# THE PHILADELPHIA BUSINESS LAW INSIDER

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INSIDE THIS ISSUE



PHILADELPHIA BAR ASSOCIATION

**Phyllis Horn Epstein, Esq., Editor**

From the Editor:

This spring brings early flowers and the next edition of *The Insider*. Pay close attention to two announcements of programs taking place in May: the YLD/BLS joint Happy Hour at The Black Sheep Pub and the Annual Commerce Court Reception. These receptions offer another opportunity to meet other members of the Section and network across generations and practices.

Like the spring robin, two articles in this edition are warning calls to the practitioner, not of warm days to come, but rather about alarming changes in the law that are either proposed or evolving in the area of LLCs and corporations. Read with special interest Luke Sampson's article, "Charging Orders: A Wake-Up Call in Pennsylvania" on how creditors rights may be expanding for single member LLCs. My own article about proposed Senate Bill 1483 is another wake-up call on this proposal to involve attorneys as "formation agents" requiring them upon subpoena or summons to turn over the names of all beneficial owners of corporations and LLCs where they have assisted in formation.

Many thanks to Thomas P. Gushue and Anthony S. Volpe for their illuminating article on the United States International Trade Commission. Elizabeth S. Fenton, Kyle Anne Midkiff, CPA, CFE, CFF, and Sandra M. Di Iorio have contributed a practical and informative article on piercing the corporate veil in Pennsylvania, New Jersey, and Delaware, with insights on bringing forensic accountants to the case.

We are pleased to provide the complete testimony of Philadelphia's Judge Annette Rizzo from her appearance on September 24, 2009, at a Congressional Hearing on Foreclosure under TARP.

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**FROM THE EDITOR continued...**

Judge Rizzo recently addressed the Executive Committee of the Business Law Section and brought them up to date on the program, which is under her supervision, known as the First Judicial District's Mortgage Foreclosure Diversion Pilot Program. This innovative program has successfully addressed the crisis of mortgage foreclosure in our area and serves as a model nationwide.

I saw a fox outside my kitchen window today and was reminded that the benign beauty of spring also awakens the predators. For me, the return of warm weather brings another tax season and new challenges. I am proud and pleased to present this latest edition of our newsletter. It is one that I will linger over and read and return to. I hope you will too.

Phyllis Horn Epstein, Esq., Editor

**Wanda E. Flowers**

From the Chair:

I am having an interesting and exciting experience chairing the Business Law Section this year. We are all living in a time when we can do a great deal to support the citizens of the Greater Philadelphia Region. One such opportunity was presented at the January meeting of the Executive Committee. The Honorable Annette Rizzo, Rachel Gallegos and David Chanin attended the meeting to request that the BLS partner with the Mortgage Foreclosure Diversion Program by helping to arrange for additional volunteer attorneys. An uptick in cases is anticipated due to the economy, but the program is at risk as a result of major cutbacks. I hope that those of us who can will consider serving as volunteers for this program.

The Annual Reception held on February 6, 2012, was well attended and was enjoyed by everyone. Larry Beaser, recipient of the Dennis H. Replansky Memorial Award embodies all of the attributes recognized by the Award. We also honored Katayun I. Jaffari Small Business Committee with the Committee Chair Award, and the Human Resources & Employee Relations Committee received the Committee Chair Award. One of the highlights of the evening was hearing Dennis Replansky's daughter, Elaine, speak lovingly about her father and the morals and ethics by which he lived.

The Section's LinkedIn Group, an initiative implemented by my predecessor Sandra Jeskie in 2011, continues to be active and is a great asset to the Section as it attracts new members. This year, the Section is focused on diversifying the Section by recruiting more young lawyers. I represented the Section at the YLD Reception, and the Section is hosting "Committee Night Out" with the YLD at an upcoming Happy Hour in May. During the Happy Hour, members of the YLD will have the opportunity to meet representatives from the Section's Committees.

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**FROM THE CHAIR continued...**

Naomi McLaurin, Director of Diversity for the Bar Association, is assisting the Section with several other diversity projects. She is working with the Executive Committee to develop criteria for an award that recognizes efforts of an individual or organization to promote diversity. We expect to honor the first recipient of the Award at the 2013 Annual Reception. As she did in 2011, Naomi is also working with the Section and the Diversity in Profession Committee to co-sponsor a program later this year. Last year's panel discussion sponsored by the BLS and DIPC featuring local in-house counsel was a great success.

I would like to thank my Executive Committee for the support they are providing to me this year. I would also like to express my appreciation to the Committee Chairs for their efforts. The Committees attract the members to the Section, and I am proud to say that the Committees are continuing to provide quality programs of substance that benefit members of the Section. Together, let's make 2012 a year in which we continue to provide value to members of our profession as well as to the broader Philadelphia community.

Wanda E. Flowers, Chair

## WHY YOU SHOULD BE CONCERNED ABOUT SENATE BILL 1483

**By Phyllis Horn Epstein, Esquire**

A new Senate Bill is taking aim at terrorism, money laundering, and tax evasion by compelling states to disclose the names of all beneficial owners of corporations and LLCs, to retain that information for five years after the company is terminated, and to turn over that information upon subpoena or summons. The new requirements would involve attorneys as "formation agents".

In an open letter dated December 16, 2011, from the American Bar Association President William Robinson, III, Esquire to Senator Joseph Lieberman, Chairman of the Committee on Homeland Security and Governmental Affairs and Senator Susan Collins, Ranking Member of the Committee, serious concerns were expressed on behalf of all attorneys including the ABA membership of nearly 400,000. Mr. Robinson stated: "In particular, the ABA opposes the proposed regulatory approach set forth in S. 1483 that would superimpose new federally mandated requirements on existing state company formation practices and regulate many practicing lawyers and law firms as 'formation agents' subject to the bill's beneficial ownership mandates. The ABA also opposes those provisions in S.1483 that would regulate lawyers and law firms as 'financial institutions' under the Bank Secrecy Act. By subjecting lawyers to new federal anti-money laundering (AML), combating the financial of terrorism (CFT), and suspicious activity reporting (SAR) requirements under that Act, the bill would undermine the attorney-client privilege, the confidential client-lawyer relationship, and traditional state court regulation of lawyers."

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**SENATE BILL continued...**

Under the proposed S.1483, states would be required to collect and retain ownership information for every business created. As justification the proposed bill states:

> "Very few States obtain meaningful information about the beneficial owners of the corporations and limited liability companies formed under their laws….Terrorists and other criminals have exploited the weaknesses in State formation procedures to conceal their identities when forming corporations or limited liability companies in the United States, and have then used the newly created entities to support terrorist organizations, drug trafficking in illicit drugs, illegal arms trafficking, money laundering, tax evasion, Internet-based fraud, securities fraud, financial fraud, intellectual property crimes, and acts of foreign corruption."

The information that would be solicited and retained includes the name of each beneficial owner, address, driver's license or passport number. If any beneficial owner is another legal entity, such as a trust or other corporation, identifying information as to all owners of that entity is also required. All information must be updated within 60 days of any change.

States may license "formation agents", individuals who may form a corporation or LLC on behalf of others. Very often, attorneys fulfill these responsibilities. Formations agents are required to solicit and retain beneficial owner information and to respond to any subpoena or summons from law enforcement or federal agency or congressional committee. The penalty for noncompliance is a maximum of $10,000 and maximum imprisonment of three years. Sanctions may be imposed for "knowingly disclosing the existence of a subpoena, summons, or other request for beneficial ownership."

While attorneys may be exempt from the requirements of formation agents if they hire paid formation agents for their clients, ABA President Robinson is of the view that attorneys should take no comfort from this limitation. The exemption applies only to the obligations with respect to Anti-Money Laundering and Anti-Terrorist Financing obligations, not the general obligations under Section 3 of the proposed bill with respect to transparency in the creation of corporations and LLCs. Attorneys who assist in the creation of companies for their clients would still be required to carry out the obligations of formation agents.

