



## PUTTING A CORE VALUE INTO PRACTICE

In our inaugural edition of *Perspectives* for 2006, we provide a survey of practical pieces of legal guidance, with Ed Willig's top ten list of business advice vying with Lori Lutzker's summary of business litigation issues for top billing of "need to know" legal items. Valerie Menager and Julie Lanz also provide practical information regarding such widely different topics as exempt employees to choosing a guardian. Our theme of practicality continues in the article about our firm's combining legal scholarship with hands on assistance to our community. Carr McClellan's recent contributions to our community range from spending a work day at Shelter Network's Haven Family House to donating 67 computer workstations to schools in Menlo Park and East Palo Alto. However, these more visible contributions do not overshadow the impact our lawyers make behind the scenes by working diligently as leaders of numerous nonprofit boards and governmental committees. All of our attorneys contribute their time and talent to our community's charitable, civic, religious and professional organizations, and only some of our lawyers' efforts are highlighted.

No one of our attorneys exemplifies our firm's commitment to combining practical but exceptional legal services with commitment to community involvement more than Norm Book. This February 1st, Norm celebrated his 40th anniversary with our firm. Norm's four-decade career has seen him guide clients through complex high profile transactions and lead community organizations such as SAMCEDA and the Hillsborough Schools Foundation. We congratulate Norm on the achievement of this milestone in his career and thank him for his contributions to our firm and our community. We also celebrated on February 11th the 25th anniversary of the launching of Mike McQuaid's legal career. As head of our Creditors' Rights and Bankruptcy Group, Mike has guided clients through the maze of ever-changing bankruptcy laws.

For more than 60 years our firm's dedication to providing practical but exceptional legal advice and service to our community has been one of our core values. Whether our lawyers have been practicing 40, 25 or 2 years they demonstrate their individual dedication to this core value every day.

Mark Cassanego, President of Carr McClellan.

## TO CASH OR NOT TO CASH

By Lori Lutzker, Esq.

You've completed your contract, providing great services or perfect products, but your customer won't pay. You've written demand letters, or had your attorney do it, with no satisfactory response. Then, one day, the mail brings you a check. Unfortunately, the check is for less than the full amount. If you cash it, are you giving up your right to the balance owed to you?

Believe it or not, there is no straightforward answer to this question, although we do have advice for you. The road to enlightenment begins with the courts. Prior to 1987, when there were no applicable statutes, here's what the courts said:

Where there is an honest dispute as to the amount due on an obligation, if the debtor sends a certain sum on the express condition that acceptance of it will constitute full payment, and the creditor so understands the transaction, acceptance by the creditor is an accord and satisfaction, even though he or she notifies the debtor that it is received only on account.

This became known as the "Potter Rule" for the case of *Potter v. Pacific Coast Lumber Co. of Calif.* In that case, the California Supreme Court stated:

[W]here a claim is disputed or unliquidated and the tender of a check or draft in settlement thereof is of such character as to give the creditor notice that it must be accepted "in full discharge of his claim" or not at all, the retention and use of such check or draft constitute an accord and satisfaction ... and it is immaterial that the "creditor protests against accepting the tender in full payment" ... for in such case "the law permits but two alternatives, either reject or accept in accordance with the condition."

Thus, under the Potter Rule, if the check you received has the notation, "payment in full," cashing it would bar a subsequent claim to the balance owed.

In 1987, however, the California legislature put a temporary end to the Potter Rule. Under the new statute, you could retain the check as partial discharge of the debt with an important caveat. see *CASH*, page 7

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## TOP TEN PIECES OF ADVICE FROM YOUR BUSINESS LAWYER

By Ed Willig, Esq.

As corporate attorneys, we are called on to advise our clients on many different legal and business issues. While it would be impossible to reduce our advice down to a top ten list that would be applicable to all of our closely held business clients, some recommendations are so sound that almost all businesses should at least consider them. Following are ten important pieces of advice that we often give to closely held businesses. Although all ten will probably not apply to your business, in our experience some of them will be helpful to you over the long term.

