California
Bar
Examination

Performance Tests
and
Selected Answers

February 2007

PERFORMANCE TESTS AND SELECTED ANSWERS

FEBRUARY 2007 CALIFORNIA BAR EXAMINATION

This publication contains two performance tests from the February 2007 California Bar Examination and two selected answers to each test.

The answers selected for publication received good grades and were written by applicants who passed the examination. These answers were produced as submitted, except that minor corrections in spelling and punctuation were made during transcription for ease in reading. The answers are reproduced here with the consent of their authors.

Contents

TUESDAY AFTERNOON
FEBRUARY 27, 2007

California
Bar
Examination

Performance Test A
INSTRUCTIONS AND FILE

PHENOM NETWORKS v. JASMINE SEMICONDUCTOR

FILE

PHENOM NETWORKS v. JASMINE SEMICONDUCTOR

INSTRUCTIONS

1. You will have three hours to complete this session of the examination. This performance test is designed to evaluate your ability to handle a select number of legal authorities in the context of a factual problem involving a client.
2. The problem is set in the fictional State of Columbia, one of the United States.
3. You will have two sets of materials with which to work: a File and a Library.
4. The File contains factual materials about your case. The first document is a memorandum containing the instructions for the tasks you are to complete.
5. The Library contains the legal authorities needed to complete the tasks. The case reports may be real, modified, or written solely for the purpose of this performance test. If the cases appear familiar to you, do not assume that they are precisely the same as you have read before. Read each thoroughly, as if it were new to you. You should assume that cases were decided in the jurisdictions and on the dates shown. In citing cases from the Library, you may use abbreviations and omit page citations.
6. You should concentrate on the materials provided, but you should also bring to bear on the problem your general knowledge of the law. What you have learned in law school and elsewhere provides the general background for analyzing the problem; the File and Library provide the specific materials with which you must work.
7. Although there are no restrictions on how you apportion your time, you should probably allocate at least 90 minutes to reading and organizing before you begin preparing your response.
8. Your response will be graded on its compliance with instructions and on its content, thoroughness, and organization.

Reed, Newcomb and Lev

Attorneys and Counselors at Law
Menlo Parque, Columbia
"First In Technology"

MEMORANDUM

To: Applicant

From: Susan Reed

Date: February 27, 2007

Re: **Phenom Networks v. Jasmine Semiconductor**

We have finished drafting our client Jasmine Semiconductor's ("Jasmine") complaint against Phenom Networks ("Phenom") for fraud and theft of trade secrets. I have just been called by Phenom's litigation counsel to inform me they have made a motion to prohibit disclosure to anyone, including the court, of a recorded voicemail conversation we have of Phenom's Executive Vice President and its attorney discussing their attempt to steal Jasmine's technology and personnel. The voicemail was left in a call to Valerie Wong, Jasmine's in-house legal counsel.

Please prepare our memorandum of points and authorities in opposition to the motion for a preliminary injunction, following our attached guidelines. Your memorandum should present our best arguments, and at the same time, address each of the arguments made in Phenom's brief to preclude our use of the voicemail as evidence. There are obvious issues of professional responsibility involved in this whole mess. Do not concern yourself with any such issues. Another associate is dealing with those issues. I will take care of preparing Ms. Wong's declaration authenticating the transcript of the voicemail. The transcript will be attached to her declaration, and you may use the contents of the voicemail in your memorandum.

Reed, Newcomb and Lev
Attorneys and Counselors at Law
Menlo Parque, Columbia
"First In Technology"

MEMORANDUM

To: Attorneys

From: Executive Committee

Re: **Persuasive Briefs and Memoranda**

To clarify the expectations of the firm and to provide guidance to attorneys, all persuasive briefs including briefs in support of or in opposition to motions (also called memoranda of points and authorities), whether directed to an appellate court, trial court, arbitration panel, or administrative officer shall conform to the following guidelines.

All of these documents shall include a Statement of Facts. Select carefully the facts that are pertinent to the legal arguments. The facts must be stated briefly, cogently, and accurately, although emphasis is not improper. The aim of the Statement of Facts is to persuade the tribunal that the facts support our client's position.

Following the Statement of Facts, the Argument should begin. The firm follows the practice of writing carefully crafted subject headings that illustrate the arguments they cover. The argument heading should succinctly summarize the reasons the tribunal should take the position you are advocating. A heading should be a specific application of a rule of law to the facts of the case and not a bare legal or factual conclusion or statement of an abstract principle. For example, **IMPROPER:** COLUMBIA HAS PERSONAL JURISDICTION. **PROPER:** DEFENDANT'S RADIO BROADCASTS INTO COLUMBIA CONSTITUTE MINIMUM CONTACTS SUFFICIENT TO ESTABLISH PERSONAL JURISDICTION.

The body of each argument should analyze applicable legal authority and persuasively argue how the facts and law support our client's position. Authority supportive of our client's position should be emphasized, but contrary authority should generally be cited, addressed in the argument, and explained or distinguished. Do not reserve arguments for reply or supplemental briefs.

Associates should not prepare a table of contents, a table of cases, a summary of the case or the index. These will be prepared, where required, after the draft is approved.

TRANSCRIPT OF INTERVIEW OF VALERIE WONG

To: Jasmine and Phenom Pre-Litigation File

Date: February 20, 2007

Re: Interview of Valerie Wong, Jasmine Senior Director of Legal and Business Affairs

Susan Reed ("Reed"): Thanks for coming right over, Valerie. You covered a good bit of the background when you called, and I talked to my patent partner to learn about Jasmine, its dealings with Phenom, and the nondisclosure agreement that you had with Phenom.

Valerie Wong ("Wong"): Yes, after two years of development, we were ready to commercialize the technology we call TocTec into a product for market. Phenom, which had been working in the same technology, and guessed we were way ahead of them, wanted to buy it, and take over the key developers. So, we began a process of showing them just enough so that we could get full partnership, producing the product, not just a buyout. We wanted a full share in development and to keep control of our product. Phenom kept putting off negotiations on the eventual deal and instead wanted even more product info. We resisted, finally saying no to most of their requests. We never got very far with negotiations on the joint development contract that we wanted, but Phenom did accept and sign the nondisclosure agreement. So, on that basis we did go ahead with restricted, tightly controlled sharing of information. That disclosure is what's been going on the last few weeks. Then I got this call from them last night.

Reed: Let's get right to the voicemail.

Wong: I've never seen, I should say, never heard anything like it. I've got my answering machine. Do you want to hear it, or read the transcript?

Reed: Both. I'll read it while you set up. And of course I'll keep a copy of the written transcript.

Wong: And I've made a couple of annotations on it. Since I know both of them on the tape and know all of the others mentioned, I identified each speaker and added a note on who the others are.

Reed: OK, Valerie, I've read it. All set. I may need to hear it to believe it too.

* * * * *

[Listening to voicemail]

* * * * *

Reed: Valerie, it's still difficult to believe what they're saying, even after hearing it. What was your reaction?

Wong: I did not understand it. Imagine it. I listen to a message, just saying that Gross and Banerjee had called. Then about 5 seconds of silence -- and I was reaching to erase it then -- when all of a sudden, they're still talking. I thought that they were talking to me, at first that it was Gross again complaining that I'm going too slow, being too careful. Gross was always telling me that, and trying to get me to accept their boilerplate nondisclosure language or open up more technology before our restricted nondisclosure agreement was signed. We had refused, and, as I said, they signed our nondisclosure agreement before there had been any disclosure.

Reed: Yes. But . . . .

Wong: The first time I listened to the entire message in total confusion . . . thinking, what is this? Why are they telling this to me? It really had not sunk in. I had just come from a meeting with Barney, so I knew he was there, and I ran and dragged him to my office.

Reed: Barney is . . . ?

Wong: Barney Ng, our CEO. Halfway through the voicemail he burst out, "The sleazebags don't know they're still on your voicemail!" I actually think that's the moment

I finally accepted what it was. Until then, I guess I resisted, thinking this may be a joke, a dream. Everything just took off, exploded, it seemed.

Reed: How? I mean, how else?

Wong: Barney takes off the second we hear the dial tone, the end. Runs to Kathleen's office, oh, Kathleen Schaus, the one they talk about in the voicemail, she's manager of our TocTec project.

Reed: My patent partner told me about Kathleen. He had worked with her in the patent application for TocTec. What did Barney do?

Wong: Kathleen wasn't there, but Barney looked at her files, messages. It was even worse than we'd heard on the voicemail. Kathleen had sent Banerjee almost the entire patent disclosure file -- our most important intellectual property, and the very technology that we had refused to let them copy and many more details than we ever showed them. I'd spent weeks negotiating a nondisclosure agreement allowing the Phenom engineers a very limited look-see at what our technology could do. We denied them any access to the patent application. There had been many conditions to prevent them from stealing our technology or people.

Reed: Such as?

Wong: Whatever they viewed could not be copied or removed. We blacked out the names of our employees working on TocTec. We did let them see some confidential trade secrets under the nondisclosure agreement. Mostly they only saw the technology in operation, what it could do, and we tried to withhold as much as we could of how it worked. Keeping that technology and time-to-market advantage is what we were protecting in the nondisclosure agreement.

Reed: You mentioned the engineers?

Wong: Yes. The nondisclosure agreement prohibited them from contacting our key engineers, and all meetings with our personnel had to be in the presence of our human relations director. We denied them important personnel information, such as pay, stock

options, benefits, that could then be used to entice them away from us with their knowledge of our technology, if we did not conclude a joint development contract. Kathleen gave it to them, all of it.

Reed: Valerie, what do you think Gross and Banerjee are talking about where they say it would be ok if the deal closes?

Wong: I guess that if they paid for our technology, there would be no problem, even though it doesn't sound like that was what they were going to do. Instead they planned to steal our technology and recruit the right engineers, and then they could beat us in the marketplace . . . they have their economic might, since they are a much bigger company than we are, as just a start-up, plus they then have the new revenue stream of a fabulously successful product. No one else in the industry will touch our technology; it's tainted, too late, and at best a guaranteed fight with Phenom. We have a lawsuit, but no product to the market; they drag it out, and eventually we'd have to accept a bitter settlement, or just walk.

Reed: The big boys in Tech Valley play real hardball.

Wong: They were just trying to mislead us long enough to clean us out, and then dare us to fight.

Reed: With this, we may change the usual scenario. Let me see if I've got anything more. There's little doubt from what's said that Gross and Banerjee know that what they are doing is fraudulent. Gross is even counseling Banerjee, preparing for the cover-up.

Wong: And the mention of blackmail and leverage, is, I guess, their worry that if we catch them, then we'll . . . threaten to smear them, and use it to up our contractual demands. They assume that we'd act like them.

Reed: Meantime, Kathleen's gone, right?

Wong: Yes. Her office is locked up. Security has never allowed her back in. We are taking stock of her damage, tracing everything she sent over to Phenom. I'll have a

report for you and Barney by tomorrow. But I expect that Kathleen's already set up a new office over at the Phenom's campus.

Reed: We both have a lot to do. We will crank up and prepare to file a complaint and enjoin any use of everything they took illegally.

END OF INTERVIEW

TRANSCRIPT OF VOICEMAIL FROM KAI BANERJEE AND MATTHEW GROSS

Kai Banerjee ("Banerjee"): Valerie, hi. This is Kai Banerjee [Executive VP for Phenom]. It's a few minutes before six on Thursday, August 16th. I am here with Matthew Gross [Phenom's General Counsel]. We'd like to discuss where we go from here. Please give me a call as soon as possible.

[about 5 seconds of silence]

Matthew Gross ("Gross"): Too bad. Not there. . . . But as you said, Kai, we can use a little more time.

Banerjee: That's ok. . . Matt, you lawyers just keep this unsettled with whatever legal maneuvers you need, so we, you know, can get enough of their TocTec technology and we can get the right people in their engineering unit to quit and come with us.

Gross: Valerie's so cautious, so paranoid, that, that's not hard. If she or Ng were suspicious, she'll draft another nondisclosure agreement.

Banerjee: We took their technology on the pretense of just evaluating it, not putting it in our product . . . . But they gave it to us, you know. . . . But if it looks like we are going to get closure, and close the deal, right?

Gross: Sure, if we were to close the deal, everything's probably fine, but if they realize what we're doing, they could hold out for more. Use it as leverage, use it as blackmail.

Banerjee: That's right. So that's how I, as our project leader, can defend it, and that's how we can defend it. They gave it to us to use. If we end up having to pay Jasmine, it's no harm, no foul.

Gross: That's, that's what's going on right now. If it blows up, maybe Manuel Lopez [Phenom's Vice President for business development] gets a black eye.

Banerjee: How's that?

Gross: Sure, Manuel is our VP out there promising big option grants if their technology is transferred in advance to speed development time so time-to-market goal can be reached. That's what's going on.

Banerjee: Matt, something else. I'm getting scared, Kathleen Shaus, Jasmine's TocTec Project manager, is transferring too much. Not just the engineers' salaries and stock options, but all the product designers' personnel files, people we don't need to bring over. And this morning she sent over pretty much all of Jasmine's TocTec patent disclosures.

Gross: All at once?

Banerjee: Yeah. One super-stuffed e-mail attachment. Lopez says he'll need at least a week to get through it.

Gross: I know we asked for most of the stuff, but it's coming too fast and that can give her away.

Banerjee: That's right. What do you think, Matt, should I do something?

Gross: Yeah, call her. No, better, e-mail her, so we leave a paper trail. Make it sound polite, like, appreciate your generous courtesy, and her cooperation exceeds Jasmine's commitments, like it's all her idea. Thank her for assisting us to do our technical due diligence and that if we do it faster, it will benefit both companies — no say benefit both of us. She'll understand that. Do it now, so I can review it while I'm here.

Banerjee: OK, right now.

END OF VOICEMAIL RECORDING

Lisa Fong, ESQ.
MADISON AND SUTRO
67 Oakmont Avenue, 6th Floor
Soper, Columbia
(555)652-7389
Attorneys for Plaintiff

SUPERIOR COURT OF COLUMBIA
IN AND FOR THE COUNTY OF PALA

PHENOM NETWORKS,
Plaintiff,

Case No. 6586359

vs.

JASMINE SEMICONDUCTOR,
Defendant
_____/

PLAINTIFF'S MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTION FOR PRELIMINARY INJUNCTION TO PROHIBIT USE AND DISCLOSURE OF RECORDED ATTORNEY-CLIENT COMMUNICATION

I. Introduction

This application rests on a few, indisputable facts; it seeks emergency, preliminary relief based on inarguable, well-settled Columbia law.

Confidential communications between Plaintiff's senior corporate officer and its general counsel were surreptitiously captured and copied by the Defendant, a competitor of the Plaintiff in the aggressive high-tech industry.

The communications were plainly privileged. And counsel for Defendant could have determined in seconds that the conversation was confidential and that Plaintiff's officer and attorney were unaware that they were being electronically eavesdropped.

A brief listening to a recording of the attorney-client conversation or look at a transcript, and a simple phone call could have resolved the matter. Instead, we believe that Jasmine and its counsel have copied, transcribed, and analyzed the contents of the confidential communications.

This Court should not countenance, or indeed encourage, conduct that is so plainly in derogation of the strong policy in favor of confidentiality.