Further, compelling attorneys to hire others as formation agents in order to claim an exemption from the information gathering requirements "would require lawyers to outsource an important and legitimate practice of law activity to non-lawyers in order for lawyers to be exempt from these requirements….(T)he formation of a corporation necessarily involves the giving of legal advice relative to the rights and obligations of those involved, and the act of forming a corporation requires the knowledge, background, and training of a lawyer for its proper performance. Therefore, by pressuring lawyers to outsource their clients' corporate formation needs to non-lawyers, Section 4(b)(3) may cause lawyers to improperly aid non-lawyers in the unauthorized practice of law, in violation of the lawyers' ethical and professional duties."

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**SENATE BILL continued...**

Clearly, by requiring attorneys to solicit, retain, and turn over identifying information of their clients to law enforcement upon demand could violate attorney-client privilege. President Robinson expressed concern that the requirements could also be interpreted as "requiring lawyers to report to governmental authorities any suspicion that their clients may be engaging in money laundering or terrorist financial activity." Such disclosure requirements would "seriously undermine the attorney-client privilege and the confidential client-lawyer relationship."

The ABA has previously promoted its own policy of "Voluntary Good Practice Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing" adopted by the Houses of Delegate in August of 2010. The Guide provides risk based assessment of potential clients and suggested practice advice for attorneys in the face of hypothetical situations involving potential money laundering and terrorist financing. The guidance is voluntary and flexible allowing for a case by case approach that is also sensitive to matters of attorney-client privilege and confidentiality. President Robinson, in his recent letter to the Senators, reminded them of the ABA's current approach and its wide ranging support from various federal agencies.

Senate Bill 1483 is currently referred to the Committee for Homeland Security and Governmental Affairs for consideration and comment.

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## GETTING THE MOST FROM EXPERT WITNESSES IN PIERCING THE CORPORATE VEIL CASES **By Elizabeth S. Fenton, Kyle Anne Midkiff, CPA, CFE, CFF, and Sandra M. Di Iorio**

The doctrine of piercing the corporate veil remains vital, especially as corporate group structures become more complicated and multi-layered and as litigation stemming from the recent economic dislocation plays out. The doctrine, which historically applied to closely-held organizations, has also been expanded in some jurisdictions to encompass parents, subsidiaries, successor and sibling corporations, and limited liability companies as well. It is a precept of corporate law that shareholders are not liable for the debts of corporations merely by virtue of their ownership of equity. Piercing the corporate veil is a powerful exception to this general rule, enabling a plaintiff to reach the assets of a wealthy shareholder or parent corporation. Once reserved for situations when a judgment was uncollectible from a corporate defendant, now the doctrine comes into play as early as the initial stages of a wide variety of litigation, e.g. bankruptcy, fraudulent transfer, et al.

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**PEIRCING THE CORPORATE VEIL continued...**

From the strategic perspective, a plaintiff may want to pierce the corporate veil to reach deeper pockets, to avoid the consequences of a bankruptcy, and to encourage settlement. Critical to this effort are expert witnesses, and in particular, forensic accountants. This article provides a general overview of the factors considered for piercing the corporate veil in Pennsylvania, New Jersey, and Delaware and some pointers for how to use forensic accountants to prove (or defend against proof of) those factors.

**I. Timing**—In our experience, the earlier a forensic accountant is retained, the better. Even in a case where the amounts at issue are not large, a forensic accountant can focus the attorney on the documents that will be critical to the analysis. Moreover, the work of the forensic accountant can be staged—that is, the forensic accountant need not do a full-blown analysis of the information relevant to all of the factors. Instead, the forensic accountant can meet with the attorney and/or client and look at samples of documents early on in order to provide a preliminary analysis. Then, after some discovery has been taken (and when motions for summary judgment are imminent), a deeper analysis should be undertaken.

**II. What Does the Forensic Accountant Need to Know?** The forensic accountant should be familiar with the law of the relevant jurisdiction. The attorney needs to provide the current law so that the analysis by the forensic accountant is under the right standard. The classic theory for piercing the corporate veil—what is often referred to as the "alter ego" or "instrumentality" theory–generally comes down to a "totality of the circumstances" test. The ultimate issue for a court to decide is whether the corporation is essentially a shell or a facade for the operations of a sole or dominant shareholder (whether an individual, a partnership, or another corporation). In making this decision, the court will consider evidence dealing with various aspects of the corporate operation including its interaction with its shareholders. The tests are similar in Pennsylvania, Delaware and New Jersey and relevant "factors" include:

- Undercapitalization;
- Failure to pay dividends;
- Commingling of corporate and personal affairs;
- Disregard of corporate formalities;
- Failure to maintain corporate records;
- Non-functioning of other officers and directors;
- Insolvency; and
- Use of the corporate form to perpetrate fraud.

See, e.g., Lumax Indus., Inc. v. Aultman, 669 A.2d 893, 895 (Pa. 1995); Verni ex rel. Burstein v. Harry M. Stevens, Inc. of N.J., 903 A.2d 475, 498 (N.J. Super. Ct. App. Div. 2006); Mason v. Network of Wilmington, Inc., No. Civ.A. 19434-NC, 2005 WL 1653954, at *3 (Del. Ch. July 1, 2005).

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**PEIRCING THE CORPORATE VEIL continued...**

While the forensic accountant must be aware of all of these factors, several of them encompass areas where a forensic accountant can be of great use in pursuing or defending a piercing the corporate veil case.

***A. Undercapitalization***—In analyzing whether the corporate veil should be pierced, one must determine whether a corporation is undercapitalized or insufficiently capitalized for purposes of the corporate undertaking. See, e.g., Tr. of Nat'l Elevator Indus. Pension, Health Benefit & Educ. Funds v. Lutyk, 140 F. Supp. 2d 407, 412-13 (E.D. Pa. 2001); Verni, 903 A.2d at 499; Mason, 2005 WL 1653954, at *3. Adequate capitalization generally describes the ability of a company to meet its capital and operating needs in a manner consistent with its intended business objectives.

The forensic accountant should first analyze whether the corporation was adequately capitalized at its inception. In determining whether the corporation was undercapitalized at inception, the forensic accountant reviews initial corporate records such as shareholder records, shareholder certificates, initial balance sheets, income statements, cash flow statements and documents supporting investments in the corporation. Those documents may include cancelled checks, notes, wire transfer remittances, and invoices/valuations for assets contributed. The forensic accountant utilizes this information to determine whether monetary amounts were truly invested in the corporation and whether any assets claimed as part of capitalization actually exist. The forensic accountant may also analyze business plans.

This concept of adequate capitalization is not limited to equity capital contributed to an entity by a shareholder. A shareholder may capitalize an entity with debt (including leases). An analysis of loans to the corporation v. investments in the corporation can be very helpful in determining if the corporation was undercapitalized. Factors to consider when determining debt vs. equity include:

- The existence of a written agreement evidencing indebtedness;
- A fixed maturity date;
- The source of payments;
- The right to enforce payment of principal and interest;
- Rights to participate in management; and
- The relationship between the lender and the borrower.

This list is not exhaustive and the forensic accountant may coordinate with counsel to ensure consideration of the appropriate factors. Evidence that accounting documentation has been altered to create the appearance of equity investment at the inception of the entity can be very compelling evidence that the corporation was a sham from the beginning.

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**PEIRCING THE CORPORATE VEIL continued...**

To determine whether the corporation was undercapitalized for its purposes, the forensic accountant must understand its purposes and try to determine how the corporation views ITSELF in comparison to other companies within its industry. Historical financial statements, business plans, private placement memoranda and similar documents will assist in this analysis. Industry research can help show how the subject corporation compares to the rest of the industry. Insolvency may or may not equate to undercapitalization. In other words, the fact that a business is adequately capitalized at its beginning but later undergoes a decline in its business rendering it insolvent may not be—on its own—a basis for piercing the corporate veil. See, e.g., Mason, 2005 WL 1653954, at *44 (noting that "mere insolvency is not enough to allow piercing the corporate veil"). The common tests for insolvency are (1) the balance sheet test (i.e. liabilities greater than the fair value of its assets), and (2) the cash flow test (i.e. the ability to meet obligations as they come due).