**1. Adopt a Qualified Retirement Plan.** An employer may deduct from its taxable income all contributions to a qualified retirement plan, while the earnings on those contributions accumulate tax-free for the benefit of the employees who participate in the plan. This is still one of the best tax reduction opportunities available. If you are unsure whether your business will be able to afford a contribution to a retirement plan every year, you can adopt a profit-sharing plan, which allows you to contribute from 0% to 15% of the total compensation paid to the plan's participants each year (subject to certain limitations).

**2. Purchase Your Facility.** Consider purchasing a location for your business. Over time, you will limit the impact of fluctuating (and generally rising) rent on the business's bottom line, you will build a source of additional equity which will be available when you retire, and you will enjoy the income tax advantages associated with real property ownership.

**3. Limit Personal Guaranties.** A business owner often must initially give banks, lessors and other creditors personal guaranties because the business does not have a credit history. It's very important to work with your banker and other creditors to limit or eliminate these guaranties as your business grows and becomes more established.

**4. Have a Buy-Sell Agreement.** Unless you are the sole owner of your business, there should be a buy-sell agreement among the owners of the business. Such an agreement will typically create a right of first refusal on the transfer of interests in the business and will address the transfer of interests in the business in the event of an owner's death and (sometimes) disability or employment termination.

**5. Think About Succession.** The old adage that "time flies" applies to the business world too. If you don't develop a succession plan, when it's time to retire you will be left with only one option: sell the business.

*"Anything can happen in litigation, but a big victory for either side is unusual."*

**6. Use Your Accountant and Attorney As Advisors.** Your accountant and attorney typically work with a variety of businesses every day. In addition to passing on knowledge about their areas of expertise, they learn what is working for their clients and can pass these suggestions on to you. If your business is a corporation, you can ask your attorney and accountant to attend your annual shareholder and director meetings and use this as an opportunity to obtain their advice.

**7. Prepare Outlines of Agreements to Be Drafted.** Write an outline of any agreement that you'd like your lawyer to draft together with any questions you have about the agreement. The outline can be simple and need not be time-consuming (a few bullet points in an e-mail message is often sufficient), but it will help you and your lawyer focus on the key points to be covered.

**8. Consider Providing Incentive Compensation.** With the rise of Silicon Valley, many employers provide all employees with equity in their business, which vests over time. In many circumstances, issuing equity to employees doesn't make sense (for example, if it is unlikely that the business will be sold or go public). In these situations, it often does make sense to put a cash incentive plan in place so that a portion of each employee's compensation is tied directly to the success of the business.

**9. Treat All Litigation Seriously.**

- Talk with your attorney early on if there is a potential dispute. Early intervention can often resolve a dispute before the positions of the parties (and their attorneys) harden and resolution becomes more difficult and expensive.

- Look for opportunities to settle - either through direct negotiations between the parties and their lawyers, or through a mediator. Anything can happen in litigation, but a big victory for either side is unusual. Litigation distracts management and is expensive.

- Be prepared to take your case to trial. The vast majority of lawsuits settle before trial. However, if you are not prepared to bear the expense and endure the distraction of seeing your case through to trial, you'll either be forced to settle on unfavorable terms or you will risk losing your case at trial.

**10. Periodically Review Your Insurance Coverages.** Check in regularly with your insurance broker or agent to review all of your business and personal insurance coverages. Be sure that your casualty insurance policies will pay for the full replacement of your assets, and review the limits of your liability policies to be sure that they continue to be adequate. Finally, review your deductibles and optional additional coverages to determine whether they make sense for you. For example, employment practices liability insurance has become increasingly popular over the past few years and it may make sense to purchase this insurance (which covers businesses against claims by workers that their legal rights as employees have been violated) for your business.



## SELECTING A GUARDIAN FOR YOUR MINOR CHILDREN

By Julie Lanz, Esq.

For parents of minor children, the hardest and most important decision they make when creating their estate plan is usually the selection of a guardian to care for their minor children. This article sets forth just a few of the things that you should consider when selecting a guardian.

### I. What does a guardian do?

A guardian provides for the care, custody, control and education of your child if you are unable. A guardian may also manage the child's assets (called a "guardian of the estate") but this role is more commonly filled by a trustee, as discussed in the answer to question IV, below.