II. Statement of Facts

Plaintiff Phenom Networks (Phenom) is a publicly held company producing telecommunications equipment in Columbia. Defendant Jasmine Semiconductor (Jasmine) is a closely held private company which designs and manufactures telecommunications chips.

Phenom and Jasmine have been working separately on the development of TocTec. Jasmine offered to sell to Phenom Jasmine's relevant technology. To further induce Phenom to accept the offer, Jasmine allowed Phenom to review its technology and interview its engineering staff, without prior commitment or payment. Ultimately Phenom determined that its own technology was better and more advanced than Jasmine's, and that a superior product could be marketed sooner without Jasmine's participation.

It cannot be overemphasized that these kinds of offers, exchange of technology for review, and interchanges of technical staffs are common in the technology-based and fast developing telecommunications industry. And most end as did Phenom's

consideration of the Jasmine offer: Phenom declined Jasmine's offer to sell. We thought that the negotiations were done.

Then, two days ago, a former Jasmine engineer applied for an engineering position with Phenom and during her interview disclosed that Jasmine had surreptitiously recorded a voicemail conversation (the "Voicemail") between Phenom's Executive Vice-President Kai Banerjee[1] and its General Counsel Matthew Gross.[2]

The verbatim contents of the Voicemail are unknown to Phenom. We have neither heard the recorded Voicemail nor seen a transcript of the conversation. However, conversations between Messrs. Banerjee and Gross during the period of the negotiations with Jasmine concerned Phenom's rights and obligations in what could have been a very complicated, costly technology transfer agreement. Their conversations during this time almost certainly included Phenom's confidential assessment of Jasmine's technology, and Banerjee would have made confidential disclosures to his attorney Gross on the status of Phenom's own technical developments, its shortcomings and problems, and its timetable for getting a product to market.

During this period, Banerjee and Gross were constantly discussing whether to pursue the Jasmine offer. It would be expected that Banerjee would be disclosing confidential information comparing Jasmine's to Phenom's technology, and requesting and receiving confidential legal advice from Gross. There could not be a clearer case of confidential attorney-client communications.

//

//

[1] Mr. Banerjee is a senior Phenom executive, second only to its Chairman and Chief Operating Officer Suhan Bizhar. Banerjee is Executive Vice-President, and Vice-Chairman of the Board of Directors.

[2] Mr. Gross is a member of the San Carlito law firm of Nemer-Fields.

III. Argument

A. This Court Should Not Permit the Inadvertent Capture of Communications That On Their Face Appear to be Subject to the Attorney-Client Privilege, And It Is Clear They Were Confidential.

The concept of confidentiality is a fundamental aspect of the right to the effective assistance of counsel. The confidentiality principle rests on the vital importance society places upon the "full, free and frank" exchange between lawyer and client, shielded from the intrusive eyes and ears of adverse parties, the government, the media and the public.

This was recently reiterated by the leading Columbia case of *State Fund v. WPS, Inc.*, 1999, where the Court of Appeal stated:

> The conclusion we reach is fundamentally based on the importance which the attorney-client privilege holds in the jurisprudence of this state. Without it, full disclosure by clients to their counsel would not occur, with the result that the ends of justice would not be properly served. We believe a client should not enter the attorney-client relationship fearful that an inadvertent error by its counsel could result in the waiver of privileged information.

The Court in *State Fund* acknowledged that its conclusion was grounded in the concern of "preserving confidentiality given the burgeoning of multi-party cases, the availability of xerography and the proliferation of facsimile machines and electronic mail *that make it technologically ever more likely that through inadvertence, privileged or confidential materials will be produced to opposing counsel by no more than the pushing of the wrong speed dial number on a facsimile machine.*" (Emphasis added.)

We are taught from first-year law school that waiver means the intentional relinquishment or abandonment of a known right. Inadvertent production is the antithesis of that concept. Phenom's lawyer might well have been negligent in failing to hit the disconnect button to terminate a conference call. But if we are serious about the attorney-client privilege and its relation to the client's welfare, we should require more

than a trivial mistake by counsel before the client can be deemed to have given up the privilege.

B. The Court May Not Require Disclosure of the Voicemail Claimed to be Privileged, And Its Contents Must Be Sealed For Purposes of this Motion.

Columbia Evidence Code Section 915 provides in part that "[t]he presiding officer may not require disclosure of information claimed to be privileged under section 954 (lawyer-client privilege) *in order to rule on the claim of privilege."* (Emphasis added.) This is the common situation on privilege determinations.

This Court can determine whether there is a prima facie case that the communication recorded between an attorney and his client is privileged without reviewing the contents of the Voicemail. Next, the Court can determine, again without resort to the privileged communication, that the attorney-client privilege has not been waived by the inadvertent disclosure by counsel.

A party need not give up the right to keep communications confidential in order to obtain judicial protection of attorney-client confidences. Listening to the Voicemail is not necessary to determine that Plaintiff has met all the elements of the test established in *State Fund v. WPS, Inc.*, Columbia Court of Appeal, 1999, where the court stated:

> When a lawyer who receives materials that *obviously appear to be subject to an attorney-client privilege* or otherwise clearly appear to be confidential and privileged and *where it is reasonably apparent that the materials were provided or made available through inadvertence* . . . [t]he parties may then proceed to resolve the situation by agreement or may resort to the court for guidance with the benefit of protective orders and other judicial intervention as may be justified. (Emphasis added.)

Indeed, the court in *State Fund* did not resort to the contents of the documents claimed to be privileged. Instead the court relied on testimony by counsel about the contents

and purpose of documents to decide that it clearly appeared that the documents contained confidential communications.

C. Defendant Cannot Rebut the Presumption or Phenom's Affirmative Evidence that the Electronically Eavesdropped Conversation Between a Senior Officer of Phenom and its Counsel Were Privileged Attorney-Client Communications.

Columbia Evidence Code Section 917 provides that "[w]henever a privilege is claimed on the ground that the matter sought to be disclosed is a communication made in confidence in the course of the lawyer-client relationship, the communication is presumed to have been made in confidence and the opponent of the claim of privilege has the burden of proof to establish that the communication was not confidential."

Additionally Columbia Evidence Code Section 952 provides that "in confidence" means a communication that "so far as the client is aware, discloses the information to no third persons other than those who are present." The section's comments make clear that so long as the client, in this case the authorized representative of Phenom, Mr. Banerjee, believed that his conversation with his lawyer was not being overheard, then their communications were "in confidence."

At the time that the Voicemail was recorded, Mr. Matthew Gross was the General Counsel of Phenom, and Mr. Banerjee was a senior Phenom executive, second only to its Chairman and Chief Operating Officer Suhan Bizhar. Mr. Banerjee, as Executive Vice-President, and Vice-Chairman of the Board of Directors, is "a person who is authorized to claim the privilege by the holder of the privilege" pursuant to Columbia Evidence Code Section 954. Their conversations must be presumed to be attorney-client communications.

Additionally, the Plaintiff has affirmatively shown that the conversations between Messrs. Banerjee and Gross during the period of the negotiations with Jasmine included, for example, Phenom's rights and obligations in the negotiations, Phenom's

confidential assessment of Jasmine's technology, and requested confidential legal advice from Gross.

Phenom has met the burden of establishing the foundation facts that its communication was "in confidence in the course of the lawyer-client relationship" requiring application of the attorney-client privilege. (Evid. Code § 917.) The presumption and proof of confidentiality will not and cannot be rebutted. There could not be a clearer case of confidential attorney-client communications.

D. Phenom Has Aggressively Defended its Privileged Communications, And a Waiver Cannot be Inferred From the Inadvertent Disclosure By Its Counsel.

Columbia Evidence Code Section 912 states the general rule that the attorney-client privilege can be waived only if the privilege holder discloses the communication or consents to the disclosure by another. "The language of the statute [Evidence Code Section 912] indicates that we are to look to the words and conduct of the holder of the privilege to determine whether a waiver has occurred." (*State Fund v. WPS, supra*.)

Jasmine will be hard-pressed to present any evidence of disclosure of the communication by Phenom. The only evidence is that presented by Phenom from Banerjee and Gross that the only time during the period of negotiations that both Messrs. Banerjee and Gross were on a telephone line was once, when they called Ms. Valerie Wong, Jasmine's Senior Director of Legal and Business Affairs. If the Voicemail was made during this call, then it was an inadvertent disclosure by counsel.

This case is clearly controlled by *State Fund v. WPS, supra*, wherein the court stated:

> Based on the language of Evidence Code section 912, we hold that "waiver" does not include accidental, inadvertent disclosure of privileged information by the attorney.

Thus, if there was an inadvertent disclosure it was by Gross's accidental operation of the telephone. There is no evidence that Banerjee or any other officer of Phenom

consented to the inadvertent disclosure. A wrongful electronic capture of privileged information is not voluntary, but coercive to the holder of the privilege.

E. Relief Sought

For the reasons set forth, Plaintiff respectfully requests (1) an order sealing the Voicemail and providing that it may not be considered, heard, or read in this proceeding, and (2) for a preliminary injunction restraining use or disclosure in any format, whether electronic or written transcript, of the Voicemail and its contents in any future pleading or proceeding.

Dated: February 27, 2007 **MADISON AND SUTRO**

Lisa Fong

By Lisa Fong, Esq.
Attorneys for Plaintiff

TUESDAY AFTERNOON
FEBRUARY 27, 2007

California
Bar
Examination

Performance Test A
LIBRARY

PHENOM NETWORKS v. JASMINE SEMICONDUCTOR

LIBRARY

SELECTED PROVISIONS OF THE COLUMBIA EVIDENCE CODE

§ 912. Waiver of privilege. Except as otherwise provided in this section, the right of any person to claim a privilege provided by section 954 (lawyer-client privilege) is waived with respect to a communication protected by the privilege if any holder of the privilege, without coercion, has disclosed a significant part of the communication or has consented to disclosure made by anyone. Consent to disclosure is manifested by any statement or other conduct of the holder of the privilege indicating consent to the disclosure, including failure to claim the privilege in any proceeding in which the holder has the legal standing and opportunity to claim the privilege.

LAW REVISION COMMISSION COMMENTS: This section states the general rule that the privilege is waived in one of two ways: the holder of the privilege may waive it by making an uncoerced disclosure, or waiver may occur by the holder's intentional consent to disclosure by a third party. If disclosure is made by the privilege holder, intent to waive the privilege is not required. Reckless, negligent, accidental, as well as conscious relinquishment by the privilege holder, can result in a waiver. In *People v. Castro*, Columbia, 1975, a court reporter was permitted to testify to a conversation which he overheard between a client and his attorney during a recess; the conversation was privileged because the client was not aware that the conversation was overheard, and "no question of surreptitious eavesdropping [was] presented," but the privilege was waived by the uncoerced, inadvertent, even unknown disclosure by the privilege holder. Under this view, inadvertent disclosures result in waiver because strict liability suffices to disclosures by the privilege holder. (8 *Wigmore on Evidence*, 3d ed., § 2326, 1940.)

* * *

§ 915. Disclosure of privileged information or attorney work product in ruling on claim of privilege. The presiding officer may not require disclosure of

information claimed to be privileged under section 954 (lawyer-client privilege) in order to rule on the claim of privilege.

LAW REVISION COMMISSION COMMENTS: Section 915 is solely applicable to claims of privilege where the information has not been previously disclosed. It has no applicability where the communication has been disclosed. In *Roe v. Superior Court*, Columbia, 1991, the Court of Appeal held that where the "confidential material has already been disclosed, the superior court did nothing to force the disclosure of previously undisclosed communications, and accordingly the superior court did not violate Evidence Code section 915." Similarly in *Klang v. Shell Oil Co.*, Columbia, 1971, where an attorney disclosed to an investigating police officer allegedly privileged information, without the client's consent, the court ruled that section 915 did not apply "because the disclosure had already occurred without action of any kind by the court."

* * *

§ 917. Presumption that certain communications are confidential. Whenever a privilege is claimed on the ground that the matter sought to be disclosed is a communication made in confidence in the course of the lawyer-client relationship, the communication is presumed to have been made in confidence and the opponent of the claim of privilege has the burden of proof to establish that the communication was not confidential.

LAW REVISION COMMISSION COMMENTS: When a party asserts the attorney-client privilege, it is incumbent upon that party to prove the preliminary fact that a privilege exists. Once the foundational facts have been presented, i.e., that a communication has been made "in confidence in the course of the lawyer-client relationship," the communication is presumed to have been made in confidence, and "the opponent of the claim of privilege has the burden of proof to establish that the communication was not confidential," or that an exception exists.

* * *

§ 952. Confidential communication between client and lawyer. As used in this article, "confidential communication between client and lawyer" means information transmitted between a client and his or her lawyer in the course of that relationship and in confidence by a means which, so far as the client is aware, discloses the information to no third persons other than those who are present to further the interest of the client in the consultation or those to whom disclosure is reasonably necessary for the transmission of the information or the accomplishment of the purpose for which the lawyer is consulted, and includes a legal opinion formed and the advice given by the lawyer in the course of that relationship.

LAW REVISION COMMISSION COMMENTS: Whether a communication between a client and attorney is “in confidence” turns on the client’s state of mind or consciousness; the test is whether the client was aware that the communications were disclosed to persons who were not entitled to it, not whether he or she should have been aware.

* * *

§ 956. Exception: Crime or Fraud. There is no privilege under this article if the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit a crime or a fraud.

LAW REVISION COMMISSION COMMENTS: Section 956 codifies the common law rule that the privilege protecting confidential attorney-client communications is lost if the client seeks legal assistance to plan or perpetrate a crime or fraud. The crime-fraud exception expressly applies to communications ordinarily shielded by the attorney-client privilege by Evidence Code section 954.

State Fund v. WPS, Inc.

Columbia Court of Appeal, 1999

Adam Telanoff, counsel for WPS, Inc., received copies of State Fund Compensation Insurance's (State Fund) internal documents containing privileged attorney-client communications because State Fund's outside lawyers inadvertently sent them along with other documents produced for use at trial. State Fund had produced for discovery approximately 7,000 pages of documents. Erroneously included were 273 pages of "Civil Litigation Claims Summaries" prepared by employees of State Fund. The heading at the top of each claim form reads: "ATTORNEY-CLIENT COMMUNICATION / ATTORNEY WORK PRODUCT." The word "CONFIDENTIAL" is repeatedly printed around the perimeter of the page of the form.

Telanoff gave some of the privileged documents to an expert witness he consulted for the WPS matter. The expert witness then provided those documents to another lawyer who was pursuing a different claim against State Fund, who used the documents to formulate a discovery request for the production of the claims forms. Counsel for State Fund in the other case was able to trace the claims forms back to the documents produced to Telanoff. In the meantime the WPS case was tried to a jury, resulting in a verdict in favor of State Fund.

State Fund's counsel then requested that the documents be returned, but Telanoff refused. State Fund's counsel then gave Telanoff ex parte notice that he would appear and seek an order for return of the documents. The court heard arguments and testimony regarding the confidential nature of the documents, and entered its order, finding that the claims forms were privileged, were inadvertently produced, and the production did not waive the privilege. The court further found that Telanoff's refusal to return the documents was in violation of counsel's ethical obligations and imposed monetary sanctions.