***B. Commingling of Funds***—Commingling of personal funds with corporate funds is one of the indicia that can lead to piercing the corporate veil. Commingling occurs when personal or corporate assets are mixed together in a single account or entity. Commingling can occur without the identified expenditure of corporate funds for some personal obligation of a dominant shareholder or some non-related debts and vice-versa. Some defendants may attempt to rebut the finding of commingling, arguing that the transactions are properly accounted for and tracked. The commingling of funds may also occur between related entities and companies and need not involve the personal accounts of the dominant shareholder. In performing an analysis of commingling, the forensic accountant should analyze the frequency and nature of transfers between related party accounts (both personal and corporate). The forensic accountant should consider whether corporate bank accounts are maintained separately and distinctly from personal accounts and from other related entity accounts.

Commingling can also occur when individuals or dominant shareholders cause personal expenses to be paid by the corporation. An entertaining, and persuasive, trial exhibit might be a listing of all personal expenses paid by the corporation on behalf of the dominant shareholder – especially if those payments list payees such as "Victoria's Secret" or "Tiffany's." The documents required for this undertaking include, but are not limited to, check registers, cash disbursement journals, general ledger expense detail, original cancelled checks, corporate credit card statements and receipts and expense reports. Courts tend to place great emphasis on the testimony of the forensic accountant regarding his or her findings pertaining to commingling, so this is a natural area of focus.

***C. Failure to Observe Corporate Formalities***—Failure to observe corporate formalities includes failing to keep meeting minutes, to observe corporate by-laws, to hold regular elections of officers/directors, and to maintain accounting and banking records. See, e.g. Verni 903 A.2d at 500 (explaining that corporate formalities include "maintaining corporate records, filing annual reports, holding shareholders' meetings, paying dividends, and employing their own officers and directors"). On its own, failure to observe corporate formalities generally may not be sufficient to pierce the corporate veil.

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**PEIRCING THE CORPORATE VEIL continued...**

See, e.g., Advanced Tel. Sys. v. Com-Net Profile Mobile Radio, LLC, 846 A.2d 1265, 1279 (Pa. Super. Ct. 2004) (noting that "not every disregard of corporate formalities or failure to maintain corporate records justifies piercing the corporate veil"). Additional evidence is usually required. The forensic accountant should review the corporate records to determine if the corporate books exist, are maintained, and are current. Analysis should also be done of the documentation pertaining to Board of Director's meeting minutes and shareholder meeting minutes. Other issues that can be considered are whether key contracts reflect fair market value and whether dividends are paid. Key documents include minute books, exhibits to minutes, shareholder listings, dividend records, and contracts.

***D. Use of the Corporate Form to Perpetrate a Fraud***—Generally the corporate form will only be disregarded where the plaintiff makes a showing that the corporate form was used to perpetrate a fraud or injustice. See, e.g., Village at Camelback Property Owners Assn. v. Carr, 538 A.2d 528, 533 (Pa. Super. 1988); Verni, 903 A.2d at 500; Trevino v. Merscorp, Inc., 583 F.Supp. 2d 521, 530 (D. Del. 2008). Although fraud is not necessarily a required element of a veil-piercing claim, a forensic accountant should be alert for evidence of potential fraudulent conduct, as it heightens the chances of success in piercing the veil. Among other things, fraudulent conduct might include deceptions or misrepresentations made by the defendant to the plaintiff about the resources of the corporation in the course of due diligence (for a contract creditor) or siphoning of funds and dissolution or merger of the corporation (for a personal injury or tort creditor).

**III. Conclusion—**As mentioned previously, the forensic accountant should at the outset of his or her involvement in a case become familiar with the law of the relevant jurisdiction, as there may be additional factors to be considered in additional to the "classic" factors discussed above. See, e.g., Fletcher-Harlee Corp. v. Szymanski, 936 A.2d 87 (Pa. Super. 2007) (discussing additional factors pertinent to whether piercing the corporate veil is warranted). In performing a veil-piercing investigation, the accountant will not necessarily be able to establish all the indicia and that may be fine. Counsel must be sure that the accountant focuses on the strong points from the analyses while maintaining his/her independence with respect to indicia both in favor of and against the client's position. Likewise, to the extent records do not exist or have been destroyed, consider what type of conclusion can be made from the absence of those corporate records.

If the matter goes as far as report issuance and deposition or trial testimony, a forensic accountant must be mindful to remain independent; his or her testimony and the analysis on which it is based "is what it is." Wherever possible, utilize corporate documents, checks, charts and the like as visual summaries of testimony and findings — in these cases, the adage that "a picture speaks a thousand words" holds true. (Relevant examples include contracts reflecting non-market rates between related entities, bank statements with numerous overdrafts, general ledgers that reflect massive related party transactions, etc.). Finally, counsel should carefully prepare the forensic accountant for cross-examination on his or her qualifications.

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## PEIRCING THE CORPORATE VEIL continued...

Given the complexity of the law on piercing the corporate veil, the forensic accountant serves as a valuable resource to a litigant attempting to utilize the doctrine or defend against its use. Persuasive analysis by an expert can mean the difference between winning or losing, since these cases are very fact-driven. Thus it is critical that the litigator and forensic accountant work together to present the best possible case for why the veil should or should not be pierced.

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## CHARGING ORDERS: A WAKE-UP CALL IN PENNSYLVANIA **By Luke Sampson**

Many lawyers tend to think of 'corporate separateness' as a line dividing the business owner and the business itself. In this context, creditors of the business may reach assets of the business, but not the owner. However, owners may have creditors too. In this context, personal creditors of the owners may attempt to reach the monetary equivalent of their interest in their business. In the case of an LLC, the creditor will seek an order from the court, charging the business owner's membership interest in the LLC with payment of the creditor's judgment; this is known as a "Charging Order". While most statutes generally define a membership interest to include both economic and governance rights, this does not mean that a transferred interest will include such rights. In Pennsylvania, the statute which limits the transferred interest to include only economic rights without the unanimous consent of the other members, was intended to restrict creditors from collecting more than they were entitled to, and also prevent business owners from being forced to accept unwanted partners. However, the statute says nothing in the context of single member LLC's. If unanimous consent is required from the other members, and there are none, does this give the transferee both economic and governance rights? There is no case law on the matter in Pennsylvania. However, in 2010 the Florida Supreme Court rendered a landmark decision, Olmstead v. FTC. The Olmstead case drew nationwide attention and has become a call to legislators across the country to re-examine their related statutes.

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**CHARGING ORDERS continued...**

In Olmstead, the Florida Supreme Court held that a judgment creditor who obtained a charging order on the membership interest of the debtor in a single-member LLC obtained both economic rights (rights to distribution) and management rights (self explanatory) on the debtor's membership interest. As a result, since the decision came out in 2010, business lawyers have scoured the statutes of their respective states. Not surprisingly, the relevant statutes in many states reveal gross inconsistencies and lack of clarity. Despite the nationwide frenzy, nearly two years have passed since Olmstead and there appears to be little discussion on this issue in Pennsylvania. For a state that borders the Delaware 'corporate mecca', it is crucial that the Pennsylvania legal community (and perhaps legislature) re-examine potential issues in light of Olmstead.