### II. Do I have to name a family member as guardian or may I select a friend?

You can nominate anyone that you wish to serve as guardian. Upon your death, a court would review your nomination and in most cases, appoint the guardian you nominate.

### III. What are some of the things I should consider when naming a guardian?

Only you can decide what characteristics are most important to you when selecting the person who may care for your child. However, here are a few items to consider when making your selection:

- Does the person already have an interest in or relationship with the child?
- Is the person emotionally equipped to raise a child, even when times get difficult? Loss of a parent is a traumatic event for a child and the child will have additional emotional needs as a result. These needs are in addition to the needs of any child or teenager.
- Would the person be physically able to care for the child until the child reaches the age of 18? Physical ability is something to consider carefully if you are contemplating naming your child's grandparents as guardians, particularly if your child is very young.
- Is the person's own family situation conducive to caring for your child? Assuming the guardianship of minor children will impact the guardian's life for years to come. Would caring for your child put an undue strain on that person's relationship with his or her existing children, spouse, or partner?

*"Physical ability is something to consider carefully if you are contemplating naming your child's grandparents as guardians, particularly if your child is very young."*

Finally, talk to the potential guardians, and if appropriate, to your children, to see how they would feel about your selection. They may raise new concerns or considerations that could change your decision.

### IV. Will the guardian also manage the money that I leave to my child?

Whether the same person will have responsibility for both the child and the child's finances depends on your estate plan. We often advise our clients with young children to design estate plans that establish separate trusts for each child after both parents die. The trustee will then manage the money for each child and make distributions to the child as needed. The guardian is named separately in each parent's will. If you name the same person as trustee and guardian, then yes, the guardian will also manage the money for the child.

You may want to name different people as guardian and trustee. Sometimes the best person to care for your child may not be someone with strong financial management skills. Splitting these responsibilities between two people can make it easier for you to focus on selecting a guardian who will be the best caregiver and a trustee who will best manage the child's assets.

### V. How can I ease the financial burden that my children will place on their guardian?

As mentioned in the preceding question, we often advise our clients with young children to provide that trusts will be established for each child's benefit after both parents die. If you wish, distributions can also be made to the child's guardian for expenses incurred as a result of caring for the child, such as for childcare, purchasing a larger car, or adding onto the house.

If you are concerned that the amount of money that you have to leave to the child may not be enough, consider purchasing life insurance. Life insurance is a relatively inexpensive way to make sure that your child will have enough money for his or her care and education.

### VI. How often do I need to look at or revise my selection of guardians?

Often. A great deal can happen in a family in just a few years that can make an earlier choice of guardian no longer appropriate. We generally advise our clients to review their estate plans every three to five years. However, if your guardian has a sudden change in situation such as a marriage, divorce, severe illness, or the birth of a child, you may want to review your estate plan at that time.

*Julie Lanz is a member of the Estate Planning, Trusts & Wealth Transfer Group.*



## COMBINING LEGAL SCHOLARSHIP WITH COMMUNITY AND PROFESSIONAL SERVICE

One of Carr McClellan's core values is its commitment to the community in which our attorneys and staff live and work. In the past six months, Carr McClellan has continued to put this value into action both as a firm and as individuals.



*Some of the Carr McClellan crew that spent a Saturday working at Haven Family House in Menlo Park.*

### Haven Family House

Both attorneys and staff from the firm participated in a volunteer work day at Shelter Network's Haven Family House in Menlo Park. Shelter Network was founded in 1987 to provide a coordinated network of housing and social services for the homeless residents of the San Francisco Peninsula. The organization operates several facilities in San Mateo County, including Haven Family House which provides safe transitional housing and comprehensive, on-site support services for up to 15 homeless families. The facility was completely rebuilt in 2000, and includes an internet-connected

computer tutoring room where volunteers help children with homework and other learning activities and a free childcare center. Over 80% of program graduates are rapidly and permanently re-housed.