The primary question presented by this appeal is what is a lawyer to do when he or she receives through the inadvertence of opposing counsel documents plainly subject to the attorney-client privilege? Before answering the abstract question posed, we must first consider the predicate issues of whether the documents here did in fact contain privileged information and whether the inadvertent disclosure of the documents resulted in a waiver of the attorney-client privilege that would excuse any use of the document by the receiving attorney.

Based on the testimony from State Fund's general counsel it clearly appears that the claims forms contained confidential communications between State Fund and its counsel. She testified that the forms were intended by State Fund as a means of confidential communications between its claims department and its in-house lawyers. The forms were used by the legal department to communicate with claims agents, to identify issues, and then for the legal department to communicate the action that the agents should take in cases. The claims forms were also used by the legal department to assess the strengths and weaknesses of cases and then to communicate this to management of State Fund. According to the general counsel the claims forms typically contained summaries of counsel's assessments of the outcome of cases, settlements, and legal positions.

Evidence Code section 912 provides that the privilege is waived if the holder of the privilege discloses the communication or consents to the disclosure by another. The statute clearly provides that it is the holder of the privilege, in this case the client State Fund, who may waive the privilege, either by disclosing or conduct that consents to the disclosure. The language of the statute indicates that we are to look to the words and conduct of the holder of the privilege to determine whether a waiver has occurred. In this case, it is clear that State Fund did not itself disclose to appellants the claims summaries, but rather its counsel effected the inadvertent disclosure. We therefore focus on whether any statement or conduct of State Fund indicates that it consented to counsel's disclosure.

State Fund had no intention to disclose nor any role in the disclosure by its counsel. There is nothing indicating that State Fund participated in selecting the documents for production in the WPS litigation. It was unaware of the inadvertent disclosure and in no way demonstrated its consent to the disclosure. Also, the promptness with which counsel for State Fund moved to secure return of the documents indicated that there was no intent on the part of State Fund to waive the privilege. It is clearly demonstrated that State Fund had no intention to voluntarily relinquish a known right.

Based on the language of Evidence Code section 912, we hold that "waiver" does not include accidental, inadvertent disclosure of privileged information by the attorney. Telanoff invites us to adopt a "gotcha" theory of waiver, in which an underling's slip-up in a document production becomes the equivalent of actual consent. We decline. The substance of an inadvertent disclosure under such circumstances demonstrates that there was no voluntary release.

Telanoff contends that even if the documents were privileged and the privilege was not waived, that sanctions were not properly awarded because his conduct was not clearly proscribed by the law of this state. He contends that the case of *Aerojet Corp. v. Transport Indemnity* (Columbia, 1993) is substantially similar to the one before us and compels a reversal of the sanction order. In *Aerojet,* an attorney received a packet which included a document prepared by an opposing counsel. The document was not marked confidential, but it was "undeniably a privileged communication between opposing counsel and his client." The document revealed the existence of a witness who would have knowledge about matters involved in the lawsuit. The receiving attorney kept receipt of the document secret, and then deposed the witness. After the trial, in which a jury found against the client of the receiving attorney, the court imposed monetary sanctions for failure to disclose receipt of the document. The Columbia Court of Appeal reversed the sanction order.

Telanoff relies on this language from *Aerojet*:

> We think that the manner in which counsel obtained the information in this case -- through documents inadvertently transmitted to him -- is irrelevant to resolution of the issue. Assuming no question of waiver, the problem would be no different if counsel had obtained the same information from someone who overheard the matter in a restaurant or a courthouse corridor, or if it had been mistakenly sent to him through the mail or by facsimile transmission. Once he had acquired the information in a manner that was not due to his own fault or wrongdoing, he cannot purge it from his mind. Indeed, his professional obligation demands that he utilize his knowledge about the case on his client's behalf. *Aerojet Corp. v. Transport Indemnity, supra.*

Without adopting this broad statement, we note that the actual basis of the Court of Appeal's decision in *Aerojet* was that the information used by counsel, the existence and identity of a potential witness, was non-privileged and would have been subject to discovery. As the court itself stated in *Aerojet*:

> Consequently, whether the existence and identity of a witness or other non-privileged information is revealed through formal discovery or inadvertence, the end result is the same: the opposing party is entitled to the use of that witness or information. This fundamental concept was lost in the skirmish below. *Aerojet Corp. v. Transport Indemnity, supra.*

The facts in *Aerojet* are simply very different from those before us. The claims forms were privileged and conspicuously labeled as confidential. State Fund has demonstrated that the claims forms have been disseminated to other lawyers, and unless preventive measures are taken, State Fund could expect to be regularly subjected to requests for production in other cases.

We are particularly concerned with preserving confidentiality given the burgeoning of multi-party cases, the availability of xerography and the proliferation of facsimile machines and electronic mail that make it technologically ever more likely that through inadvertence, privileged or confidential materials will

be produced to opposing counsel by no more than the pushing of the wrong speed dial number on a facsimile machine.

Accordingly, we hold that the obligation of an attorney receiving privileged material is as follows: When a lawyer who receives materials that obviously appear to be subject to an attorney-client privilege or otherwise clearly appear to be confidential and privileged and where it is reasonably apparent that the materials were provided or made available through inadvertence, the lawyer receiving such materials should refrain from examining the materials any more than is essential to ascertain if the materials are privileged, and shall immediately notify the sender that he or she possesses material that appears to be privileged. The parties may then proceed to resolve the situation by agreement or may resort to the court for guidance with the benefit of protective orders and other judicial intervention as may be justified. We do, however, hold that whenever a lawyer ascertains that he or she may have privileged attorney-client material that was inadvertently provided by another, that lawyer must notify the party entitled to the privilege of that fact, and refrain from using and return the privileged material.

The conclusion we reach is fundamentally based on the importance which the attorney-client privilege holds in the jurisprudence of this state. Without it, full disclosure by clients to their counsel would not occur, with the result that the ends of justice would not be properly served. We believe a client should not enter the attorney-client relationship fearful that an inadvertent error by its counsel could result in the waiver of privileged information.

The order imposing sanctions is affirmed.

Hopwood Oil Exploration v. Nahama Exploratory Company

Columbia Court of Appeal, 1988

The basic issue involved in this appeal is the proper standard for determining whether the party seeking discovery of an otherwise privileged attorney-client communication has made the prima facie showing of crime or fraud required to negate the privilege.

Respondent Nahama Exploratory Company (Nahama) claims it had unique, confidential geological ideas based on many years of research and analysis to develop underground oil and gas reserves in an area known in the industry as the Bakersfield Arch controlled by Tenneco Oil Company (Tenneco). To persuade Petitioner Hopwood Oil Exploration (Hopwood) to participate in a large-scale exploration venture in the Arch area, Nahama disclosed confidential information about five prospects on Tenneco land and other prospects on adjoining property. Nahama delivered maps, montages and other proprietary data to Hopwood for its use in evaluating the proposal.

After Nahama introduced geologists of Hopwood to Tenneco, Hopwood's chief geologist called Nahama and said that Hopwood was not interested in the Nahama proposal.

Nahama learned of a Hopwood-Tenneco exploration agreement when it was announced in trade publications months later and threatened to sue because of its exclusion from the exploration agreement, claiming that based on the discussions of the parties and the industry custom that there was an implied agreement that Nahama would participate in the Tenneco venture.

Because of the threat of litigation, Mike Brownhill, Hopwood's vice president in charge of exploration, asked Frederick Dorey, Hopwood's general counsel, to assist Brownhill in investigating Nahama's claims. Sometime during the investigation, Dorey sent a report to Hopwood officers regarding the investigation.

Thereafter, Rod Nahama met with Brownhill, Dorey, and Hopwood's chief geologist to discuss each side's position. After the meeting, Brownhill prepared a memorandum summarizing the meeting and sent copies to other Hopwood personnel for their evaluation. General counsel Dorey reviewed and approved the memorandum.

At the conclusion of the investigation and with the approval of general counsel Dorey, Brownhill wrote Nahama on December 23, 1985, denying that Nahama had any right to participate in the Tenneco agreement and stating various reasons for his conclusion. Nahama contends the December 23, 1985 letter contains several misrepresentations of fact which were aimed at convincing Nahama that the confidential information Nahama provided to Hopwood did not contribute to Hopwood's decision to proceed with the Tenneco exploration agreement. Nahama sought discovery of the report prepared by Dorey, Hopwood's general counsel, and the memo by Brownhill, prepared at the direction of general counsel Dorey, and describing the meeting with Nahama.[1]

Respondent court granted the motion finding Nahama had made a prima facie showing of fraud so the attorney-client privilege did not apply.

To invoke the Evidence Code section 956 exception to the attorney-client privilege, the proponent must make a prima facie showing that the services of the lawyer "were sought or obtained" to enable or to aid one to commit or plan to commit a crime or fraud.

Mere assertion of fraud is insufficient; there must be a showing that the fraud has some foundation in fact. A prima facie case is one which will suffice for proof of a particular fact unless contradicted and overcome by other evidence. In other words, evidence from which reasonable inferences can be drawn to establish the fact asserted, i.e., the fraud.

---

[1] The contents of these documents have not been disclosed to either the trial court or this court. Columbia Evidence Code § 915.

Hopwood submits Nahama must show each element of a fraud cause of action to make a prima facie case -- a false representation as to a material fact, knowledge of its falsity, intent to defraud, justifiable reliance and resulting damage. Since Nahama was not misled by the allegedly false statements in the December 23 letter, Hopwood argues there is no showing of reliance or damages by Nahama.

Hopwood's argument, however, misses the point. Evidence Code section 956 does not require a completed fraud. It applies to attorney communications sought to enable the client to plan to commit a fraud, whether the fraud is successful or not. Moreover, we are not reviewing the merits of a fraud cause of action (none of the causes of action allege a fraud) but rather we are reviewing the merits of a discovery order to determine if Nahama will have access to communications between Hopwood and its attorneys to aid Nahama in proving its causes of action. Without passing judgment in any way on the truth or falsity of the fraud allegations, it is entirely possible that Hopwood could have planned to commit a fraud when it investigated and sought legal advice from its attorneys on Nahama's claim in November 1985, i.e., that Hopwood intended to use the attorney's advice to avoid liability to Nahama by falsely representing the facts concerning the use of Nahama's confidential data in putting together the Tenneco deal. If this is shown, then Hopwood has forfeited the benefits of the attorney-client privilege for discovery purposes even though Nahama has not shown at this stage of the proceedings that it relied on and suffered damages from the misrepresentations contained in the December 23 letter.

We conclude that because section 956 applies where an attorney's services are sought to enable a party to plan to commit a fraud, the proponent of the exception need only to prove a false representation of a material fact, knowledge of its falsity, intent to deceive and the right to rely.

Nahama points to several alleged misstatements in the December 23 letter. The first statement reads: "The only proposals for a joint venture with Nahama that were considered by Hopwood were your suggestions for participation in Tejon

Ranch, the Arroyo Hondo, and English Colony exploration ventures." Nahama claims that Hopwood in fact considered additional areas for exploration that were proposed by Nahama.

Nahama presented documents received from Hopwood in response to Nahama's requests to produce that referred to three other prospects identified by Nahama. In addition, the documents showed Hopwood had prepared financial analyses of these additional prospects. Also, confidential maps and documents which were returned to Nahama were cut up, pasted, colored, marked up and annotated. Hopwood did not explain the alterations to Nahama. Nahama presented a map prepared by a Hopwood geologist that outlined areas for exploration that is substantially the same as the area outlined and recommended on the Nahama maps.

The next challenged statement reads: "After we declined your suggestions for the joint ventures, Hopwood determined to focus their onshore Columbia exploration efforts on the Stevens Sand within the Bakersfield Arch area. The major landowner in this area is Tenneco. Accordingly, Hopwood contacted Tenneco . . . ."

Nahama interprets the paragraph to represent that Hopwood decided to go to Tenneco only after it had rejected Nahama's proposals. That representation is belied by documents prepared by its geologists stating that meetings with "Nahama produced very attractive prospects" and that these prospects were "currently under discussion between Nahama and Tenneco." And that "we understand that Tenneco does not know about this attractive play which has been identified on their land by Nahama. Reserves could be as high as 50 million barrels at a risk of one in five."

This evidence supports the conclusion that Hopwood intended to deceive Nahama into believing that Nahama's confidential information had nothing to do with the Tenneco agreement. It constitutes a prima facie showing the letter was an attempt to defraud Nahama and to dissuade it from pursuing its claims.

Finally, Hopwood contends that, even assuming a prima facie showing of fraud was made by the misrepresentations contained in the December 23 letter, Nahama did not establish that Hopwood engaged in the attorney-client communications in furtherance of the fraudulent scheme. In this case, Nahama proved that the Hopwood communications with counsel were made as part of the investigation that resulted in the fraudulent December 23 letter. This established the reasonable relationship between the subject matter of the fraud and the privileged communications. Mr. Dorey, Hopwood's corporate counsel, was made a member of the team investigating Nahama's claims to which the December 23 letter responded. This evidence permits a reasonable inference that the fraudulent scheme reflected in the December 23 letter evolved from the privileged communication.

We emphasize, again, that our holding is not to be construed in any way as an indication that the fraud inferences are true -- only that they exist from the present record.

The discovery order is affirmed.

Answer 1 to Performance Test A

1)

Attorney Applicant
Reed, Newcomb, and Lev
Menlo Parque, Columbia
Attorneys for Defendant

SUPERIOR COURT OF COLUMBIA

IN AND FOR THE COUNTY OF PALA

PHENOM NETWORKS,

Plaintiff

Case No. 6586359

vs.

JASMINE SEMICONDUCTOR,

Defendant

_____/

DEFENDANT'S MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION TO PROHIBIT USE AND DISCLOSURE OF RECORDED ATTORNEY-CLIENT COMMUNICATION

Statement of Facts

Jasmine Semiconductor is a small start-up company that has developed a breakthrough technology called TocTec. Phenom Semiconductor is a large, publicly traded company that worked on the same technology but had not yet achieved the results that

Jasmine had.

Phenom represented to Jasmine that it was interested in buying the TocTec technology and entered into negotiations with Jasmine regarding the acquisition of that technology. Jasmine was hesitant to reveal too much of the technology but was interested in a deal with Phenom so Jasmine began showing Phenom just enough of the technology to entice Phenom to enter into an agreement. Jasmine was interested in a partnership with Phenom, but not in an [sic] straight buyout of TocTec technology. Although Phenom continued to push for more disclosure, Jasmine refused several requests, attempting to protect its trade secrets, and made Phenom sign a nondisclosure agreement.

Jasmine attempted to prevent Phenom from removing any documents relating to the technology, from gaining knowledge of the names of key employees and engineers or with respect to the contract and personnel information of such engineers in order to prevent Phenom from stealing the technology and/or their important employees. Unbeknownst to Jasmine, however, Phenom was actually in the process of acquiring detailed information regarding the identity of the engineers, their salaries and stock options, the designer's personnel files, and TocTec patent disclosure that Jasmine had made through the theft of such information by Kathleen Schaus, a former employee of Jasmine and current employee of Phenom.

