendment only by all persons who are shareholders at the time of the amendment, "unless the agreement provides otherwise."[17] The failure to satisfy these requirements does not invalidate an agreement that would otherwise be valid. In other words, if these requirements are not met, the agreement must be consistent with the MBCA; if these requirements are met, then the agreement can be inconsistent with the MBCA in one or more of the ways listed above. Section 488 agreements should be noted on the corporation's stock certificates. If the corporation's stock is listed on a national securities exchange or Nasdaq, a Section 488 agreement will no longer be effective.

NOTE

17. MCL 450.1488(2).

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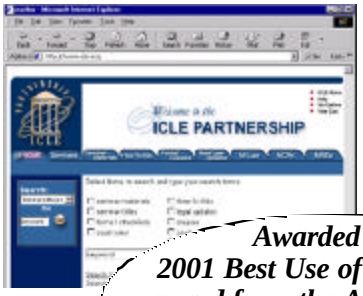

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