The Carr McClellan crew spent a Saturday working on a list of projects both inside and outside in the shelter's garden, which provides organically grown vegetables to residents of Haven Family House and Shelter Network's other facilities. The group laid pavers to enlarge a patio area, installed donated cabinets inside and cleaned the garden shed, and cleaned and organized the clothing and housewares donation storage areas. Shelter Network has ongoing volunteer opportunities. For more information, call Shelter Network at (650) 685-5880.

### Hurricane Katrina Relief

During previous holiday seasons, Carr McClellan has made donations to a variety of charities. This past year, given the devastation caused by hurricane Katrina, the choice of causes was clear. After speaking to members of our firm whose families were directly impacted by the hurricane, the firm determined the greatest need in the coming years would be the long term rebuilding of people's homes and lives along the Gulf Coast. Consequently, the firm made a sizable donation to the Peninsula Community Foundation Katrina Disaster Relief Fund to specifically benefit Habitat for Humanity in the Gulf Coast Region.

Carr McClellan also offered a gift matching program for employees of the firm who wanted to donate to the relief fund – doubling every dollar they chose to give. Recent media reports have highlighted the slow progress being made in rebuilding New Orleans and other communities devastated by the hurricane. The money Carr McClellan and other organizations donate to the relief fund will go directly to rebuilding the homes, businesses and lives of the poorest victims of hurricane Katrina. If you or your company would like to donate to the relief fund contact the Peninsula Community Foundation at (650) 358-9369.



*Putting their backs into it, Carr McClellan attorneys and staff lay pavers to form a patio in the Haven Family House garden.*

## Computer Donation

Carr McClellan donated 67 computers and accompanying monitors and keyboards to students at Menlo-Atherton High School in Menlo Park and the Ravenswood Elementary School District in East Palo Alto. The firm was in the process of upgrading its network and software systems when it decided to update its hardware as well, making the donation possible.



*Sue Kayton, Chairman of the Menlo-Atherton High School PTA Computer Donation Program and Jan Mendez, Executive Director of Carr McClellan, stand next to Kayton's car, overflowing with just some of the donated computer equipment.*

The computers going to students at Menlo-Atherton were refurbished by Sue Kayton, Chairman of the Menlo-Atherton High School PTA Computer Donation Program. For the past 10 years, Kayton has volunteered her time to provide home computer systems to hundreds of students who otherwise would not have one. She identifies and collects usable equipment; wipes the hard drives of all software; loads new operating systems, word processing and educational software; installs the machines in the students' homes; and sets up free Internet access.

To learn more about the Menlo-Atherton High School PTA Computer Donation Program, or to donate computers, other technology or software to the program, contact Sue Kayton at [kayton@alum.mit.edu](mailto:kayton@alum.mit.edu).

**Sinclair Hwang** – Hwang, who is a member of Carr McClellan's Estate Planning Trusts & Wealth Transfer Group, joined the board of the Peninsula Humane Society and SPCA last year and was recently elected Secretary of the Board. While new to this particular organization, Sinclair has a history of working with nonprofit organizations and served as the Director of Volunteer Programs at the Association to Benefit Children in New York before attending law school.

**Deborah Landstrass** – One of the firm's six estate planning paralegals, Landstrass has been recognized by the Legal Aid Society of San Mateo County with the Natalie Lanam Achievement Award. Presented to her at the organization's March 24 *And Justice for All luncheon*, the award is in recognition of her many years of volunteer service with the Legal Aid Golf Committee. Debbie is serving on the committee again this year, working to ensure another successful fund raising event for Legal Aid. This year's golf tournament is June 19 at the Stanford Golf Course.

**Barry Parker** – Intellectual property attorney Parker currently serves as the Vice-Chair of the Board of Directors for Community Gatepath. Gatepath is the largest non-profit provider of services to children and adults with developmental disabilities in San Mateo County. For more than 85 years, Gatepath has provided vital direct services, entrepreneurial business methods and educational programs to help disabled persons achieve their full potential. Mr. Parker is also a member of the Rotary Club of Burlingame where he serves as a Board Director and Co-Chair of the Club Services Committee. Comprised of business leaders and united by Rotary International, each Rotary Club provides community services that support a wide variety of philanthropic, humanitarian, and educational programs.