Jasmine was alerted to Phenom's fraudulent and criminal activities on August 16th when Kai Banerjee, the Executive VP of Phenom, left a message for Ms. Wong, Jasmine's Senior Legal Director. The message began as an ordinary message, requesting that Miss Wong contact Banerjee regarding the ongoing negotiations but then continued. Ms. Wong was not at first aware of what was happening and asked Barney Ng, Jasmine's CEO, to listen to the message with her. Upon a second listening with Mr. Ng, it became clear that Banerjee had failed to disconnect the phone after leaving the voicemail for Ms. Wong and had continued to talk with Mr. Gross, Phenom's in-house counsel, regarding the situation with Jasmine. The conversation revealed that Phenom had taken Jasmine's technology on the pretense of evaluating it but had actually been putting in into their own product. In addition, the conversation also revealed that Kathleen Schaus, an employee of Jasmine at that time, had been stealing confidential information from Jasmine and sending it to Phenom.

Jasmine immediately fired Kathleen and informed security not to allow her back into the building. However, the damage had already been done. The TocTec technology is now tainted and Jasmine has been unable to promote it to anyone else in the industry as acquisition of the technology will result only in a fight with Phenom. Jasmine has filed a complaint against Phenom for fraud and theft of trade secrets and Phenom has now filed a motion to prohibit the disclosure of the message left on Ms. Wong's voicemail, claiming that the message is protected by the attorney-client privilege.

This brief presents Defendant Jasmine Semiconductor's arguments in opposition to that motion.

Argument

The Recorded Communications Are Not Privileged Because Phenom, Through the Actions of Banerjee, Waived its Privilege.

Under Columbia Evidence Code Section 912, the right of any person to claim a privilege provided by Section 954 is waived with respect to a communication protected by the privilege if any holder of the privilege, without coercion, has disclosed a significant part of the communication or has consented to disclosure made by anyone. Consent to a disclosure is manifested by any statement or other conduct of the holder of the privilege indicating consent to the disclosure.

Further, according to the comments of the law revision commission, if disclosure is made by the privilege holder, intent to waive the privilege is not required. Reckless, negligent, accidental, as well as conscious relinquishment by the privilege holder can result in waiver. For example, in People v. Castro, the court found waiver of privilege where a court reporter overheard a conversation between a client and his attorney during a recess even though the client was not aware that the conversation was overheard and no question of surreptitious eavesdropping was presented.

First, there is no indication of coercion and Phenom has made no assertion that the disclosure was in any way coerced. Banerjee voluntarily made the phone call to Ms. Wong, counsel for Jasmine. Banerjee knew that he was being recorded as he intended to leave a voicemail. Banerjee failed to disconnect the call, allowing the recording to continue. Neither Jasmine nor Ms. Wong took any action to cause the continued recording of the conversation between Banerjee and Matthew Gross. In fact, Ms. Wong did not even realize what was going on and that the conversation had been unintentionally recorded until she had listened to it for a second time with Barney Ng, who pointed out that they must not have known that they were still on voicemail when they continued to discuss the matter.

Second, no intent is required on behalf of Banerjee or Phenom to waive the privilege. While Banerjee may have been unaware that the conversation was still being recorded, as the client in Castro was unaware that the court reporter could overhear his conversation with his attorney, a lack of intent or even knowledge that the conversation is being overheard does not prevent the waiver of the privilege. Consent is manifested by any conduct on behalf of the holder. Here, Banerjee voluntarily made a phone call to opposing counsel and failed to ensure that the phone had been disconnected prior to continuing in a conversation regarding the case with his attorney. Although the information may have concerned the case and Banerjee may have intended that discussion to be confidential, the conduct on behalf of Banerjee, the holder of he privilege, resulted in a waiver of the privilege.

Even if the Disclosure was Inadvertent, It Constitutes a Waiver Because It Was Not Made By Counsel But Rather Was Made by Banerjee, Acting on Behalf of Phenom, the Holder of the Privilege.

Phenom argues in its brief that a waiver cannot be inferred from the inadvertent disclosure by its counsel. Phenom relies on State Fund for this argument and while State Fund does stand for the proposition that inadvertent acts by counsel do not constitute waiver, this is not a case where the attorney acted independently to make an inadvertent disclosure. State Fund does not discuss cases such as the present case in which the client, the holder of the privilege, him or herself engages in conduct consistent with waiver.

Contrary to State Fund, the comments to Section 912 point out that under the view of the court in People v. Castro, as accepted by the law revision commission, an uncoerced, inadvertent and even unknown disclosure by the privilege holder results in

waiver because strict liability suffices to disclosures by the privilege holder.

Phenom argues in its brief that the disclosure was inadvertent and thus, under State Fund, it does not constitute a waiver of the privilege. However, State Fund applies to cases in which the inadvertent disclosure is made by the attorney. The court clearly states that "we are to look to the words and conduct of the holder of the privilege to determine where a waiver has occurred." The court found that because State Fund had no intention of disclosure nor any role in the disclosure by its counsel, the inadvertent disclosure did not result in a waiver. As Phenom points out, the public policy behind this rule is to allow for full disclosure by clients to their counsel without fear that an inadvertent error by its counsel could result in the waiver of privileged information. Nothing in State Fund indicates that this same rule does or should apply to a situation in which the client does play a role in the inadvertent disclosure of privileged information. In fact, based on the commentary following Section 912 as discussed above, where a client makes an inadvertent disclosure, strict liability results in a waiver of privilege for such disclosures.

First, as discussed above, there was no coercion in this case.

Second, Banerjee, as a representative for Phenom, is responsible for, or at the very least played a role in, the disclosure. Banerjee is the one that made the call to Valerie in the first place. Banerjee further requested that Valerie give Banerjee a call as soon as possible in response to the message. Thus, the evidence indicates that Banerjee initiated the call and left the message for Valerie. Banerjee should have then ensured that the call had in fact been disconnected before continuing the conversation with Matthew Gross, counsel for Phenom. At the very least Banerjee played a role in the disclosure, even if it was inadvertent, and the disclosure was not based solely on the negligence or error of Phenom's counsel.

As such, State Fund does not apply in this case and under Section 912 of the Columbia Evidence Code, the disclosure results in waiver because strict liability applies to even inadvertent and unknown disclosures by the privilege holder.

Section 915 of the Columbia Evidence Code Does Not Operate to Bar Disclosure of the Allegedly Privileged Recorded Communications Because the Disclosure Has Already Occurred Without Any Action By the Court.

Phenom also argues in its brief that the court may not require disclosure of the voicemail and that its contents must be sealed, relying on Section 915 of the Columbia Evidence Code and State Fund. Section 915, however, states only that the court may not require disclosure of information claimed to be privileged in order to rule on the claim of privilege. Phenom has attempted, in its brief, to improperly broaden this rule in order to prevent the court from hearing the communication in order to rule on privilege in this case.

The comments to Section 915 clearly state that the rule applies only where the information has not been previously disclosed. In Roe v. Superior, the court held that where the confidential material has already been disclosed, the superior court did nothing to force the disclosure of previously undisclosed communications, and thus did not violate Section 915. Even where disclosure was without the client's consent, as in Klang v. Shell Oil, the court found that Section 915 did not apply because the disclosure had already occurred without action of any kind by the court.

Here, the disclosure had already occurred and the court had no involvement in that

disclosure. Jasmine is not attempting to gain access to documents that are privileged that it has not yet seen and asking the court to rule on such a request. Jasmine is simply asking the court to rule on the admissibility of an already disclosed communication. Thus, the court has had no role in the disclosure and would not violate Section 915 by examining the disclosure itself in ruling on the question of whether or not the disclosure is privileged.

Whether or not listening to the voicemail is necessary to determine that Plaintiff has met all the elements of the test established in State Fund, as Phenom argues, is irrelevant. It is true that in State Fund, the court did not resort to the contents of the documents but in State Fund, the documents stated in [sic] clearly and conspicuously on their face that they were privileged, confidential, and work product and the court was seeking to protect State Fund from further requests for production in other cases. Here, the conversation made no express statement that it was privileged or confidential and in the conversation has already been disclosed through no fault of the court. Thus, State Fund does not apply to preclude the court from examining the conversation and under Section 915 the court may do such.

The Recorded Communications Are Not Privileged Because They Were Not Made in Confidence in the Course of the Lawyer-Client Relationship.

Under Section 917, the presumption that certain communications are confidential arises only once the foundational facts that a communication has been made in confidence in the course of the lawyer-client relationship have been presented. Additionally, the comments to Section 917 clearly lay out that even once the presumption is raised under such foundational facts, the presumption is rebuttable by the opponent establishing that the communication was not confidential or that an exception exists.

Phenom argues in its brief that Jasmine cannot rebut the presumption set forth by Section 917 that the conversation is privileged. However, even if the court accepts the assertion by Phenom that the communication was made in confidence in the course of the lawyer-client relationship such that the presumption in Section 917 applies, the presumption is rebuttable and Jasmine has offered several solid basis for rebutting the presumption. First, any privilege was waived by the conduct of Banerjee, acting on behalf of Phenom. Second, as discussed below, the conversation falls under the exception of Section 956 as it was sought to enable or aid Phenom in a plan to commit a crime or fraud against Jasmine.

The Recorded Communications Are Not Privileged Because The Services of the Attorney, Matthew Gross, Were Sought or Obtained to Enable or Aid Phenom to Commit a Crime or Fraud.

Under Columbia Evidence Code Section 956, there is no privilege if the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit a crime or fraud. Section 956 applies to communications ordinarily shielded by Section 954.

According to Hopwood v. Nahama, Evidence Code Section 956 does not require a completed fraud. It requires only that the attorney communications sought to enable the client to plan to commit a fraud, whether the fraud is successful or not. The party claiming an exception to privilege based on Section 956 does not need to make a prima facie

showing of all of the elements of fraud in order to make a prima facie showing of fraud such that the attorney-client privilege does not apply. A prima facie case is one which will suffice for proof of a particular fact unless contradicted and overcome by other evidence. The court in Hopwood concluded that the proponent of the exception need only to prove a false representation of a material fact, knowledge of its falsity, intent to deceive and the right to rely.

Here, Phenom sought the advice of its attorney for the purposes of enable [sic] a fraud and the crime of theft of trade secrets against Phenom. Phenom signed a nondisclosure agreement and represented to Jasmine that it was only interested in making a deal with Jasmine regarding the rights to the TocTec technology. Jasmine took continual measures to protect the technology as much as possible during these negotiations and had a right to rely on the representations by Jasmine that it was interested in acquiring the technology and on the nondisclosure agreements signed by Phenom. However, it now appears that Phenom's intention was instead to simply incorporate the new technology into its own products.

The conversation itself is admissible to determine whether the advice was sought to enable a crime or fraud based on the discussion of Section 915 above. The conversation itself clearly indicates that a crime and fraud are being committed by Phenom with the advice of Gross. Banerjee states that "we took their technology on the pretense of just evaluating it, not putting it in our product" and goes on to say that "if they (Jasmine) realize what we're doing, they could hold out for more. Use it as leverage, use it as blackmail." This clearly indicates that Phenom has made false representations to Jasmine concerning its intentions with respect to the TocTec technology. These representations are of material fact as the technology is Jasmine's main product and the only reason that it gave Phenom any access in the first place was with the understanding the [sic] Phenom was interested in purchasing the technology but needed to know what it would be purchasing. The conversation between Banerjee and Gross also clearly indicates that Phenom had knowledge of the falsity and they intended to deceive Jasmine. Finally, these statements were made in negotiations over the acquisition of the TocTec technology and Jasmine had a right to rely on such statements. Based on these facts, Jasmine has made the requisite showing under Hopwood for the court to apply Section 956 to remove the protection of privilege under Section 954.

In addition, Banerjee and Gross go on to discuss a plan to cover up the theft of trade secrets by Kathleen Schaus, a former employee of Jasmine that was acting on behalf of Phenom in stealing trade secrets from Jasmine. Gross advices Banerjee to send an e-mail to Schaus, "so we leave a paper trail," and to make false statements in the e-mail in order to give the impression that Phenom had not been involved in the trade secrets. This is clearly advice sought and given to enable a crime or fraud. Thus, the privilege does not apply under Section 956.

In addition, even in the absence of review of the recording itself, there is sufficient evidence of the enabling of a crime. Jasmine has discovered evidence that Kathleen Schaus did in fact steal trade secrets and Schaus is now an employee of Phenom. This is adequate evidence to raise the inference under Section 956 of enabling a crime and thus Section 956 applies on these facts as well and the recording is not privileged.

Conclusion

For the reasons set forth, Defendant respectfully requests 1) that Plaintiff's request for an order sealing the voicemail and providing that it may not be considered, heard, or read in this proceeding be denied, and 2) that Plaintiff's request for a preliminary injunction restraining use or disclosure of the Voicemail and its contents also be denied.

Answer 2 to Performance Test A

Defendant's Memorandum of Points & Authorities In Opposition to Plaintiff's Motion for a Preliminary Injunction to Prohibit Use & Disclosure of Recorded Attorney-Client Communication

I. Statement of Facts

Defendant Jasmine Semiconductor ("Jasmine") is a small start-up company. Jasmine designs and develops telecommunications technology. Plaintiff Phenom Networks ("Phenom") is a large, publicly-traded company in the business of producing telecommunications equipment in Columbia. For two years, Jasmine has been in the process of developing its proprietary TocTec technology. (Wong Trans. at 4) Jasmine is now ready to commercialize this technology into a product for market. (Wong Trans. at 4)

Phenom expressed an interest in buying Jasmine's TocTec technology. Id. Phenom had been working in the same technology area, but determined that Jasmine was substantially ahead of Phenom in the development process. Id.

Jasmine, interested in a potential partnership with Phenom in producing the product but not wanting a straight buyout, began a process of showing Phenom enough of the technology to facilitate such a deal. Id. Jasmine's goal was to keep control of the TocTec product & have a full share in the product development. Id.

Phenom & Jasmine's negotiations did not get very far. Although Phenom accepted & signed a nondisclosure agreement & Jasmine permitted restricted, tightly controlled sharing of technological information, Phenom put off negotiations on the deal & continued to ask for more product information. Id.

This sharing of product information provides the context for what happened next.

Valerie Wong, Jasmine's Senior Director of Legal & Business Affairs, received a voicemail message from Kai Banerjee, Phenom's Executive VP & Matthew Gross, Phenom's General Counsel. The start of the message was routine & simply stated who was calling & asked Ms. Wong to call back Mr. Banerjee.

However, after 5 seconds of silence in which Mr. Banerjee must have thought he hung up the phone, the callers have a discussion amongst themselves that reveals a deliberate & conscious plan to misappropriate Jasmine's trade secrets regarding its proprietary TocTec technology.

Mr. Banerjee begins by telling his counsel, Mr. Gross, to "keep this unsettled" with "legal maneuvers" so Phenom has time to get enough of the TocTec technology & can get Jasmine engineers to quit & join Phenom. See Voicemail Trans. at 9, lns. 9-11.

Mr. Banerjee goes on to sound out Phenom's position to cover their fraudulent acts,

thereby revealing Phenom's intentional & premeditated false representations. See id. at lns. 14-16, 17-21. ("We took their technology on the pretense of just evaluating it, not putting it in our product. . .But they gave it to us. So that's how I . . .can defend it, and that's how we can defend it. They gave it to us to use. If we end up having to pay Jasmine, it's no harm, no foul."