In a Pennsylvania case involving a multi-member LLC, the court interpreted 15 Pa.C.S.A. §8924 to prohibit the right of a transferee to participate in the management of the business absent the consent of all members. Frank R. Zokaites v. Pittsburgh Irish Pubs , LLC. Like the statute, the case was silent on what rights are transferred in the context of a single-member LLC. However, the court provided some value in its discussion of the purpose behind the restriction, which in turn, implies that the same may not apply to single member LLC's:

> Pennsylvania Limited Liability Company Law prohibits transferring or assigning a member's interest without the unanimous approval of other members of the company. When such approval is not forthcoming, a judgment creditor is still entitled to the debtor-member's economic rights (which are transferable) to satisfy the member's indebtedness……When Appellant attempts to expand his recoupment efforts from one of just securing economic rights to also obtaining governance rights, we find this approach proscribed when viewed against the backdrop of Pennsylvania's Limited Liability Company Law…

It is important to note that Zokaites was decided in 2008, two years before Olmstead. Since the Olmstead decision, there appears to be no case law or statutory guidance in Pennsylvania on the application of §8924 to single-member LLC's.

In addition to the inconsistencies surrounding Section 8924, many business lawyers in Pennsylvania are admittedly unclear on the function, use and scope of a Charging Order, let alone its equivalent function within the context of a Partnership or Corporation. As implied in Zokaites, the answer to these questions depends on the entity classification. However, the accuracy of these answers depends on clear and consistent statutes and more case law. Because these issues can have a serious impact on both clients and attorneys, there should be an increased awareness of these issues in the Pennsylvania legal community. Even more, perhaps there should be a call to the legislature for a statutory amendment.

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**CHARGING ORDERS continued...**

Given the court's reasoning in Zokaites, the Pennsylvania legislature may wish to amend §8924, such that it reflects the fact that a creditor should therefore be able to obtain economic and governance rights in a transferred interest, given that there are no other members to unanimously approve the transfer.

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## HEARING ON FORECLOSURE MITIGATION EFFORTS UNDER TARP—TESTIMONY OF THE HONORABLE ANNETTE M. RIZZO

Judge Annette Rizzo recently addressed the Executive Committee of the Business Law Section to apprise them of the nationally-recognized program in Philadelphia, known as the First Judicial District's Mortgage Foreclosure Diversion Pilot Program. This program has successfully addressed the crisis of mortgage foreclosure in our area and serves as a model for other communities. On September 24, 2009, Judge Rizzo presented remarks at a Congressional Hearing on Foreclosure under TARP. Her remarks follow.

**"Build It and They Will come"**

Madame Chair, distinguished members of the Oversight Panel, invited guests, members of the Bar and local community:

Such were the words which started my testimony approximately one year ago before Senators Arlen Specter and Robert Casey who presided over a United States Senate Judiciary Committee Hearing hosted by the First Judicial District on the Diversion Program.

And when we commemorated our one year mark in June of this year, our mantra became "We Built It and They Came"!

We welcome the Oversight Panel to Philadelphia to bring focus to our local initiative to stem the flood of home loss through foreclosure proceedings. I appreciate the opportunity to share with you a brief overview of the First Judicial District's Mortgage Foreclosure Diversion Pilot Program in addition to the "Lessons Learned" from being in operation almost one and one-half years. Lastly I will discuss the ongoing challenges the Program faces to effectuate meaningful solutions under new relief plans in light of increased job loss of our citizens. These are challenges we meet head-on!

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**FORECLOSURE DIVERSION PILOT PROGRAM continued...**

Since our inception, we have been the subject of a multitude of media events, locally, nationally and even internationally. We have been the subject of conferences in the business and legal sectors. We have been a blueprint for the implementation of similar programs across our Commonwealth of Pennsylvania and the country, with inquiries coming to us from Alaska to Maine, and even the "Paradise Island" of Hawaii!

## I. OVERVIEW

In a judicially driven foreclosure state, such as Pennsylvania, we view the Diversion Program as one of effective case management which meets the needs of a burgeoning caseload where equitable remedies are available. It is not perfect- it is ever-evolving as circumstances change and new relief plans avail themselves, however programs such as ours which are locally-based serve as the staging, "the theatre" in which direct and timely relief can be crafted for a homeowner on a micro basis.

We are in extraordinary times. I do not refer to it as crises- but we are in an era of new financial challenges the likes of which we have not faced in our lifetimes until now– and, as such, these times are in need of extraordinary response.

In problem-solving, we often look to new ways to deal with existing problems. I view our Diversion Program as really the harkening back of an "old way" to deal with our new challenges. By that I mean that our Program is a return to the principles of community banking- the "George Bailey Building & Loan Model." That was a system where the local banker knew you and your family, when there were "highs" with finances of the family or business being stable, or when there were "lows"- a death of the breadwinner, or loss of a job, etc. The direct financial relationship was impacted accordingly- a grant of delay in mortgage payment, a risk of a new loan taken by the bank to expand a small business, etc. That familiarity, or stated another way, the human connection was at the heart of the relationship. That "connection," that "touch" is the foundation of our efforts here in Philadelphia.

Our Program is all about the face-to-face between the lender and borrower. We have created a forum in which lenders and borrowers can dialogue on the reality of the situation, where they can work, IN GOOD FAITH, to bring about attainable, and more importantly, sustainable solutions to keep borrowers in their homes. The provisions under The Making Homes Affordable Plan (MHAP) have provided a useful roadmap for participants in our Program to achieve such results. That is not to say we have not encountered some bumps in the road along the way which I believe are not insurmountable.

The true genesis of our current program, which became fully operational in just 7 weeks, actually began in 2004. At that time Philadelphia Sheriff John Green had cancelled the Sheriff's Sale list and had come before the Court to seek injunctive relief by way of a moratorium of sales.

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**FORECLOSURE DIVERSION PILOT PROGRAM continued...**

The matter was before me and though I did not grant the relief then sought, I did establish what would amount to be the prototype of the program we now have-taking the time to look at cases and homeowner situations on a micro basis and foster the opportunity for the lenders and homeowners, through counsel, to negotiate favorable resolutions. Success was seen with many of the homeowners based on newly available state funding criteria; however another significant result came from that proceeding.

The Sheriff argued to the Court that the Sheriff Sale system was "fundamentally broken" and needed to be fixed. At that point the Mortgage Foreclosure Steering Committee was formed with all sides of the issue coming together on one committee to meet monthly regarding the ever present problem that foreclosures posed for the community as a whole. This Steering Committee, comprised of representatives from the lender bar, consumer bar, Sheriff's Office, City, Office Community Housing and Development, and Volunteers for the Indigent Program (VIP), was ready in 2008 to form this Program where need arose. It remains in existence today and acts as the Steward of the Program.

There are two major criteria of the Program. The first concerns eligibility for our program. Only properties that are residential owner-occupied with four or less units are eligible for the Program. The second criterion is that no property goes to Sheriff's Sale without a "conciliation conference" in the City of Philadelphia. Once the property has been deemed eligible and the homeowner has called the hotline after receiving notice sent to the homeowner along with the complaint in foreclosure, the homeowner is then scheduled for an appointment with a housing counselor. At this appointment the homeowner and housing counselor work together to organize all of the necessary financial information for a formal "Hope Now " proposal which is then sent to the lender attorney for submission to the mortgage servicer for response. At this point the dialogue really begins. If a deal cannot be struck prior to the date of conference, parties attend the conference.

When the Program began, homes were literally being pulled off the sale block for conferences in what was termed a "Day Backward" Program. The Program proved very successful in saving homes in what were deemed hopeless situations for many Philadelphians. Philadelphia is a historic east coast city comprised of neighborhoods and an aging inventory of row homes, thus our foreclosure picture is distinct from that found in the Sunbelt area as well as other locations nationwide. In particular, we found many seniors and single women who were at risk of losing homes where they had resided for decades and who benefitted directly from our Program.

Our focus at present is our "Day Forward" caseload which is comprised of all residential foreclosure cases that have been filed since September 8, 2009. These cases are automatically scheduled for a conciliation conference 45 days from the date of commencement of the civil action, or the filing of the complaint.

Continued...