**Penny Greenberg** – Providing legal services to Carr McClellan's exempt organization clients, Greenberg is often called on to advise community organizations on the many regulations and laws applicable to these entities. This expertise makes her a particularly valuable nonprofit board member. Greenberg is a strong advocate of the community college system and has served on the Board of Directors of the San Mateo County Community Colleges Foundation for the past six years. She was elected President of the Board in January.

**Laurelle Gutierrez-Lundquist** – Gutierrez-Lundquist is one of the nine attorneys in Carr McClellan's Estate Planning, Trusts & Wealth Transfer Group. Her community involvement extends to several organizations, including the Burlingame Library Foundation and the Peninsula Community Foundation Professional Advisory Council. Most recently, she joined the Board of Directors of the San Mateo County Medical Center Foundation, which since 1991 has helped raise funds to support the San Mateo Medical Center and raise awareness of the significant work of the center.

see OUR FIRM, *page 8*



## EXEMPT EMPLOYEES' ACCRUED VACATION FOR PARTIAL DAY ABSENCES: AN ONGOING DILEMMA

By Valerie Menager, Esq.

In a recent case, the California Court of Appeals ruled that under certain circumstances, employers may dock exempt employees' vacation pay and still maintain their status as exempt employees not eligible for overtime pay. However, recent actions by the California Division of Labor Standards Enforcement ("DLSE") indicate that following the Court's holding may prove perilous for California employers.

### Background

In order to be exempt from wage and hour law, employees must perform exempt work more than 50% of the time, and they must meet a "salary basis" test. In California the salary basis test requires that:

- the exempt employees be paid a salary no more frequently than once a week;
- the salary be no less than a minimum amount (\$28,080 per year in 2006); and
- the salary not be subject to "reduction because of variations in the quality or quantity of work performed."

Thus, deductions from the salary of an exempt employee absent for a partial day of work are not permitted. The rationale is that to dock the salary of an exempt employee would support a claim that the exempt employee has lost their exempt status since they are no longer paid on a basis of a fixed salary but rather are paid on a fluctuating hourly basis. An employee losing their exempt status could have serious implications for an employer since these previously exempt employees could claim back wages for all overtime they may have worked and penalties for late payment of these wages.

However, under federal law, employers are allowed to dock accrued vacation pay from exempt employees who miss partial days of work, so long as the exempt employees' weekly salary is not diminished. Despite this federal precedent, in 2002 an opinion letter was issued by the DLSE prohibiting the docking of vacation pay for exempt employees when they took partial days off work for personal reasons. No authority was cited to support this opinion. Further, this DLSE opinion letter ignored the fact that there was federal and state legislation that specifically allowed for partial day

*"Despite this federal precedent, in 2002 an opinion letter was issued by the DLSE prohibiting the docking of vacation pay for exempt employees when they took partial days off work for personal reasons."*

leaves for exempt employees and the use of accrued vacation time during these partial day leaves (e.g. Family Medical Leave Act; California School Partnership Act, etc.).

### Conley v. Pacific Gas & Electric Company

In this 2005 case, exempt employees sued their employer, PG & E, for forcing them to use their accrued vacation time in half day increments for partial days of work they missed for personal reasons. These employees argued that due to this vacation docking policy, they had lost their exempt status and were now entitled to overtime pay and penalties. The California Court of Appeals disagreed with the employees, stating that "nothing in California law precludes an employer from following the established federal policy permitting employers to deduct from exempt employees' vacation leave, when available, on account of partial-day absences from work." Notably the Conley court limited these deductions to half-day (4 hour) increments of vacation pay. Deductions in smaller increments of vacation pay were not sanctioned by the court's holding.

### Contradictory Messages from the DLSE

The Conley court declined to follow the 2002 opinion letter issued by the DLSE. Although DLSE letters do not constitute binding law, the DLSE is the administrative forum that decides wage claims brought by employees, and can award compensation to employees, and fines and penalties against employers. So the tension between the DLSE opinion letter and the holding of the Conley court presented a dilemma for California employers. This dilemma initially appeared to be resolved when current Labor Commissioner Donna Dell noted that the reasoning in the 2002 opinion letter was "clearly flawed," and the opinion letter was withdrawn by the DLSE. However, in the recently revised DLSE "Enforcement Policies and Interpretations Manual" issued in November 2005, the DLSE has again stated that the salary of an exempt employee absent for a partial day cannot be replaced with a vested benefit such as vacation because this would be an unlawful forfeiture of wages under California law.