Mr. Gross advises Mr. Banerjee of the effectiveness of the position being tested by stating that everything would probably "be fine" if Phenom & Jasmine were to close the deal at this point. See id. at lns. 17-18.

Finally, Mr. Banerjee solicits, & Mr. Gross provides, legal advice on perpetrating this fraud. Mr. Banerjee states that he is worried that Kathleen Shaus, Jasmine's TocTec Project manager, is transferring too much information all at once. See id. at 10, lns. 3-6. In particular, Mr. Banerjee frets that the information, such as engineers' salaries & stock options, product designers' personnel files & the TocTec patent disclosures, "are coming too fast" & could "give her away."

Mr. Gross directly responds to this concern by advising Mr. Banerjee to e-mail Ms. Shaus, to "leave a paper trail." See id. at ln. 13. He recommends that Mr. Banerjee write that he appreciates her courtesy & her cooperation "exceeds Jasmine's commitments." See id. at lns. 14-15. Mr. Gross suggests the e-mail should make it look like it was her idea to disclose all of this information to Phenom. Mr. Gross was assisting in covering up Phenom's intentional misappropriation of Jasmine's trade secrets.

Kathleen Shaus, after turning over all of this confidential information to Phenom, has left Jasmine & applied for an engineering position with Phenom. A review of Ms. Shaus's files & e-mail messages confirms that she sent to Phenom almost the entire Jasmine TocTec patent disclosure file — Jasmine's most important intellectual property. See Wong trans. at 6, lns 6-13.

II. Argument.

A. Phenom Waived its Privilege in the Voicemail By Making an Uncoerced & Voluntary Disclosure.

Section 12 of the Columbia Evid. Code provides that a person waives the right to claim atty-client privilege in a communication where the person has disclosed a significant part of the communication "without coercion" or has consented to its disclosure. The official comment explains that the holder of the privilege may waive it by making an "uncoerced disclosure." See § 912 Col. Evid. Code, official comment (emphasis added).

Here, the voicemail message was left by Phenom completely voluntarily. Though presumably inadvertent, nobody coerced the disclosure of Mr. Banerjee's communications with Phenom's attorney. Thus, leaving this voicemail waived the privilege & Jasmine should not be enjoined from using it on its trade secret action against Phenom.

Phenom asserts that the disclosure of the voicemail cannot be deemed a waiver of privilege b/c waiver means only intentional relinquishment of a right. As discussed above, this is not so under § 912, which has no intent requirement for waiver but only lack of coercion.

Phenom relies on State Fund v. WPS, quoting dicta that the court was concerned w/ inadvertent disclosure of confidential communications in an increasingly high-tech world. In State Fund, it was the party's counsel who effected the inadvertent disclosure in document production. Here, Mr. Banerjee, a senior Phenom director — i.e., the client himself, left a voicemail message. Thus, State Fund is distinguishable on its facts. Counsel is not the holder of the privilege, under § 912 either.

Further, People v. Castro is more on point here. In Castro, the court found a client waived the atty-client privilege where a reporter overheard a conversation between the attorney & client. The official comment notes that there was no question of eavesdropping & the court held there was a waiver b/c the disclosure was uncoerced, inadvertent & unknown. Such is the case here, where the voicemail message was left w/o any coercion or knowledge by Mr. Banerjee. There was a waiver b/c strict liability suffices for such inadvertent disclosures. See 8 Wigmore on Evidence, 3d Ed. § 2326, 1940. Thus, Phenom's argument that no waiver can be inferred from inadvertent disclosure has no merit.

B. The Court May Require Disclosure of the Voicemail to Rule on This Issue Because the Communication Has Already Been Disclosed.

§ 915 of the Col. Evidence Code governs disclosure of information claimed to be privileged to a tribunal for purposes of ruling on a claim of privilege. This provision generally prohibits such disclosure.

However, the official comment to this section clearly states that § 915 is "solely applicable to claims of privilege where the information has not been previously disclosed" & has no applicability where the communication has been disclosed.

The rationale is to avoid disclosure of privileged communications that have not been waived. In Roe v. Superior Court, the Col. Court of Appeal held that the lower court had not violated § 915 where it required disclosure to the court b/c the material had already been disclosed.

In the instant case, the voicemail message has already been left in Ms. Wong's mailbox. The communication has been disclosed, so § 915 does not apply here.

Phenom asserts that listening to the voicemail is not necessary to determine whether the communication is privileged. Pl's Brief at 15. Phenom notes that the State Fund court did not review that allegedly privileged documents there, but instead relied on counsel's testimony about the contents & purpose of the documents. Id. at 15. Finally, Phenom

asserts that § 915 proscribes review of the voicemail here.

Jasmine does not dispute that the court here could hear testimony from its counsel as to the contents of the voicemail. But Phenom's assertion that § 915 forbids review of the voicemail, as discussed above, is patently false. The court may require disclosure of the voicemail b/c its prior disclosure removes it from the purview of § 915.

Further, hearing the voicemail would be the best method of assessing the nature of its contents. Phenom cannot testify about it b/c they deny hearing it or seeing a transcript of it & Phenom admits that they do not know its verbatim contents. See Phenom Brief at 13, lns. 5-6.

Thus, the court may & should require disclosure of the voicemail for purposes of deciding this motion.

C. Jasmine Can Rebut the Presumption of Privilege Because the Communication Was Made in Furtherance of a Fraud.

§ 917 of the Col. Evidence Code provides that a communication made in confidence in the course of a lawyer-client relationship is presumed to be confidential & the opponent of the claim of privilege has the burden of proof to establish that the communication was not confidential.

Jasmine can meet its burden of proof here. § 956 provides that there is no attorney-client privilege if the services of the lawyer were sought or obtained to enable or aid anyone in committing a crime or fraud.

The communications here were provided by Mr. Gross to Mr. Banerjee to assist in perpetrating the theft of Jasmine's trade secrets. Jasmine can show a sufficient prima facie case of fraud to rebut the presumption of § 917.

In Hopwood Oil, the Columbia Court of Appeal held that § 956 does require that the opponent of privilege show a completed fraud. Rather, the proponent of the crime fraud exception need only prove (1) a false representation of a material fact, (2) knowledge of its falsity, (3) intent to deceive & (4) the right to rely.

Here, Phenom made the false representation to Jasmine that they only wanted to look at the TocTec technology to evaluate it, when they really intended to misappropriate the technology. See voicemail trans. at 9, lns. 14-16 ("we took their technology on the pretense of just evaluating it, not putting it in our product"). Mr. Banerjee's statement demonstrates that Phenom knew that they were lying & truly intended to steal the technology. Phenom also clearly intended to deceive Jasmine into thinking the two companies could partner so Jasmine would provide access to the technology. Like the plaintiffs in Hopwood Oil, Phenom intended to deceive Jasmine into thinking the disclosure of confidential information was only for evaluation & not for Phenom's true purpose.

Finally, Jasmine had a right to rely on Phenom's representations & promise of secrecy because the two companies were in good faith negotiations & Phenom signed a nondisclosure agreement. See Wong Trans. at 6, lns. 22-27.

Therefore, Jasmine has made the required showing that Phenom planned to commit a fraud. Because Mr. Gross provided advice to his client on how to cover up their request to Ms. Schaus, the communication disclosed in the voicemail was advice sought & provided to aid Phenom in committing a fraud. Thus, under Hopwood Oil & § 956, Phenom has "forfeited the benefits of the attorney-client privilege" & Jasmine has overcome the presumption that the communication is privileged.

D. Conclusion

For the reasons set forth above, Defendant Jasmine respectfully requests that Phenom's motion for a preliminary injunction restraining use or disclosure of the voicemail & its contents be denied.

Further, Defendant Jasmine submits that the court may & should review the contents of the voicemail to decide this motion if it so wishes & Phenom's request to seal the voicemail should be denied.

THURSDAY AFTERNOON
MARCH 1, 2007

California
Bar
Examination

Performance Test B
INSTRUCTIONS AND FILE

IN RE ERGOMETRIX, INC.

FILE

IN RE ERGOMETRIX, INC.

INSTRUCTIONS

1. You will have three hours to complete this session of the examination. This performance test is designed to evaluate your ability to handle a select number of legal authorities in the context of a factual problem involving a client.
2. The problem is set in the fictional State of Columbia, one of the United States.
3. You will have two sets of materials with which to work: a File and a Library.
4. The File contains factual materials about your case. The first document is a memorandum containing the instructions for the tasks you are to complete.
5. The Library contains the legal authorities needed to complete the tasks. The case reports may be real, modified, or written solely for the purpose of this performance test. If the cases appear familiar to you, do not assume that they are precisely the same as you have read before. Read each thoroughly, as if it were new to you. You should assume that cases were decided in the jurisdictions and on the dates shown. In citing cases from the Library, you may use abbreviations and omit page citations.
6. You should concentrate on the materials provided, but you should also bring to bear on the problem your general knowledge of the law. What you have learned in law school and elsewhere provides the general background for analyzing the problem; the File and Library provide the specific materials with which you must work.
7. Although there are no restrictions on how you apportion your time, you should probably allocate at least 90 minutes to reading and organizing before you begin preparing your response.
8. Your response will be graded on its compliance with instructions and on its content, thoroughness, and organization.

Martinez, Petit & Liefer, LLP
Attorneys at Law

MEMORANDUM

TO: Applicant
FROM: Alma Martinez
DATE: March 1, 2007
SUBJECT: **Ergometrix, Inc. – Schaeffer Stock Options**

Melinda Choy, Chief Executive Officer of our client, Ergometrix, Inc. ("Ergometrix"), has asked for our advice on whether Arthur Schaeffer, who recently resigned from Ergometrix, can be prevented from accepting employment with a competitor and from exercising certain stock options issued to him pursuant to a company stock option plan. Mr. Schaeffer worked for Ergometrix as its Senior Vice President of Engineering and, despite his agreement that he would not do so, accepted a job with a competitor immediately upon his resignation. Also, at various times over the course of his employment, Mr. Schaeffer received stock options to acquire a total of 100,000 shares of Ergometrix common stock. As of the time of his departure, he had not exercised any of the options. He has now attempted to exercise the options and, through his attorney, has demanded that Ergometrix issue 100,000 shares to him.

Ergometrix has put a "hold" on Mr. Schaeffer's stock options pending receipt of our advice.

Your task is to draft for me an objective memorandum analyzing whether Mr. Schaeffer's agreement not to work for a competitor and the forfeiture provisions of the Ergometrix stock option plan are enforceable against Mr. Schaeffer.

Specifically, address the following issues:

1. Whether the covenant not to compete contained in the employment agreement is enforceable.

2. Whether Mr. Schaeffer can exercise any of his stock options, i.e.,

(a) Whether any and, if so, which of the stock option grants have lapsed by the passage of time.

(b) Whether the stock options are “wages” within the meaning of Columbia Labor Code section 200.

(c) Whether either the lapse or the forfeiture provisions in the stock option plan violate Columbia Labor Code sections 221 and 222.

(d) Whether the forfeiture effected by the noncompetition component of the stock option plan violates Columbia Civil Code section 1600.

Discuss all the issues and reach a reasoned conclusion on how each should be resolved.

EXCERPT OF TRANSCRIPT OF INTERVIEW WITH MELINDA CHOY

February 25, 2007

* * *

Alma Martinez ("Martinez"): So, the problem is twofold: first, that Arthur Schaeffer violated his agreement not to go to work for a competitor and, second, that he wants to exercise his stock options, and Ergometrix doesn't believe he's entitled to. Is that right?

Melinda Choy ("Choy"): That's right. Mr. Schaeffer – Art – quit us at a crucial time and went to work for Indonix, a major competitor of ours. I'd like to know if I can keep him from working for Indonix, and I certainly don't want him to end up with 100,000 shares of our company.

Martinez: Well, I know you're about to launch your initial public offering – your IPO – and Ergometrix stock will be offered on the market at $10 a share. Is that what you mean when you say Art left at a crucial time?

Choy: Yes, that and the fact that we're rolling out some new products he was instrumental in developing and marketing.

Martinez: OK, let's go back to the beginning. What's the main issue as far as you're concerned?

Choy: Well, it's prompted by a letter we got from Art's attorney – here it is. He's basically claiming that we can't stop Art from working for Indonix, that the forfeiture language in our stock option plan is void, and that Art has the right to exercise all his options.

Martinez: Let's deal first with the fact that he's gone to work for Indonix. Why do you think he shouldn't be allowed to do that?

Choy: Well, he signed our standard non-compete agreement – all our key employees agree not to work for a competitor for six months after leaving Ergometrix. Art was one of our original employees when we started up the company eight years ago – that was in 1999. He was a very talented product engineer, and he moved up steadily in

the ranks and ended up as one of our key executives. Here's the employment contract he signed containing that agreement.

Martinez: Were any of the terms of Art's employment covered by a union contract?

Choy: No, we've never been unionized.

Martinez: What are you concerned about – that Art will give up your trade secrets to Indonix or issues like that?

Choy: No, not really. Our customers, pricing, and products are pretty much in the public domain, so there's not much harm he can do to us on that score. It's just that he'll give Indonix a competitive advantage because of his engineering talents.

Martinez: OK. Let's talk about the stock options. How did Art acquire the options?

Choy: Like most high-tech start-up companies, we used stock options to create incentives for our employees, you know, to give them a stake in what we hoped would be our success. At different times, Art received five separate stock option grants under our stock option plan – 20,000 shares each time. The option prices were anywhere from 50¢ to $2.00 a share. In other words, each grant gave him the right to buy 20,000 shares at whatever the option price was in that particular grant.

Martinez: So, by exercising the options at the option prices, he could buy the shares for just a fraction of the $10 per share the stock will be offered for when the IPO goes through.

Choy: That's right. I mean, the underwriters have set the opening IPO share price at $10 – it might be lower or higher, depending on how the market reacts. For sure, it will be more than Art's option prices, and he stands to make a killing.

Martinez: What's the harm if you just let him exercise the options?

Choy: The harm is that he will end up holding 100,000 Ergometrix shares. This is especially a problem because he's now working for Indonix, a head-on competitor of ours. But even if he just turns around and sells the stock at the market price, he will end up with about a million dollar windfall. He shouldn't be able to breach his contract with us and then get rich at our expense. And, if he gets away with it, what's to stop others from doing the same thing?

Martinez: You've got a good point there. The letter from Art's attorney says the stock options were part of Art's wages. Is that right?

Choy: You know, we never thought of it in those terms. He received a fairly high salary and the usual fringe benefits – health insurance and vacation – that's what we figured his compensation was. It's not like he gets the stock for free. He has to put up his own money to exercise the options, so I don't see how it can be considered part of his pay. The stock options were really intended as an incentive to stay with the company and give him a stake in making it a success. If we succeeded, which we did, he could share the wealth. If we had failed, the options would have been worthless. So he took a chance along with the rest of us.

Martinez: How did you determine whether an employee would receive option grants and how large the grants would be?

Choy: We – the board of directors – met periodically and decided who the key employees were and roughly how many options shares to grant to each one.

Martinez: What guidelines or criteria did you apply?

Choy: Nothing very definite. We started out as a very small company, and we're still not very large. We know who's doing a good job for us and who isn't – just a general sense of how valuable the particular employee was and what he or she had accomplished for the company. Art was always a hard worker and top producer, so he got fairly large grants.