**FORECLOSURE DIVERSION PILOT PROGRAM continued...**

This is a Program wherein conferences are mandated in each case as opposed to other jurisdictions which may have fashioned "opt-in" provisions for borrowers who must take the affirmative step to be part of a meditative process. In several discussions I have had with program directors of such programs, the sentiment has been that caseloads have been lower than capacity of such Opt-in Programs (with the expense, are the Programs getting their bang for the buck?) where the system can effectively handle more cases as houses continue to go up for sale with homeowners not availing themselves of the services.

There can be discussion on both sides of the issue, as some programs have moved from "opt-in" to "mandatory", however for the Philadelphia Program we have found that our efforts have been best served with mandated conferences on all matters. Such mandates do pose challenges to the Court, however, as the Program has been shouldered by existing court budget with myself and all other court personnel staffing the Program on "stretch" assignment from their other Court duties.

One unique aspect of our Court Program is the Judiciary being in direct and full partnership with non- judicial entities. Our Mayor, Michael Nutter, has given full support to our Program with his funding of community outreach groups, expansion of our dedicated Housing Counseling and legal services team, and his own support of the Hotline efforts through personal PSA's, and other public notices. For that, the Court is ever grateful.

A significant reason for any success of our Program stems from the community outreach groups under the City's budget, which literally canvas neighborhoods with lists of homeowners in foreclosure. These groups go door-to-door to contact borrowers at their homes to notify them of their upcoming conference and to make sure they contact our "Save Your Home Philly Hotline." Once this call is placed, the homeowner is set up with an appointment with a housing counseling agency and they are "in the chute" as we affectionately say. We have found that this "connection," "this human touch" has greatly reduced our "Failure to Appear" rate, which at the beginning of our program was near 50% and has now been reduced to less than 30% each week. The canvassing efforts have also helped to determine which properties are commercial and vacant and thus not eligible under program guidelines.

We sit in session every Thursday with a morning and afternoon list of approximately 150 cases called in each session. It is a non-adjudicatory proceeding, I am not robed, nor do I sit on the bench. There is a formal "Call of the list", although those who visit may view it as a Moroccan Open Air Market. I tend to view it as the floor of the original Stock Exchange in terms of "organized chaos". We of course welcome a visit this afternoon from our panel members to witness first hand our program in action.

Continued...

**FORECLOSURE DIVERSION PILOT PROGRAM continued...**

Most often a resolution is reached in the courtroom either by ongoing discussions or with the assistance of a judge pro tempore ("JPT") appointed by the Court to oversee the meditative process in private settings. Lenders and housing counselors along with volunteer attorneys have established good working relationships, that connection or "human touch" helps to resolve these cases without the use of formal mediation. If, however, no consensus is reached, a JPT can be requested for a formal conciliation conference, and the parties are escorted to a private room where the JPT attempts to resolve the case. A recommendation is then made to the Court as to a possible postponement "with purpose" or that the conciliation has not borne fruit and the case must then proceed.

Our borrowers have the benefit of well-trained housing counselors to assist them in the process as well as volunteer lawyers through Philadelphia Volunteers for the Indigent Program ("Philadelphia VIP"). To date over 300 lawyers have been trained and approximately 200 lawyers have served in various cases along with volunteer JPT's, over 40 in number, to represent approximately $1 million in pro bono services rendered.

The volunteer aspect of the Program is in and of itself a testament to local organizations, particularly our Philadelphia Bar Association "stepping up to the plate" to serve! In fact, the Association was a recipient of a national award from the American Bar Association just this summer for their outstanding efforts!

So how do you measure success? Since the Program's inception approximately 6,300 conferences have been scheduled with some 1,600 homes being saved outright from Sheriff's Sale. According to OHCD, another 3,000 cases are in "queue" for future resolution as the parties continue to negotiate and await responses from lenders. We anticipate more cases to be in a "holding pattern" as a result of the HAMP provisions for trial forbearance provisions. The Philadelphia Program will be the subject of an in-depth study by leading Foundations on the Program's effectiveness of sustainable fixes for homeowners.

Success is seen by outright dismissal of court actions, settlements, loan modifications, forbearances, deeds in lieu, short sale, and what I term "graceful exits".

I wanted to take a moment to talk about "graceful exit," a phrase I use to describe a case where it is not feasible for the homeowner to remain in the property-there is no means by which a loan can be performing- and therefore this process again, on a micro level, fosters discussion on planned departure from the property which brings certainty to the parties and dignity to the homeowners in planning for the next phase of their living situation. We have seen many cases in this regard and view this as a success for these homeowners.

Continued...

**FORECLOSURE DIVERSION PILOT PROGRAM continued...**

## I. CHALLENGES

With the advent of the HAMP and its provisions I have seen a welcomed benchmark for case analysis embraced by our stakeholders to the process- we do, however, see some fraying . I am seeing an increase in postponement due to the inability of lenders to react to proposals, the converse of delay caused by the homeowners not being prepared with their necessary paperwork. Both scenarios have a negative impact, with increased arrearages, further possible deterioration of the properties, increased hopelessness of the homeowners, adding yet further impediments to the discussions. I am also experiencing educational gaps on all the nuances of the HAMP provisions which come into play in resolving cases. I have postponed cases directly as we wait for clarity from Washington on certain HAMP provisions. As with any major governmental program, time will hopefully sort out some aspects of the Program, however diverse interpretations of such rules could mean the difference between a borrower staying in his home or having it go to sale.

On the part of lenders and servicers, we are also seeing, in some cases, a lack of knowledge of the guidelines requiring exploration on alternative relief efforts for homeowners beyond HAMP, as well as less than full explanation on denials of loan modifications after trial forbearance periods. My request is for further field training on the HAMP provisions with technical support of designated help-lines readily available for timely guidance.

As new provisions come forward and/or others are clarified, clearly programs such as ours are primed to react on almost an instant basis to what is in place. As a result we serve an important role in being able to effectuate the new directives that come down from Washington on a regular basis.

In addition, an ever growing concern is with the rate of unemployment these homeowners are facing. With homeowners out of work, resolutions are nearly impossible as there is no sustainable capacity to pay. This is clearly not only a Philadelphia problem but a nationwide issue. Here in Pennsylvania we have the benefit of HEMAP (Homeowners Emergency Mortgage Assistance Program), and other local initiatives, which offer money in the form of a loan to help homeowners sustain their mortgage payments when faced with job loss, illness, divorce, etc. This is a program that has been very successful and has in fact MADE money for the state. This is a program that should be reviewed on a national level to provide support to those homeowners facing unemployment.

I would be remiss if I did not take a moment to mention the Court's dismay on the cropping up of scam operations and fraudulent conveyances occurring in response to needy homeowners searching for quick fixes in the wrong places. We applaud the FDIC, the Philadelphia Federal Reserve and the City along with other federal, state and local agencies who are assisting to educate the consumers about such fraudulent acts so that government authorities may impose proper criminal and civil sanctions.

Continued...

**FORECLOSURE DIVERSION PILOT PROGRAM continued...**

## II. CONCLUSION

In sum, we are here to provide a micro-focus to citizen borrowers and lenders in the hopes of achieving as many performing mortgage agreements as possible for the sanctity of these individuals, their families, and our community.

With the continued support and input from our valued stakeholders and the commitment of the wonderful members of the Court and First Judicial District Staff we are encouraged that our efforts will be fruitful.

We invite other jurisdictions within our Commonwealth borders and on a national level to continue to partner with us in this endeavor and avail ourselves to achieve this goal by whatever means necessary.

As this Program continues past its Pilot phase into the year 2010 we continue to evolve to meet the ongoing needs of parties involved in foreclosure actions by providing a forum in which resolutions can be crafted and our mission can be fulfilled; saving homes, one address at a time!

We appreciate the "radar" that this panel has placed to our program. Your interest has put a real face to the current and continuing national and international debate surrounding these critical financial times.