### The Bottom Line

The Conley case was not appealed and so is now binding precedent in California. However, the DLSE's interpretation of the law regarding docking exempt employee's vacation pay for the partial day absences is in direct conflict with the ruling of the California Court of Appeals in Conley. Employers should therefore review with their employment law counsel the potential risks involved prior to implementing policies based on the holding in Conley.

*Valerie Menager is a member of the Employment Group.*

If the check has the words "payment in full" or other words of similar meaning on it, you can cash it as a partial payment only if you strike out or otherwise delete the notation. If you inadvertently or without knowledge of the notation cash the check (and you can prove it - which has to be difficult), the court may determine that cashing it did not waive your claim to the balance of the debt.

But this is not the end of the story. In 1992, the legislature enacted Uniform Commercial Code section 3311. With minor variations to reflect modern business conditions, UCC section 3311 restates the Potter Rule. So, what does this mean?

Well, a federal district court in central California concluded that the two provisions are in irreconcilable conflict and held that the later enacted statute, UCC section 3311, trumped Civil Code section 1526. Other California courts have followed this approach.

But until the California Supreme Court or a majority of appellate courts settle the law, the issue must be viewed as undecided. Given the natural inclination to accept the check as a partial payment, your best course of action is to send a letter to the customer stating that you have received the check and intend to strike the notation out, cashing it as a partial payment and, if this is not acceptable, he or she should advise you of this in writing within 10 days of the date of the letter. If the customer protests, send the check back. If not, cash it and contact us to help you recover the remainder.

## THE RIGHT TO A JURY CANNOT BE WAIVED BEFORE THE DISPUTE ARISES

Business agreements today routinely provide for disputes to be resolved through either binding arbitration or court action without a jury. In a case decided by the Supreme Court in 2005 (*Grafton Partners v. Superior Court*), the Court held that parties cannot waive their right to a court trial by jury before a dispute arises.

In *Grafton*, an accountant's engagement letter included the terms of the retainer agreement. Under the heading "Release and Indemnification," the letter included a waiver expressed in these terms: "In the unlikely event that differences concerning [the accountant's] services or fees should arise that are not resolved by mutual agreement, to facilitate judicial resolution and save time and expense . . . both parties agree not to demand a trial by jury in any action, proceeding or counterclaim arising out of or relating to [the accountant's] services and fees for this engagement."

The Court began its analysis by noting that when parties elect a judicial forum in which to resolve their civil disputes, the California Constitution accords them the right to trial by jury (with limited exceptions). Our Constitution treats the historical right to a jury resolution of disputes that have been brought to a

*"The advocacy group alleged that the late fee liquidated damages provision in the service agreement was illegal because the amount of liquidated damages provided by the agreement was unilaterally set by AT&T..."*

judicial forum as fundamental, providing that in "a civil cause," any waiver of the inviolate right to a jury determination must occur by the consent of the parties to the cause as provided by statute.

The statute implementing this constitutional provision holds inviolate the right to trial by jury, and prescribes that a jury may be waived or forfeited in civil cases only by six means. These include failure to appear at trial, failure to demand jury trial within a specified period after the case is set for trial, failure to pay required fees in advance or during trial, oral consent in open court, or written consent filed with the clerk or the court.

The Court found that contractual jury trial waivers were not comparable to arbitration agreements. Unlike predispute jury waivers, predispute arbitration agreements are specifically authorized by the Code of Civil Procedure. Moreover, arbitration agreements are distinguishable from waivers of the right to jury trial in that they represent an agreement to avoid the judicial forum altogether.

After considering the history of California's constitutional and statutory provisions governing waiver of the right to jury trial, the Court concluded that it is for the legislature, not the courts, to determine whether, and under what circumstances, a predispute waiver of jury trial will be enforceable in this state.