Martinez: Did the options depend to any degree on how much work he produced or how many hours he worked? In other words, how was it decided when and how many options he'd get?

Choy: No. They had nothing to do with volume or hours of work by Art or anyone else. The timing and the size of the options pretty much depended on what we thought it would take to keep our key people committed. Of course, we wanted to be sure that whoever got stock options was a good, hard working employee.

Martinez: Let's take it a piece at a time. First, were Schaeffer's options vested? In other words, was there any reason he couldn't have exercised them while he was still working for you?

Choy: I don't think so. You can look at the stock option plan and figure that out. But Art never attempted to exercise any of them while he was still with us.

Martinez: Why do you suppose that is?

Choy: We all knew we were eventually going to take Ergometrix public and that the stock would shoot up in value, so maybe he didn't think it made much sense to put out his own money to buy the shares before he really had to. Besides, I think some of the options have lapsed by now. I think that's somehow stated in the Plan.

Martinez: Why would Art have let any of them lapse?

Choy: Probably just by inadvertence. In the early days we were all so busy and focused on getting the business headed in the right direction that no one paid much attention to that. Plus, the business didn't look too promising, so I guess he thought it wasn't worth the risk to pay the option price for stock that might end up being valueless.

Martinez: What was the reason for having the lapse provisions?

Choy: Well, the idea was that it would induce employees to exercise the options, and every time they did it would generate some cash for the company. It worked to some extent but not very much.

Martinez: Did the company ever extend or renew any of the "lapsed" grants?

Choy: A couple of other employees came to me just before some of their grants lapsed, and I signed extensions for them. I guess if Art had asked, I would've done it for him too, but he never asked, and I didn't even think anything about it.

Martinez: When did Art quit, and what were the circumstances?

Choy: He came in to my office about three weeks ago and told me that he'd received a very attractive offer from Indonix and that he had accepted it. He gave two weeks notice and has been gone a week. He said he'd made up his mind and wouldn't even discuss alternatives with me. When I reminded him about his non-compete

agreement, he just laughed and said his attorney told him it wasn't worth the paper it was written on.

Martinez: Did you have any discussion with him about his stock options?

Choy: Yes. I told him the Plan says his unexercised options – which are all of his – are rescinded. He said his attorney told him I couldn't rescind his unexercised options, no matter what the forfeiture clause in the Plan says.

Martinez: Did he try to exercise the options?

Choy: Yes. He said he wanted to exercise them all immediately. He handed me a letter so stating and his check for $115,000 to cover the option prices. I gave him his letter and check back and told him, "Get lost!" And, you can see, he didn't waste any time in getting his attorney to write us a nasty letter.

Martinez: Is the information in the letter from Art's attorney accurate as to the dates, amounts, and option prices?

Choy: Yes, and the tender of $115,000 is the correct amount if we have to allow him to exercise all the options.

Martinez: Is this the first experience you've had with someone leaving and wanting to exercise his stock options? I mean have you ever had to invoke the forfeiture provisions before?

Choy: No, it's the first time this has happened.

Martinez: All right. Let me look into it, and I'll get back to you in a few days with an answer. I know that a federal court, in a case called *Ball v. International Machinery Corp.*, recently dealt with some of these issues and certified to the Columbia Supreme Court the question whether stock options are wages. But the parties settled the case and mooted the question before the Columbia court had a chance to decide the issue. So this may be a matter of first impression.

Choy: Thanks. I'll look forward to hearing from you.

END OF INTERVIEW

Law Offices of Rankin Bayard III
44 Melton Plaza, Suite 2400
Anniston, Columbia 94501
(490) 531-4333

February 24, 2007

Melinda Choy
Chief Executive Officer
Ergometrix, Inc.
820 Miramar Parkway, Building 5
Anniston, Columbia 94502

Re: Arthur Schaeffer – Stock Options

Dear Ms. Choy:

I write on behalf of my client, Arthur Schaeffer, to demand that Ergometrix, Inc. honor Mr. Schaeffer's request to exercise all five grants of stock options awarded to him while in the employ of Ergometrix.

In the eight years of Mr. Schaeffer's employment with your company, he earned and was awarded the following stock option grants:

1st Grant: May 1, 1999 – 20,000 shares @ 50¢ per share; fully vested as of August 1, 1999

2nd Grant: May 1, 2000 – 20,000 shares @ 75¢ per share; fully vested as of August 1, 2000

3rd Grant: May 1, 2002 – 20,000 shares @ $1.00 per share; fully vested as of August 1, 2002

4th Grant: October 1, 2004 – 20,000 shares @ $1.50 per share; fully vested as of January 1, 2005

5th Grant: July 1, 2005 – 20,000 shares @ $2.00 per share; fully vested as of October 1, 2005

On February 8, 2007, Mr. Schaeffer announced his resignation to accept employment with Indonix, an acknowledged competitor of Ergometrix, and his intention to exercise

all outstanding stock options. You crassly told him that Ergometrix would refuse to honor the options. I can only assume that, in refusing to honor the options, you were relying on the forfeiture provisions contained in the stock option plan. Those provisions are unlawful and unenforceable for the following reasons.

First, the stock options constitute "wages" as that term is defined in Columbia Labor Code § 200. They were fully vested, and, under the 1982 holding of the Columbia Supreme Court in *Suarez v. Dressers, Inc.*, any forfeiture of earned and vested wages is unlawful.

Second, both the lapse and forfeiture provisions violate Columbia Labor Code § 221, also because the options are fully vested wages. Those provisions also violate Columbia Labor Code § 222 because they constitute an unlawful withholding of wages previously agreed to.

Third, the provision in the stock option plan that calls for a forfeiture in the event a participant becomes employed by a competitor of Ergometrix violates Columbia Civil Code § 1600, which voids any contract to the extent that it restrains a person from engaging in a lawful profession, trade, or business. The obvious effect of the forfeiture provision is to restrain Mr. Schaeffer from accepting employment with a competitor. Such "covenants not to compete" are void and unenforceable as a matter of public policy in Columbia. *McGill v. Donald Reuben Corp.*, Columbia Supreme Court (1965).

Finally, if you have any inclination to try to challenge Mr. Schaeffer's having accepted employment with Indonix, please disabuse yourself of that notion. The noncompetition clause of your standard employment agreement is a blatant violation of Columbia Civil Code § 1600. Any effort on your part to disrupt his relationship with Indonix will be resisted vigorously.

On behalf of Mr. Schaeffer, I hereby tender the sum of $115,000 to cover the cost of exercising the options on all 100,000 shares, and I demand that you forthwith issue 100,000 shares to Mr. Schaeffer.

I am authorized by Mr. Schaeffer to file suit against Ergometrix to enforce the options if I have not received a satisfactory response from you within 30 days of the date of this letter.

Very truly yours,

Rankin Bayard IJI

Rankin Bayard III

EXCERPTS FROM ERGOMETRIX, INC.'S EMPLOYMENT AGREEMENT

* * *

Sec. 22. COVENANT NOT TO COMPETE

EMPLOYEE agrees that during the term of his employment and for a period of six months after the termination thereof, whether said termination be voluntary or involuntary, he will not render, directly or indirectly, any services, whether as an employee or otherwise, to any business that is a competitor of Ergometrix. This covenant not to compete is voluntarily undertaken by EMPLOYEE at the time of his initial employment.

* * *

Date: February 2, 1999 *Arthur Schaeffer*

Employee

EXCERPTS FROM ERGOMETRIX, INC.'s STOCK OPTION PLAN

Sec. 1.01 – Purpose: Ergometrix, Inc. promulgates this Stock Option Plan to gain the commitment of its key employees to the success of the company. Its purpose is to allow the employees to acquire an ownership interest in the company through the investment of their own time, effort and money and to give them the opportunity to share in the success and growth of the company.

* * *

Sec. 4.01 – Vesting: The right to exercise all options granted pursuant to this Plan shall fully vest in the Participant to whom the grant is awarded three months after the date of the grant. "Vesting" shall mean that, subject to the lapse and forfeiture provisions of this Plan, the Participant shall have the right to exercise the option at the stated option price, whereupon the company shall issue to the Participant the number of Common Class A shares stated in the grant so exercised.

Sec. 4.02 – Exercise: At any time after vesting of any grant awarded hereunder, the Participant shall have the right to exercise the option to acquire up to the number of shares stated in the grant. "Exercise" means a timely tender to Ergometrix by the Participant of the option price for the number of option shares the Participant wishes to acquire accompanied by a written demand that Ergometrix issue said shares to the Participant.

Sec. 4.03 – Lapse: Unless the Participant exercises an option granted hereunder within three years of the date of the grant, all rights conferred by said grant shall lapse, and, unless the grant is expressly renewed or extended, the Participant shall lose all rights thereunder.

* * *

Sec. 8.01 – Forfeiture of Options: The Participant under this Plan understands and agrees that in the event a Participant directly or indirectly accepts employment with, or performs any work for, any person or entity that is engaged in the same line of business and in competition with Ergometrix, either while the Participant is employed by Ergometrix or within six months after the Participant's termination of employment with

Ergometrix, all unexercised grants awarded to the Participant shall be deemed rescinded and all rights of the Participant thereunder surrendered.

THURSDAY AFTERNOON
MARCH 1, 2007

California
Bar
Examination

Performance Test B

LIBRARY

IN RE ERGOMETRIX, INC.

LIBRARY

EXCERPTS FROM THE COLUMBIA LABOR CODE

Section 200. Wages

As used in this Code, the term “wages” includes all amounts for labor of every kind or description performed by employees, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation.

* * *

Section 221. Repayment of Wages to Employer

It shall be unlawful for any employer to receive from an employee any part of wages theretofore paid by said employer to said employee.

Section 222. Withholding of Part of Wage

It shall be unlawful, in the case of any wage agreement arrived at through collective bargaining, for an employer to withhold from any employee any part of the wage agreed upon.

* * *

Section 227. Vested Vacation Wages

Unless provided by a collective bargaining agreement, whenever a contract of employment or employer policy provides for paid vacation and an employee is terminated without having taken off his vested vacation time, all vested vacation shall be paid to him as wages at his final rate of pay; provided, however, that an employment contract or employer policy shall not provide for forfeiture of vested vacation time upon termination.

* * *

Section 407. Investment in Business in Connection with Employment

Investments and the sale of stock or an interest in a business in connection with the securing of a position are illegal as against the public policy of this State and shall not be advertised or held out in any way as part of the consideration for any employment.

EXCERPT FROM THE COLUMBIA CIVIL CODE

Section 1600. Unauthorized Contracts

Every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.

McGill v. Donald Reuben Corp.

Columbia Supreme Court (1965)

Plaintiff appeals from an adverse judgment in an action for declaratory relief to establish his right to be reinstated in the employees' retirement plan of the defendant corporation.

Plaintiff left defendant's employ on July 1, 1960, after meeting all the requirements for benefits under the retirement plan. On October 24, 1960, he went to work for a competitor of the defendant. On December 5, 1960, the retirement committee that administers the plan notified plaintiff that his rights to receive payments had been terminated pursuant to section 7.1 of the plan on the ground that he had entered the employ of a competitor.[1] Plaintiff then brought this action against the corporation seeking a declaration that he was entitled to reinstatement on the ground that the section invoked by the retirement committee was against public policy and unenforceable. The trial court held that section 7.1 was valid.

Section 1600 of the Columbia Civil Code provides that "Every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void." This section invalidates provisions in employment contracts prohibiting an employee from working for a competitor after leaving his employment with his previous employer or imposing a penalty if he does so. The pension plan is part of an employee's contract of employment. See *Bos v. U.S. Rayon Co.*, Columbia Court of Appeals (1958).

As this Court said long ago in *Car-Na-Var-Corp. v. Mossler*, Columbia Supreme Court (1944):

---

1 Section 7.1 provides: "The annuity payments to any retired Employee shall be suspended or terminated in the event such retired Employee at any time enters any occupation or does any act which, in the judgment of the Retirement Committee, is in competition with any phase of the business of the Employer."

> Equity will to the fullest extent protect the property rights of employers in their trade secrets and the preservation of their hard-won business advantages, but public policy and natural justice require that equity should be solicitous for the inherent right in all people, not fettered by negative covenants upon their part to the contrary, to follow any of the common occupations of life. A former employee has the right to engage in a competitive business for himself and to enter into competition with his former employer, even for the business of those who had been the customers of his former employer, provided such competition is fairly and legally conducted.

That principle emanates from the common law and is embodied in section 1600 of the Civil Code. It is true that a number of states have abandoned the common law prohibition of covenants restraining competition in employment agreements, adopting instead an approach enforcing such covenants to the extent they are reasonable. It may even be correct to say that this "rule of reason" represents a majority rule among jurisdictions that have considered the question.

However, the Columbia courts, led by this court, have been clear in their expression that section 1600 represents a strong public policy of the state that should not be diluted by judicial fiat.

The forfeiture imposed upon the plaintiff by the defendant corporation in this case therefore violates section 1600.

The judgment is reversed.

Suarez v. Dressers, Inc.

Columbia Supreme Court (1982)

At issue is the question of when vacation time becomes "vested" under Columbia Labor Code § 227, which provides, essentially, that upon termination an employee is entitled to receive pay for all vested vacation time and that "an employment contract or employer policy shall not provide for forfeiture of vested vacation time upon termination."[1]

Emilio Suarez was employed by Dressers, Inc., a non-union employer, from December 1, 1972 until July 1, 1978, at which time he was laid off in a general reduction in Dressers' workforce. Throughout the period of his employment, Suarez received an hourly wage for the hours he worked each week. In addition, he received certain fringe benefits, including holiday and vacation pay.

The company's vacation policy provided that each hourly employee was entitled to between one and four weeks of paid vacation annually, depending on the length of his or her employment. Under the policy, an employee did not become eligible for a paid vacation until the anniversary date of his or her employment; vacation must be taken during the year of eligibility; vacation could not be carried over from one year to the next; and employees were not entitled to receive pay in lieu of vacation.

Suarez regularly took his accumulated vacation time through December of 1977, at which time his length of service was such that he was in the three-weeks-per-year

1 Suarez also invokes Labor Code §222, which forbids an employer from withholding any part of earned wages "arrived at through collective bargaining." We dismiss this claim inasmuch as Suarez's employer was non-union, and his wages were not subject to a collective bargaining agreement.

eligibility category. However, from December 2, 1977 until the date of his termination in July 1978, he did not take any paid vacation time.

On July 1, 1978, the company paid Suarez a final paycheck covering his accumulated hourly wage but refused to pay him anything for pro-rated vacation pay. The company's position was none of Suarez's vacation pay "vested" until his next anniversary date of December 1, 1978 and, since he was not employed on his anniversary date, he had no "vested vacation time."

Suarez asserted in the court below that his annual paid vacation was a form of wages earned for labor performed throughout the year and "vested" as it was earned. He claimed that, as an employee who worked for some part of a year, he had a "vested" right to a proportionate share of his vacation pay at the time of termination. The court below ruled in his favor.