Respectfully Submitted,
Annette M. Rizzo, Judge

# RECENT DEVELOPMENTS AT THE ITC By Anthony S. Volpe and Thomas Gushue

Anthony S. Volpe

Thomas Gushue

**Introduction**

In recent years, actions before the United States International Trade Commission (ITC) to exclude importation of allegedly unfairly competitive products have become the actions of choice where monetary damages are not being requested. As a mission, the ITC is an independent federal agency which protects domestic industries from unfair trade practices. The ITC has been seen as an attractive alternative forum to federal courts because it was perceived as a cheaper and faster alternative to traditional infringement litigation with the ability to quickly enforce equitable relief through importation bans. While the ITC cannot award damages, it can close the borders to importation. As a consequence of being subject to an exclusion order, many companies will look to license the asserted rights so they can continue to sell into the United Sates. This has the effect of giving the rights holder an opportunity to negotiate payments for past infringement and future royalties. At the same time, the requester (the equivalent the plaintiff) did not have to demonstrate many of the economic factors that were considered in a district court action where monetary damages were requested. This feature of ITC actions has made them increasing popular for use by Non Practicing Entities (NPEs) and foreign rights holders who did not have a significant presence in the U.S. to sufficiently prove the factors considered under a traditional Georgia Pacific damages analysis.

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**ITC continued...**

Because of the increasing popularity of ITC actions, two provisions governing the right to bring actions before the ITC and, if successful, obtain an exclusion order have experienced considerable alterations. One provision addresses the requester's qualification as domestic industry with the right to bring an action in the ITC. The other provision addresses the public interest factors that the ITC considers prior to issuing an exclusion order. The domestic industry provision of the Tariff Act of 1930, which once seemed like a relatively unambiguous provision, is becoming less of a hurdle for foreign entities seeking protection in the ITC. Similarly, after decades of largely ignoring the public interest factors, recent developments indicate the ITC is inching closer to having a meaningful treatment of public interest factors in determining whether to grant exclusion orders or importation bans. An entity considering the filing of an ITC request for an investigation needs to be aware of and take into account the ITC's varying treatment of these important provisions.

**Domestic Industry Provision**

In order to qualify for ITC protection, a requester must be a domestic industry under Section 337 of the Tariff Act. At its inceptive outset, the domestic industry provision was focused on being sure the ITC complainant had the degree and frequency of involvement in the U.S. economy necessary to qualify as a domestic industry under the Act and benefit from its protection. With the changes in the economic picture and the reduction in traditional manufacturing, the definition of domestic industry has been evolving. The reduction in the domestic manufacturing industry and the rise in knowledge-based enterprises have accelerated the evolution and altered the showing necessary to convince the ITC domestic industry status. The original Tariff Act of 1930 did not specify how a complainant proved it was a domestic industry. In 1988, the Act was amended with the help of Congress and the ITC. The ITC originally suggested restricting domestic industries to only complainants that invested hard capital within the U.S. Complainants would have to prove a significant investment in manufacturing facilities (bricks and mortar) or investment of labor or capital. However, due to political pressures, Congress demanded a more expansive interpretation of domestic industry to include soft capital investments. Congress relaxed the domestic industry requirement and inserted language allowing claimants to meet the requirement by proving sufficient licensing and research costs. This amendment allowed an entire new class of complainants to utilize the ITC for relief from unfair trade practices. And, the domestic industry requirement has been subject to shifting interpretations since that 1988 revision.

The intervening twenty plus years have not resolved precisely what level of investment is needed to meet this soft capital investment prong. In John Mezzalingua Associates (dba PPC) v. ITC, the Court of Appeals for the Federal Circuit (Federal Circuit) reviewed an ITC decision that the complainant PPC failed to prove a violation under the Act due to its failure to invest sufficient capital in licensing and research. The Federal Circuit, in addressing the domestic industry prong, enumerated the activities which qualify a complainant as a domestic industry, and focused on whether PPC's aggregate licensing expenses were substantial enough to meet its burden.

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**ITC continued...**

The Federal Circuit's fact sensitive inquiry of whether PPC met the domestic industry requirement addressed many factors and noted how each factor influenced its determination. Licensing activity was among the factors considered by the court. It noted that the number of licenses held by a complainant suggested that the complainant was actively engaged in a licensing strategy; a pattern of previous licensing efforts tends to indicate a complainant was likely trying to license the patent at issue; and, the overall importance of the patent at issue to a complainant's licensing efforts is another factor. If the patent is critical to securing a licensing agreement or a substantial component of complainant's licensing efforts, the Federal Circuit was more likely to find that those attempts to license that critical patent qualifies the complainant as a domestic industry.

There was at least one bright-line rule in the Federal Circuit's decision: expenditures on patent litigation do not automatically entitle a complainant to qualify as a domestic industry. As a result of this holding, foreign companies and NPEs cannot rely upon pending or prior U.S. litigation expenses as the basis for establishing the domestic industry qualification necessary for an ITC action against alleged infringers in the U.S. Initially, it was thought that this hurdle could be overcome by demonstrating substantial time, money, and effort in licensing the asserted patent portfolio. In Mezzalingua, PPC advanced licensing expenditures to satisfy the requirement. However, the ITC determined that PPC failed to prove licensing efforts sufficient to establish itself as a domestic industry.

PPC presented a witness explaining that members of the industry generally do not license design patents and therefore PPC decided it was necessary to proceed with infringement litigation prior to any licensing efforts. The court dismissed this argument and noted PPC still failed to make a substantial investment in licensing as required under the Act. PPC advanced a second argument that the salaries paid to the inventor of the patent at issue should be considered an investment in research and development. The ITC noted the inventor of the design patent also invented at least two other utility patents of the same family of patents. The ITC held the time and resources spent developing the disputed design patent were insufficient to satisfy the Act's requirement of a substantial investment. As noted, the Federal Circuit affirmed the ITC decision that PPC failed to establish itself as a domestic industry and it did not qualify as a complainant under the Act.

The Mezzalingua decision is best read in conjunction with another recent ITC opinion addressing the domestic industry requirement. The ITC's opinion in Inv. No. 694, "Certain Multimedia Display and Navigation Devices and System Components Thereof and Products Containing Same," (Panasonic) listed a multi-factor test for determining whether a complainant is a domestic industry. Regarding the existence of a licensing portfolio, the ITC stated a complainant's efforts to license asserted patent, the importance of an asserted patent to that overall licensing portfolio, and the number of patents in a licensing portfolio all impact the determination.

In terms of the marketplace for the patent, the ITC noted that recognition by the market of an asserted patent and its value, the relation of an asserted patent to an industry standard, and any infringement of an asserted patent in the U.S. all help a complainant establish itself as a domestic industry.

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**ITC continued...**

Discussions and negotiations regarding a disputed patent and any successful litigation also help a complainant prove its status as a domestic industry. It is clear that the ITC and the Federal Circuit recognize that the language of § 337 fails to provide adequate guidelines to complainants attempting to prove their domestic industry status. It is also clear that both are struggling to find the correct fit between the current form of rights holders and the ITC's domestic industry requirement.

Due to the imprecise language in § 337 and these recent decisions, complainants that cannot demonstrate hard costs within the United States to create or exploit their rights are relegated to advancing novel arguments for characterizing their soft costs as meeting the domestic industry threshold. In the Mezzalingua decision, the Federal Circuit offered some insight into the factors considered under the domestic industry requirement, but failed to offer a definitive framework for future complainants to follow. As evident by the list of factors expounded by the ITC in the Panasonic decision, foreign entities and NPEs will need to carefully consider every decision regarding a patent or family of patents for its likely influence on the ITC's decision on whether it qualifies as a domestic industry.

The Mezzalingua and Panasonic decisions raise the additional concern for potential complainants, that the ITC no longer has the advantage regarding economic discovery. Now that there is possibility of the economic value of asserted rights in the ITC will be measured against the value of a larger bundle of rights, there may be a whole new category of discovery. This additional burden on the potential complainant may outweigh the ITC's benefit of a quick action, especially since monetary damages are not available in the ITC.