Interestingly, the accountant and many third parties as "friends of the court" argued that because predispute waivers of the right to jury trial have become commonplace in the commercial context, the Court's decision should apply only prospectively. In light of the nature of the interests at stake, the Court held it would be inappropriate to apply the decision only prospectively. Moreover, in light of the determination that governing California constitutional and statutory provisions do not permit predispute jury waivers, the Court found it would not be appropriate to enforce such a waiver and thereby deny the right to jury trial to a party who has timely and properly requested such a trial and complied with other applicable statutory prerequisites.

The decision will not deny any party a substantial right or his or her day in court; the decision simply will deny to those a benefit that they never had the right to obtain - that is, a predispute waiver of the right to a jury trial. Under the Court's decision, of course, once a dispute arises the parties may elect to waive a jury trial.

## LIQUIDATED DAMAGES

Innumerable businesses use standardized customer contracts that include a liquidated damages provision for a late payment fee. The courts have used language in many decisions that refers to a reasonable endeavor by the parties when setting the amount of liquidated damages. In light of this, is that provision of a consumer services contract valid even though a business does not sit down and negotiate a late fee amount individually with each customer?

see DAMAGES, page 8

That was the issue that the Second Appellate Division (in *Utility Consumers' Action Network, Inc. v. AT&T Broadband*) grappled with in January of this year. The plaintiff was a nonprofit consumer advocacy group. The defendants were cable internet service providers sued for unfair competition. The advocacy group alleged that the late fee liquidated damages provision in the service agreement was illegal because the amount of liquidated damages provided by the agreement was unilaterally set by AT&T and was not the result of mutual negotiations between AT&T and their individual subscribers.

The general law of liquidated damages is that the parties to a contract may agree in advance to liquidate their damages – to provide ahead of time that a certain sum of money is conclusively presumed to represent the amount of damage that will be caused by a specified breach of the contract. Before 1977, the law provided that a liquidated damages clause was void unless the parties agreed it would be impracticable or extremely difficult to determine the actual damage. In 1977, the California legislature adopted a new law favoring liquidated damages except in contracts for the sale or lease of consumer goods and services, or in residential leases. In non-consumer contracts, the new law stated that a liquidated damages provision was valid unless the party seeking to invalidate that provision "establishes that the provision was unreasonable under the circumstances existing at the time the contract was made." When a liquidated damages provision is contained in a consumer contract, or a residential lease, the prior law still applies.

The courts developed a two-part test for determining whether a liquidated damages provision in a consumer contract was valid. The first: fixing the amount of actual damages had to be impracticable or extremely difficult. The second: the amount selected must represent a reasonable endeavor by the parties to estimate fair compensation for the loss sustained. Determining whether a reasonable endeavor was made depends upon both (1) the motivation and purpose in imposing the charges, and (2) their effect. If the amount selected is designed to substantially exceed the damages suffered, and its primary purpose is to serve as a threat to compel compliance through the imposition of charges bearing little or no relationship to the amount of actual loss, then the purported liquidated damages provision is an invalid attempt to impose a penalty.

Because the selected amount of liquidated damages must result from a reasonable endeavor by the parties, the consumer group contended that a sum selected by only one party in that party's pre-printed form contract was invalid. The Court disagreed, holding that the endeavor requirement does not require face-to-face

negotiations for the amount of liquidated damages. Instead, the Court held that the important element in determining intent is the reasonableness of the stipulated sum. If there is an intent to fix liability without any reference to the actual damage to be sustained, the stipulated sum is a penalty, but if there is an intent to establish a just compensation for the loss sustained, it is enforceable as liquidated damages. "Intent" means "legal intent" that would be imputed to the parties based on the language used, and not their actual intention at the time of contracting.

*Lori Lutzker is a member of the Corporate & Business, and Civil Litigation & Dispute Resolution Groups.*

OUR FIRM, from page 5

**Golnar Yazdi** – Having recently completed a two-year tenure as President of the Legal Aid Society of San Mateo County, estate planning attorney Yazdi joined the Board of Directors of the Mills-Peninsula Hospital Foundation. In addition to her new commitments with this organization, Yazdi remains involved in Legal Aid both as a member of its Board of Directors and Endowment Campaign Committee.

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