When considering the meaning of the phrase "vested vacation time" as used in § 227, it is important to keep in mind the nature of vacation pay. It is well established that vacation pay is not a gift or gratuity but is, in effect, additional wages for services performed. The consideration for annual vacation is the employee's year-long labor. Only the time of receiving these "wages" is postponed until the employee goes on vacation. This court has adopted the view that vacation pay is a form of deferred compensation in the form of a reward of additional wages for constant and continuous service. In the modern economy, employers have devised increasingly complex use of compensation in the form of "fringe benefits," some types of which are not payable until a time subsequent to the performance of the work that earned the benefits.

Recently, this court had the occasion in *Maynard v. State of Columbia* (1980) to consider whether and when pension entitlements are a "vested right." We held that the right to pension benefits vests upon acceptance of employment, even though the right

to immediate payment of the pension may not mature until certain conditions are satisfied. The employee earns *some* pension entitlements as soon as he or she has performed some substantial services for the employer even though the payment of the pension earnings is to be made at a future date. The pension right continues to vest cumulatively as the work for which it is intended as compensation is performed. Although the right to a pension may still be, in whole or in part, subject to divestiture upon the happening of certain contingencies (e.g., insufficient length of service, employee's failure to pay required contributions), that does not prevent the right from vesting.

Likewise, the right to vacation pay, being a form of wages, vests cumulatively and proportionately as the employee performs his or her work for the employer. The requirement in Dressers' vacation policy that the employee must be employed on his or her anniversary date in order to be entitled to receive paid vacation does not prevent the vacation entitlement from accruing and vesting *pro rata*. At most, it is a condition that attempts to effect a forfeiture of vacation pay already vested. Unlike the situation with a pension plan, where there *may* be valid conditions that result in lawful forfeiture, [2] Columbia law forbids the forfeiture of vested vacation pay, i.e., Labor Code § 227 specifically provides that "an employment contract or employer policy *shall not provide for forfeiture* of vested vacation time upon termination." (Emphasis added.)

Dressers argues that its policy requiring that an employee be employed on his or her anniversary date in order to be entitled to vacation pay is not a condition that effects a

---

2 However, there are limits to circumstances under which forfeitures can lawfully occur. For example, in *McGill v. Donald Reuben Corp*. (1965), this court found invalid a retirement plan provision that made an employee's pension forfeitable if the retired employee at any time enters into any occupation or does any act in competition with the firm from which he retired. This provision, we held, violated Columbia Civil Code § 1600, which expresses a strong, immutable principle of Columbia public policy invalidating any contract that purports to restrain one from engaging in a lawful profession, trade, or business.

forfeiture. Rather, says Dressers, it is a condition that prevents those rights from vesting at all. That is to say, it is intended as an incentive to the employee to remain in the company's service and vacation pay is a reward for fulfillment of that condition. Dressers claims that failure of that condition prevents vesting.

There may very well be employer benefit and incentive plans that are designed to reward employees for remaining on the job for periods of time. Vacation pay is not one of them. If, in fact, vacation pay served simply to induce employees to remain on the job for a certain period of time, then interpreting Dressers' eligibility requirement as a condition would be entirely reasonable and the forfeiture would be lawful because the vacation time would not be vested. However, there are at least two flaws in the argument: first, it is not necessarily within the employee's control whether to remain employed until the anniversary date. In this case Suarez was laid off in a reduction in force prior to his anniversary date. Second, once it is acknowledged that vacation pay is part of the employee's wage, the justification for requiring the employee to remain employed for the entire year disappears. It would be like arguing that an employee who is terminated before payday is not entitled to receive the accrued wages earned up to the moment of termination because he was no longer employed on payday.

Accordingly, we hold that the right to a paid vacation constitutes deferred wages for services rendered that vests *pro rata* and that, once vested, is protected from forfeiture by § 227 and we affirm the judgment.

Ball v. International Machinery Corp.

United States Court of Appeals, 15th Circuit (2005)

In this case, we consider the question whether stock options granted by an employer to any employee are wages.

Dr. William Ball worked as a senior scientist in the research and development department of International Machinery Corp. (IMC) in Mayville, in the neighboring State of Olympia, which is where IMC is incorporated and headquartered. In the course of his employment, Dr. Ball acquired stock options issued by IMC. The options were worth more than $900,000 when he exercised them. The IMC stock option plan included a promise that if an employee/participant worked for a competitor within six months after exercising the options, he would return to IMC all profits from the options. A week after exercising his options, Dr. Ball resigned from IMC and went to work for a competitor in Bay City, Columbia. IMC therefore notified him that his stock options were cancelled and demanded that he return the $900,000 in profits.

Dr. Ball filed this suit for declaratory relief in the Columbia federal district court, seeking a declaration that the forfeiture provisions of IMC's stock option plan are unenforceable. Dr. Ball claims that the forfeiture provisions violate two provisions of Columbia law: Labor Code § 221, which makes it unlawful "for any employer to receive from an employee any part of wages theretofore paid by said employer to said employee," and Civil Code § 1600, which voids "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business." The trial court entered judgment for Dr. Ball on both claims.

Jurisdiction in Dr. Ball's suit is based on diversity of citizenship. Both Columbia and Olympia are within this, the 15th Circuit. The IMC stock option plan contains a choice of

law clause providing that any dispute arising under the terms of the plan shall be governed by the laws of the State of Olympia.

A. Choice of Law

The threshold question is whether the dispute is governed by the substantive law of Olympia as prescribed in the stock option plan, or, as Dr. Ball claims, by the substantive law of Columbia.

The choice of law question turns on whether the Columbia statutes in issue – Labor Code § 221 and Civil Code § 1600 – are applicable to the transaction and reflect fundamental public policies of the State of Columbia that would be impermissibly offended if the laws of Olympia were applied.

B. Columbia Labor Code §§ 200 and 221

As we have noted, § 221 makes it unlawful "for any employer to receive from an employee any part of wages theretofore paid by said employer to said employee." Dr. Ball's theory is that allowing IMC to recover the profits he made by exercising his stock options would be tantamount to allowing IMC to "collect or receive" from him "wages theretofore paid" to him. This statute, passed in 1937, has as its purpose the prevention of employers extracting "kickbacks" from employees and protecting employee expectations regarding receipt of the wages the employer has contracted to pay.

There is no question whatsoever that § 221 expresses a fundamental public policy in protecting the wages of employees in the State of Columbia. See *Alton v. Emery Iron Foundry*, Columbia Supreme Court (1956): ("The Legislature has expressed in the strongest possible terms this state's public policy that wages, once earned by and paid to employees, is theirs and cannot be taken back by the employer.")

The more difficult question, however, is whether stock options are "wages." The controlling law in the State of Olympia is that stock options are not "wages." The courts of Columbia have not considered this question, so this court has two choices on how to proceed on this issue: we can review tangentially related Columbia court decisions and other authorities and try to deduce therefrom how the Columbia courts would rule if confronted by the question; or we can certify this question of law to the Columbia Supreme Court pursuant to Columbia Appellate Rule 12.2 and request the Columbia court to determine it.

In Columbia, "wages" are defined in Labor Code § 200 as "all amounts for labor of every kind or description performed by employees, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation."

The courts in different states that have considered the question in the context of statutory language similar to that in § 200 have reached differing conclusions. For example, the courts of the State of Franklin, applying that state's Wage Payment and Collection Law, have concluded that stock options *are* wages "if the employer specifically agreed to deliver the option as employment compensation." The courts in Olympia, as we have noted, have determined the opposite – that stock options *are not* wages under any circumstances.

Although we do not pretend to suggest how the Columbia Supreme Court would ultimately rule on the question, we are inclined toward the view that stock options are not wages under § 200 because the concept underlying stock options does not seem to fit into the § 200 definition of "all *amounts* for *labor* of every kind or description performed by employees, whether the *amount is fixed* or ascertained by the *standard* of time, task, piece, commission basis, or other method of calculation." (Emphasis added.) Parsing the statute and examining it in terms of the words we have italicized tends to

demonstrate what we mean when we say that the stock option concept does not seem to fit.[1]

First, stock options are not "amounts," i.e., money. They are contractual rights to buy shares. The employee is free to exercise the options or not as he or she sees fit.

Although the amount of money for which the stock can be purchased may be "fixed" in the sense that each option has a stated exercise price, that cannot be a criterion for determining whether stock options are wages because the option price is money the employee must pay, not the employer. The value to the employee is the amount for which the stock acquired through the option can be sold, and that "amount" varies unpredictably depending on market conditions, so it is not "fixed or ascertainable" by any method of calculation when the options are awarded. Moreover, the amount is not fixed or ascertained by any "standard" related to the quantity or units of work performed, which are usually the criteria by which wages are determined. Nor can stock options be analogized to pension plans or profit sharing plans because the latter are ordinarily based on continued length of service and the earnings of the participating employee and are usually fixed in amount.

However, we are cognizant that there are important public policy overtones peculiar to the State of Columbia that will inform the Columbia court's decision on this question of first impression. For that reason, we decline to speculate on the outcome, and we shall certify the following question for determination by the Columbia Supreme Court:

---

1 We note in passing that Columbia Labor Code § 407 makes it illegal for an employer to condition on an employee's acquisition of stock or an interest in the business. If stock options were considered to be "wages," it would be difficult to reconcile such a characterization with the proscription of § 407, i.e., would having to pay his or her own money for the acquisition of the shares be tantamount to requiring an employee to pay for part of his or her "wages?" Given that stock options plans are an increasingly common form of employee incentive plan, such an interpretation would run counter to a trend that is generally acknowledged as a significant benefit to workers.

> Are stock options awarded employees by their corporate employers and the proceeds therefrom "wages" within the meaning of Columbia Labor Code § 200?

If the Columbia Supreme Court answers the question in the affirmative, we will at that time turn to the question whether it would offend Columbia's public policy to apply Olympia law.

C. Columbia Civil Code § 1600

It is also beyond dispute that § 1600, which voids any contract to the extent that "anyone is restrained from engaging in a lawful profession, trade, or business," expresses a strong and fundamental public policy of the State of Columbia. The courts of Columbia strictly enforce the spirit and letter of that statute. See *McGill v. Donald Reuben Corp.* The statutory and case law in Olympia is to the contrary. Olympia follows the majority view that allows and enforces reasonable and limited restraints in the nature of covenants not to compete.

However, it is not necessary for us to decide whether the forfeiture provision that Dr. Ball objects to runs afoul of § 1600 and, if so, whether it would offend Columbia's public policy to apply Olympia law. That is because the forfeiture provision is *not* one that restrains Dr. Ball from working for a competitor. He was entirely free to do so. It is undisputed that he agreed that, if he did so within six months of exercising his options, he would give back any money he got from the stock options. Moreover, Dr. Ball could have exercised the options six months before he quit, kept the money, and *then* gone to work for the competitor. Or he could have continued to work unrestrained in his profession, gone to work for a non-competitor, and kept the money. Thus, it was no restraint at all. It was simply a contractual obligation to give back the money if he did what he had agreed not to do.

Thus, § 1600 is simply inapplicable here. Therefore, as to Dr. Ball's claim of violation of § 1600, we hold that Olympia law will be applied because there is no public policy to be vindicated by applying Columbia law. Of course, if the Columbia Supreme Court rules that stock options are wages, we will then have to revisit the choice of law issue to determine whether applying Olympia law would offend Columbia's public policy as expressed in § 221.

Accordingly, the judgment is reversed in part, and further proceedings in this matter are stayed pending the return of the question certified to the Columbia Supreme Court.

Answer 1 to PT-B

To: Alma Martinez

From: Applicant

Date: March 1, 2007

Re: Ergometrix, Inc. ("Ergometrix") - Schaeffer Stock Options

You asked for an objective memorandum analyzing:

1. Whether Mr. Schaeffer's agreement not to work for a competitor of Ergometrix; and

2. Whether Mr. Schaeffer is entitled to exercise all or any portion of his stock options.

These issues are addressed below.

1. Covenant Not to Compete

Mr. Schaeffer, one of Ergometrix's original employees, who is a key executive, has resigned from Ergometrix and commenced employment with Indonix, a direct competitor. This is a clear violation of §22 of Mr. Schaeffer's employment agreement, which prohibits rendering services, as an employee or otherwise, within 6 months of termination from Ergometrix, whether voluntarily or involuntarily. Mr. Schaeffer commenced employment with Indonix immediately, prior to expiration of the 6-month period.

However, §1600 of the Columbia Civil Code ("Civil Code") provides that contract provisions "restraining" anyone from engaging in a lawful trade, profession or business of any kind is void. In McGill, the Columbia Supreme Court noted that while the strong majority trend among states is to permit "reasonable" covenants not to compete, §1600 of the Civil Code represents a strong public policy to invalidate contract provisions prohibiting work with a competitor or imposing penalties to do so. This is contrary to the majority trend.

While the United States Court of Appeals in Ball found that a provision requiring forfeiture of stock options upon leaving a company and working with a competitor is not a restraint subject to §1600, §22 of the Employment Agreement is a direct prohibition of work for a competitor. This provision is therefore likely void under Civil Code §1600 and McGill, and so Ergometrix is unlikely to succeed in enforcing the prohibition to prevent Mr. Schaeffer from working for Indonix.

2. Stock Options

(a) Have any of Mr. Schaeffer's Options Lapsed with the Passage of Time?

§4.03 of the Ergometrix Stock Option plan provides that unless exercised within 3 years of the grant date, all rights under the options will lapse unless the grant is expressly renewed or extended.

Of the stock options held by Mr. Schaeffer, all but 40,000 have grant dates more

than 3 years prior to Mr. Schaeffer's effort to exercise his options about 3 weeks ago. Ms. Choy states that Mr. Schaeffer made no prior effort to exercise the options, made no request to extend or renew any of the options for which 3 years have passed, and no such extension or renewal was granted. Ms. Choy noted that extensions were granted to employees who requested them, but Mr. Schaeffer did not do so. The 60,000 options with grant dates of May 1, 1999, May 1, 2000 and May 1, 2002 will therefore have lapsed by passage of time under §4.03, provided it is enforceable.

Counsel for Mr. Schaeffer argues that this lapse provision is unenforceable as the options are "wages" under §200 of the Labor Code, and violate §221 and §222 of the Labor Code. Thess issues are addressed below. As explained above, the options are unlikely to be deemed wages, and so the lapse provision is likely to be enforceable, resulting in the lapse of the 60,000 options.

(b) Are the Stock Options Wages?

§200 of the Labor Code defines wages to include "all amounts for labor of every kind or description performed by employees, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation."

The question of whether §200's definition of wages applies to stock options has not been addressed by the courts of Columbia. However, the United States Court of Appeals considered this issue in Ball. While the court did not decide the issue, it noted that the concept of stock options does not fit the §200 definition. First, stock options are not easily defined as an "amount," which would normally refer to money. Rather, the options are rights, which may or may not be exercised.

Second, because the value of options varies depending upon the market price of the underlying stock, any "amounts" are not susceptible to being fixed, ascertained or calculated at the time of the award. Third, the stock options are not fixed or amounts determined based upon a "standard." Stock options also require the payment of monies by employees at the time of exercise, and so it is difficult to argue that the employees are granted an "amount."