**Public Interest Factors**

Similar to the recent shifting interpretation of the domestic industry provision, the public interest factors have also been experiencing some dramatic changes in terms of what information the ITC considers before issuing an exclusion order. Section 337 requires the ITC to consider four public interest factors, including: (1) public health and welfare, (2) competitive conditions in the US economy, (3) the production of like or directly competitive articles in the U.S., and (4) U.S. consumers. Generally, unless any one of these four factors is present, the ITC may issue an exclusion order barring a product from importation. Another notable difference between the ITC and federal courts is based on the type of evidence used for adjudicating a dispute. In the federal court system, a complaining party must prove four factors prior to granting an injunction. These factors, commonly referred to as the eBay factors due to the case that promulgated this framework, require a complainant to prove: (1) that it has suffered an irreparable injury; (2) that remedies available at law are inadequate to compensate for that injury; (3) that considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.

While the two sets of factors are considerably different, both address the impact of an injunction on the public. Another critical difference between the analysis performed by the ITC versus the federal courts is the relative strength and usage of these factors.

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**ITC continued...**

In the ITC, the factors are used mainly as a safety valve against a potentially detrimental importation ban that could seriously negatively impact any one of the four areas listed. In the federal courts, the eBay factors must be adequately established before a plaintiff is entitled to injunctive relief.

For many years, the ITC public interest factors were rarely considered prior to issuing a decision. By its own admission, the ITC had acknowledged that "there have been a few investigations in which public interest concerns have led to the denial of relief after a violation of section 337 has been found." As a result, many experts believed that the ITC would continue ignoring these factors. However, the ITC has issued two substantial amendments to the procedures governing the public interest factors in the past two years. In 2010, the ITC issued a notice regarding publication of a complaint to solicit comments regarding potential public interest issues implicated by a complaint. Because third parties can more readily and easily collect information related to the public interest factors, this new procedure made it much easier for the ITC to review information related to these factors and consider the effect of an exclusion order on the public. In 2011, the ITC issued another notice regarding the public interest factors. The amended rule, which took effect in November 2011, requires a complainant to file a separate statement of public interest, identifying any impact that the injunctive relief could have on any public interest issues. The ITC ultimately decides at the outset of an investigation whether the administrative law judge may collect evidence regarding the public interest. These separate statements allow the ITC to determine at an early stage in its investigation whether or not the administrative law judge (ALJ) needs to consider public interest factors when reaching a determination. These procedures seem to signal that the ITC is more willing to accept, review, and consider public interest factors prior to issuing a potential harmful exclusion order. However, a recent high-profile decision may provide some evidence to the contrary.

In 2011, the ITC's Office of Unfair Import Investigation (OUII) provided some valuable insight into how these procedures would affect the ITC's public interest analysis, if at all. Apple and HTC are currently engaged in an extensive ongoing intellectual property battle involving the mobile device marketplace. Although there are a number of infringement actions ongoing in various stages, one case in particular presented the ITC with a chance to provide insight into its treatment of public interest factors. As part of the ongoing dispute, Apple filed a complaint with the ITC accusing HTC of violating a number of its patents.

In this particular case, an ALJ found that HTC infringed two Apple patents. Google and T-Mobile, which use HTC products for providing cellular phone services, were permitted to submit statements of public interest regarding the potential impact resulting from an exclusion order of infringing HTC products. Google and T-Mobile emphasized how an importation ban would be detrimental to the general public.

The companies presented evidence that importation bans would harm critical safety and emergency personnel because of the ability of HTC smartphones to be compatible with hearing aids and comply with security requirements for enhanced 911 location services.

Continued...

**ITC continued...**

They also emphasized the size of their market share in the smartphone industry to highlight the potential impact of an importation ban on the general public. The OUII rejected these assertions and concluded that the exclusion of HTC's accused products from importation would not significantly impact any public interests. The OUII stressed the number of alternatives to HTC brand phones. The OUII also noted the number of alternative operating systems available for smartphone users. Because the U.S. consumer demand for smartphones could easily be met by alternatives other than HTC brand phones, the OUII concluded that the injunctive relief was "not contrary to the public interest." In December 2011, the ITC's review commission largely affirmed the decision of the OUII and barred HTC phones from being imported into the United States. The review commission reversed the ALJ's decision with respect to one of the patents but affirmed the decision regarding two other patent claims. Notwithstanding the change, the review commission upheld the exclusion of the infringing HTC products. This decision serves as the latest indication of how the ITC's treatment of public interest factors continues to evolve.

Despite the large market share of HTC products in the cellular community, the ITC did not find the public interest factor should be invoked in this particular case. The ITC has occasionally found the public interest factors trumped the need for an injunction. In these rare cases, the ITC typically found that the marketplace could not meet the demand necessary to compensate for the lack of products due to an importation ban, which was arguably not present in the Apple-HTC decision due to the robust cellular phone market. The cases where the ITC found public interest should limit the available remedies despite a violation of § 337 involved rare or unique products. Exclusion orders were also denied due to the unique ability of the disputed product to meet an important and substantial need in the marketplace.

**Conclusion**

Much like the increasing uncertainty regarding the ITC's domestic industry requirement under § 337, the ITC has similarly neglected to provide adequate guidance on the public interest factors. The domestic industry provision still seems relatively amorphous as the ITC has not identified a comprehensive principle regarding what exactly qualifies an entity as a domestic industry. And although the ITC has been promulgating institutional procedures to help breathe new life into the public interest factors, it is clear that meeting the threshold burden to avoid an exclusion order under these factors is still relatively high.

The domestic industry provision and the public interest factors are clearly in play before the ITC and they bear careful consideration before filing an ITC request for an investigation.

Anthony S. Volpe, a shareholder at Volpe & Koenig, has corporate and private practice experience in securing, licensing, and enforcing all aspects of intellectual property rights. His patent work includes appeals before the USPTO Board of Patent Appeals and Interferences and International Trade Commission, prosecution of patent applications, rendering opinions regarding patentability and enforcement of patent rights.

Thomas P. Gushue, a mechanical engineering associate at Volpe & Koenig, has patent prosecution experience in automotive systems, mechanical devices, consumer products, and electromechanical devices. He works with clients to provide strategies to secure and protect their intellectual property.

## BOOK REVIEW: *The Wall Street MBA, Second Edition* by Reuben Advani

*Reviewed by Neil C. Maskeri, Associate at Volpe and Koenig, P.C.*

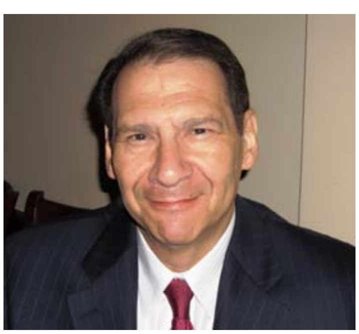
Reuben Advani has done it again! If you are looking for a corporate finance and accounting book that doubles as a sedative, the second edition of *The Wall Street MBA*, is not for you. Through his use of humorous anecdotal examples, Mr. Advani eloquently demystifies financial statements, and educates the reader on analyzing earnings and detecting fraud, all while keeping things simple and fun.

*The Wall Street MBA* is perfect for the busy attorney who wants to learn the basics of corporate finance principles without sacrificing loads of precious billable time. Whether your aim is to learn the difference between a cash flow statement and an income statement, assess stock prices, determine the cost of capital, or understand what a derivative is, Advani's simple, creative, and humorous style will not disappoint. Combining his real world Wall Street experience and unique teaching style, Advani has crafted an easy to read overview of corporate finance and accounting concepts, without getting bogged down in overly complicated details. By artfully removing the clutter, Advani focuses on key information to provide the reader with a clear understanding of crucial business concepts. *The Wall Street MBA* also functions as a handy reference, filled with useful tables, appendices, and exercises.

Advani’s second edition is updated with new chapters on currency trading, real estate valuation, and commodities. In today's business environment, it is important for professionals in the legal field to understand the financial side of business. The second edition of *The Wall Street MBA* is the perfect resource for today's busy legal professional.