The Columbia Supreme Court held in McGill that vacation days are considered wages, and in Suarez that pension plans are wages. These also are not fixed or definite dollar figures, and so it could be argued that, by analogy, the Columbia courts may find stock options to be wages relying on these cases. Both are rights also that vest over time, as stock options often do. However, stock options, and in particular the options granted by Ergometrix, differ in important ways. First, while vacation days and pension plans are not necessarily clear "amounts," vacation days may easily be reduced to an amount by applying the employee's daily salary, and are frequently cashed out in this way. Pension plans also vest according to clear rules, and so the value can normally be readily calculated in a way not possible with stock options. Second, it is common, and as Ms. Choy noted is the case here, for the granting of stock options to be at the discretion of the company, normally by decision of the board of directors. Thus, the inevitable vesting of rights to vacation days and pensions over time based on length of employment emphasized in McGill and Suarez is not present in the case of stock options, especially in the case of grants made at the discretion of the board.

The stock option plan here may also be more clearly analogized to an incentive plan,

given the discretion of the board of directors to determine whether or not to grant options.

Moreover, as noted in Ball, if stock options are characterized as wages, it would be very difficult to reconcile the granting of options with §407, as this may be construed as requiring the employee to use wages to acquire an interest in the company.

While the lack of case law makes the outcome unclear, the better view is that stock options should not be treated as wages under §200 of the Labor Code.

(c) Are §221 or §222 of the Labor Code Violated by the Forfeiture or Lapse Provisions?

The simplest issue to address is application of §222, preventing the withholding of wages under a wage agreement "arrived at through collective bargaining." On its face, this provision applies only to agreements arrived at through collective bargaining. Moreover, Suarez further emphasizes the point by noting that this provision does not apply where the employer is non-union.

Ms. Choy noted that Ergometrix has no union. There appears to be no basis to conclude that either Mr. Schaeffer's wage agreement or the stock option plan were arrived at through collective bargaining, and so §222 has no application here.

§221 applies to "wages." If stock options are found not to be "wages," §221 would not apply. Even if stock options are found to be wages, it is not clear that §221 would invalidate the lapse or forfeiture provisions of the stock option plan. Suarez provides an argument that §221 would prevent forfeiture, as provisions for forfeiture of unused vacation days of the employer were found to be invalid. Arguably, by analogy, stock options forfeiture provisions may be found invalid. However, there are important differences. First, the court in Suarez relied upon a specific provision, §227 of the Labor Code, expressly preventing forfeiture of vacation days, rather than on §221. There is no analogous provision for stock options.

Second, the Suarez court noted that vacation days are not generally considered an incentive plan, while other benefit arrangements may be. It may be argued that a discretionary stock option plan is more in the nature of an incentive plan.

The Suarez court also noted that some benefit plans, such as pensions, may be divested by later conditions. This would support the argument that Ergometrix may divest stock options previously granted upon the occurrence of conditions, as it has done here, upon the passage of 3 years from the grant date or employment with a competitor. The primary reason the court did not permit such conditions for vacation days was the existence of the specific provision, §227, as noted above.

The Lapse and Forfeiture provisions are therefore unlikely to violate §221, whether or not stock options are deemed wages.

(d) Does the Forfeiture Provision of the Stock Option Plan Violate Civil Code §1600?

§8.01 of the Ergometrix Stock Option plan provides for forfeiture of any options granted if a participant accepts employment or performs any work for a person or entity in the same line of business with or in competition with Ergometrix. Mr. Schaeffer's acceptance of employment with Indonix, a direct competitor of Ergometrix, is a clear violation of §8.01, and will result in forfeiture of all options of Mr. Schaeffer if enforceable,

based upon Mr. Schaeffer's acceptance, as communicated to Ms. Choy, of employment with Indonix prior to his attempt to exercise the options.

The Columbia Supreme Court held in McGill that §1600 of the civil code, which by its terms applies to contract provisions which "restrain. . ." engagement in lawful profession, trade or business, invalidates provisions in employment contracts prohibiting working for a competitor or "imposing a penalty" for doing so. This reads §1600 broadly in two important ways. First, it reads restraint on "professing trade or business" to include restraints on working for competitors. Second, McGill interprets "restrained" to include not only prohibitions, but penalties. The court then held that forfeiture of a pension for working with an employer violates §1600.

It can be argued that the forfeiture provision in the stock option plan is analogous to the provision in the pension plan in McGill, and therefore represents a penalty for accepting employment with a competitor, in violation of §1600.

By contrast, the U.S. Court of Appeals in Ball found §1600 inapplicable to stock option plans. The Ball court reasoned that a provision requiring the disgorging by a former employee of profits where stock options are exercised after leaving to work for a competitor is not a "restraint," because the employee was free to work for a competitor, but would merely no longer be entitled to certain contractual benefits if he did so. The court further noted that the employee could have exercised six months prior to leaving, or worked for a non-competitor, and enjoyed the benefits of his options.

In the instant case, the stock option provision in the Ergometrix plan is less restrictive and less harsh than the Ball provisions, in that the employee forfeits only unexercised options, and is not forced to disgorge profits from options already exercised. Moreover, the Ergometrix plan does not potentially reach back to options exercised prior to leaving employment with Ergometrix, as the Ball plan does, except in the case that an employee engages in work for or accepts employment with a competitor while still employed with Ergometrix.

Similar to Ball, Mr. Schaeffer could have avoided losing the options simply by exercising the options at an earlier time.

The forfeiture provision of stock option plan is therefore likely to be subject to the rule under Ball, rather than McGill. As such, §1600 would not be applicable. However, as this is a US Court of Appeals decision, there is a risk that the Columbia Supreme Court may find McGill to be a better analogy, and find that §8.01 is a penalty in violation of §1600.

Answer 2 to Performance Test B

MEMORANDUM

TO: Alma Martinez

FROM: Applicant

DATE: March 1, 2007

SUBJECT: Ergometrix, Inc. - Schaeffer Stock Options

1) Is the covenant not to compete contained in the employment agreement enforceable?

According to the transcript of the interview with Melinda Choy, Chief Executive Officer of our client, Ergometrix, Inc. ("Ergometrix") Arthur Schaeffer, who recently resigned as Senior Vice President of Engineering of Ergometrix, signed the company's standard non-compete agreement contained in his employment contract voluntarily and as far as we know - knowingly and intelligently.

However, under the Columbia Civil Code §1600 (which states that every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void) - this non-competition covenant in the Ergometrix employment contract would seem to be invalid as against public policy and therefore unenforceable.

In McGill v. Donald Reuben Corp., a Columbia Supreme Court case from 1965, the court states that §1600 "invalidates provisions in employment contracts prohibiting an employee from working for a competitor after leaving his employment with his previous employer or imposing a penalty if he does so." (P. 3) Furthermore the McGill court goes on to quote an earlier case of theirs, Cor-Na-Var-Corp. v. Mossler (1944), which states that "a former employee has the right to engage in a competitive business for himself and to enter into competition with his former employer, even for business of those who had been the customers of his former employer, provided such competition is fairly and legally conducted." (p. 4).

And while the McGill court goes on to point out that this rule to prohibit covenants restraining competition is not a majority rule - Columbia upholds §1600 of the Civil Code because it represents a strong public policy of the state. This can even be seen in the opinion from the 15th Circuit United States Court of Appeals 2005 case Ball v. International Machinery Corp. where it was stated that CCC §1600 "expresses a strong and fundamental public policy of the State of Columbia" (p. 13) and that "the Courts of Columbia strictly enforce the spirit and letter of that CCC §1600 statute." (P. 13).

Thus, it seems relatively clear that in Columbia the kind of covenant not to compete found in Ergometrix's employment contract would be found to be unenforceable. We may argue, however, that Columbia, in this case, should use the same public policy argument usually used to strike down non-competition clauses to uphold it by using our particular facts. This is not a situation where an employee has been let go from their position and a

no-compete covenant would keep them from finding gainful employment elsewhere. Here, Art was a valuable asset to Ergometrix, and he abruptly left the company of his own free will at a time when the company was in particular need of his time and services to move on to a more lucrative position with a competitor. Melinda said it best when she said in her interview, "he shouldn't be able to breach his contract with us and then get rich at our expense." (p. 4).

This is a difficult argument to make considering the longstanding public policy against these covenants, however, and my opinion is that this Ergometrix covenant not to compete is unenforceable in Columbia (elsewhere, of course, it may be).

2) Ability of Mr. Schaeffer to exercise any of his stock options:

(a.) Have any of the stock options lapsed? And, if so, which ones?

Under the Ergometrix Stock Option Plan Sec. 4.03 "unless the Participant exercises an option granted hereunder within three years of the date of the grant, all rights conferred by said grant shall lapse, and, unless the grant is expressly renewed or extended, the Participant shall lose all rights thereunder." (p. 11) Discussion of whether this lapse provision in the stock option plan is valid will take place below is subsection (c) - so for purposes of the discussion here, we will presume the lapse provision is valid. Thus, looking at the grants made throughout Mr. Schaeffer's eight years with Ergometrix and following the lapse provision in the stock option plan it seems as if the first 3 grants made on the respective dates of May 1, 1999, May 1, 2000 and May 1, 2002 have all lapsed. Nothing indicates that Mr. Schaeffer utilized his ability to renew or extend these grants (as other employees did by coming to Melinda Choy and having her sign extensions).

Thus, it can be concluded that 3 of the 5 grants made to Mr. Schaeffer have lapsed - but that there may still b an ability to exercise the options granted on October 1, 2004 and July 1, 2005.

(b.) Under Columbia law, specifically CLC §200, are stock options considered wages?

§200 of the CLC states that the term "wages" includes "all amounts for labor of every kind or description performed by employees, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation."

Mr. Schaeffer's attorney has cited the case Suarez v. Dressers, Inc. (1982) to assert that the stock options in this case are "wages" under Columbia law because in Suarez vacation time was considered to be "wages" and this "vested" as it was earned. The Suarez court held that vacation time was considered to be "wages" because of its nature. The court stated that it is "well established that vacation pay is not a gift or gratuity but is, in effect, additional wages for services performed." (p. 6). The court adopted the view that "vacation pay is a form of deferred compensation in the form of a reward of additional wages for constant and continuous service." (p. 6).

Similarly, the Suarez court points to another case, Maynard v. State of Columbia, where pension benefits were considered to be a form of wages because "the employee earns some pension entitlements as soon as he or she has performed some substantial services for the employer. . ." (p. 6).

While there may be a case for stock options to be considered in the same vein - as

a form of "deferred compensation" - I believe that a strong argument can be made to consider stock options in a wholly different light that excludes it from being thought of as "wages" under §200.

In the US Ct. of Appeals, 15th Cir. case Ball v. International Machinery Corp. (2005), while the court declined to speculate on the determination of whether stock options would be considered "wages" in the State of Columbia - they did provide some argument as to why they would not be considered so that is persuasive. Parsing the language of the Columbia statute defining "wages" (noted above from §200) asserted that the stock option concept did not fit the definition of "wages" in CLC §200. First, it was asserted that stock options are not "amounts" - they are only contractual rights to buy shares. Next, it was asserted that they are not "fixed or ascertainable" because while the option price the employee pays may be fixed, the price at which it can be sold varies according to market conditions. Third, whereas "wages" are determined by a standard related to the quantity or units of work performed, and even pension plans and profit sharing plans are determined by a standard related to continued length of service and the fixed amount of earnings of the participating employee, the same cannot be said for stock options.

According to Melinda Choy in her interview Ergometrix used the stock options not to compensate and reward employees for their service to the company, but as an incentive for the employees to stay with the company and have an interest in its success. Employees were given salaries and "fringe benefits" such as health insurance and vacation as compensation, and furthermore, the participants had to put up their own money in order to exercise the option and there never was a guarantee that the company would do well and the option would be of value. Also, as Melinda points out the grants were not given based on volume or hours of work; they were simply given based on management's subjective belief at the time that some incentive was necessary to keep a valuable employee around.

Arthur Schaeffer may try to argue that the stock options can be considered wages and compensation for work performed because the hardest workers and top producers (according to Melinda) got the largest grants - but on the whole I conclude that the Columbia court will not consider stock options to be "wages" under CLC §200.

(c.) Are the lapse and forfeiture provisions in the stock option plan valid under Columbia law?

Lapse Provision

Mr. Schaeffer asserts that the lapse provision in the stock option plan is invalid under Columbia Labor Code §221 and §222, which respectively hold that it is : (1)unlawful for any employer to receive from an employee any part of wages theretofore paid by said employer to said employee; and; (2) unlawful, in the case of any wage agreement arrived at through collective bargaining, for an employer to withhold from any employee any part of the wage agreed upon.

First, it should be noted that §222 of the CLC does not have any application to our case because, as affirmed by Melinda Choy, Ergometrix has never been unionized and as was similarly the case in Suarez (1982) where the employer is non-union the wages were not subject to a collective bargaining agreement.

Next, is the lapse provision violative of CLC §221? Only if the stock options are

considered "wages" and thus vest "cumulatively and proportionately as the employee performs his or her work for the employer." (Suarez, p. 7). However, as discussed earlier it is likely that the options are not wages and thus do not vest pro rata, so that the lapse would not be considered receiving of wages from an employee to an employer theretofore paid.

Forfeiture Provision

The Ergometrix forfeiture provision provides that in the event the participant violates the non-competition covenant in the employment contract he forfeits his rights to any unexercised grants they had been awarded. Mr. Schaeffer claims that this provision is also violative of CLC §221 and §222.

As already discussed, §222 is not applicable to this case. And as discussed above with respect to the lapse provision, this provision cannot be seen to violate §221 unless it is found that the stock options are "wages." And, again, as discussed early it is most likely that stock options are not "wages" under Columbia law.

(d) Does the forfeiture effected by the noncompetition component of the stock option plan violate CCC §1600?

As already discussed earlier in regards to the Ergometrix noncompetition covenant in the employment contract - the state of Columbia has a long history of upholding its policy-based decisions to void noncompetition covenants even though that is not a majority view in this country.

Thus, it can be seen as a different argument to make to uphold the forfeiture provision of the stock option plan that is based upon a noncompetition clause the court is likely to find distasteful.

However, there may be some chance to succeed on this issue. Even in the Suarez case, where the court found that vacation pay is a vested interest and "wage" that cannot be forfeited - they did admit that there are certain situations where even a vested interest may run up against valid conditions that result in lawful forfeiture. Of course, this statement was made in relation to a pension plan and the footnote asserts that lawful forfeiture is limited - pointing to the McGill case presented earlier where a forfeiture provision was invalid when effected by a noncompetition clause.

Thus, it seems likely from precedent that even if the forfeiture provision would have been valid on its own - the noncompetition clause that effects it may make it invalid.

Another argument, made in the case discussed earlier, Ball, is that the forfeiture provision itself does not violate §1600 and keep the participant from working for a competitor. Mr. Schaeffer could have exercised his option at any time prior to quitting his position with Ergometrix and he would not have had to forfeit the proceeds even after going to work for the competition. Thus, as the court in Ball states, the forfeiture provision was "no restraint at all. It was simply a contractual obligation to give back the money if he did what he had agreed not to do." (p. 13) This would make §1600 inapplicable to the forfeiture provision.

I believe this is a strong argument, however, as noted earlier, Ball is not a Columbia Supreme Court case and the Ball court may have been influenced in their decision by Olympia law, which generally upholds noncompetition clauses, unlike Columbia. I do, however, think since this is a matter of first impression that it is an argument worth making

and believe that we can be successful on this issue.