Neil C. Maskeri, an Associate at Volpe and Koenig, focuses his practice on the preparation and prosecution of domestic and foreign patents. Neil’s expertise includes securing and leveraging intellectual property in technologies including telecommunications and chemical processing. He is also experienced in providing litigation support and has been involved in major case discovery and in technical issues related to validity and infringement studies.

## CONTROLLING MEANS AND METHODS OF CONSTRUCTION MAY SUBJECT PROJECT OWNER TO LIABILITY FOR SAFETY OF SUBCONTRACTOR’S EMPLOYEES **By Richard H. Agins**



**Richard H. Agins**

When an employee of a subcontractor is injured on the jobsite, the subcontractor sometimes may seek coverage of the injury under the project owner’s insurance policy. A recent Pennsylvania Supreme Court decision clarifies the circumstances under which the owner will be liable for such coverage based on its interpretation of the “retained control exception” – an exception under which the owner has retained enough control over the substantive means and methods of construction to warrant the imposition of liability.

Continued...

## MEANS AND METHODS continued...

Courts have held that "[i]t is not enough that [the property owner] has merely a general right to order the work stopped or resumed, to inspect its progress or to receive reports, to make suggestions or recommendations which need not necessarily be followed, or to prescribe alterations and deviations. …

There must be such a retention of a right of supervision that the contractor is not entirely free to do the work in his own way." Pennsylvania courts generally have declined to apply this so-called "retained control exception" to an owner who has implemented safety regulations out of concern for jobsite safety.

The retained control exception was most recently examined by the Pennsylvania Supreme Court in Beil v. Telesis Construction, Inc., et al.1, a case in which the plaintiff-employee of the roofing subcontractor was seriously injured while utilizing scaffolding erected by the masonry contractor, causing him to sue the construction manager, the masonry contractor and the owner for damages. In his personal injury action filed in the Court of Common Pleas of Philadelphia County, the plaintiff charged that all three defendants were negligent.

The owner filed a motion seeking to escape liability asserting that because it had hired the construction manager to perform the work on the premises, the owner therefore was not liable for injuries to employees of the independent contractor or its subcontractors because it did not fall within the retained control exception. The Court of Common Pleas denied the owner's motion without opinion and following a trial, a jury awarded damages in favor of the plaintiff against all three defendants for $6.8 million, apportioning liability 50% to the construction manager, 35% to the owner, 10% to the masonry contractor, and 5% to the plaintiff.

The owner filed post-trial motions seeking judgment notwithstanding the verdict ("n.o.v."), a new trial, a new trial on damages, or a reduction in the damages. By unpublished opinion and order, a unanimous panel of the Superior Court reversed the lower court and remanded for entry of a judgment n.o.v. in favor of the owner, concluding that, as a matter of law, it was not liable under the "retained control exception." The Superior Court noted that a property owner has no duty to warn the contractor or its employees of conditions that are at least as obvious to the contractor and its employees as they are to the landowner. Therefore, responsibility for protection and liability for negligence generally are placed squarely on the contractor and its employees. The critical exception to this rule arises where a property owner who hires an independent contractor retains control of the "means and methods of the contractors work," in which case the property owner then assumes liability.

In Beil, the construction manager acknowledged that it was in complete control of the project and responsible for the safety of its subcontractors, including the roofer and its employees. Accordingly, because of the construction manager's direct control and the fact that the owner did not 1 11 A.3d 456 (PA 2011) retain control over the means and methods of the operative details of the masonry work (even though it did have a project manager on-site), the Superior Court reasoned that the record did not support the trial court's conclusion that the owner had retained control sufficient to impose liability.

Continued...

## MEANS AND METHODS continued...

On appeal to the Supreme Court, the issues to be decided were: (1) did the Superior Court misapply case law as to the retained control exception; (2) did the Superior Court improperly fail to view the evidence in the light most favorable to the Plaintiff; and (3) did the Superior Court misapply both § 414 of the Restatement (Second) of Torts and other case precedent?

As to the first consideration, the Supreme Court held that it is preferable to leave the level of review and inspection the parties intend in any given contractual situation to be decided by the contracting parties according to the needs of each project. Therefore, at trial, the inquiry regarding what level of review and inspection the parties intended is left to the finder of fact. The Supreme Court has recently endorsed the principle that certain safety-related conduct, including the employment of on-site safety representatives with the authority to stop work, does not constitute control of the work site as a matter of law. By extension in this case, the Court held that "a property owner retaining a certain degree of authority over safety issues, such as supervising and enforcing safety requirements, and even imposing its own safety requirements at a work site, does not constitute control for purposes of imposing liability."

As to the second consideration, the Court found that Plaintiff's assertions that safety-related conduct at the work site established requisite control to impose liability is contrary to consistent pronouncements of Pennsylvania courts rejecting such arguments as against public policy. Therefore, the Court concluded that even when viewed in the light most favorable to the Plaintiff, the owner did not control the work of its subcontractors with respect to safety-related conduct and was therefore not liable for the Plaintiff's injuries on that basis.

Finally, as to the third consideration, the Court drew a clear line between the imposition of safety requirements and the control of means and methods of the operative details of construction as a determinant for the purpose of imposing liability. The former, it held, is well within the purview of the owner, while the latter – relating to the substantive performance of the work – is not. The Court also found that the contractual relationship between the owner and a contractor or its employees largely determines whether liability may be imposed and determined that in Beil, the appellant did not have a sufficiently direct contractual relationship with the owner to impose such liability.

### Conclusion

Under the Pennsylvania Supreme Court's holding in Beil v. Telesis Construction, Inc., et al., a property owner who exercises control over jobsite safety, but who is otherwise not involved in determining the substantive methods and means of construction will not be subject to liability for injury to a subcontractor's employee under the "retained control" as adopted by Pennsylvania courts.

Continued...

**MEANS AND METHODS continued...**

This determination can be made as much by observance of jobsite practice as by contract language, so the collaboration of owner, contractor and attorney is necessary to ensure that liability is apportioned in accordance with the expectations of all parties.

Richard Agins is a member of Sigman & Zimolong, LLC. He holds an MBA, is licensed as a CPA, and spent more than 30 years in financial, operations and chief executive positions in industry before becoming a lawyer. He brings significant practical and legal experience to the representation of lenders, contractors, and business owners, and has worked on a variety of complex workout and restructuring engagements. Rich is English/Spanish bilingual and enjoys working with Hispanic/Latino business owners. He can be contacted at (215) 665-0842 or rich@sigzim.com.

## THE NEW LINE OF PRIVACY IN A SOCIAL MEDIA AGE

**By Reneé Bergmann, Esq. and Colleen M. Washburn, Esq.**

**Reneé Bergmann, Esq.**

Suppose you meet someone, say a new source of business referrals and you then find a "friend request" in your inbox. Do you accept? Now suppose after a job interview the Human Resources Director sends you a "friend request?" Do you accept? Perhaps during the interview the Human Resources Director asks for your Facebook login information, or maybe she spins her computer around, asking you to login to your Facebook account during the interview. In fact, this practice has become commonplace enough it has a name - "shoulder surfing."

If you found yourself in an interview with someone who wanted to be your Facebook "friend," asked for your login information or to "shoulder surf," how would you feel? Under pressure to comply? Or if you are asked to "friend" the Human Resources Director of your potential employer, would counting your new HR "friend" among your personal friends curb your speech?" When you are confronted in a job interview with such a request, and the job is one you really need and otherwise want, do you even have a meaningful choice?

**Colleen M. Washburn Esq.**

These scenarios are not hypothetical. In 2010, Robert Collins, a security guard with the Maryland Department of Public Safety was returning to his job after taking leave following his mother's death and during a reinstatement interview was asked for his Facebook login and password. The agency told Mr. Collins that reviewing his Facebook page was necessary to rule out gang affiliations. The security officer complied, but his compliance leaves more questions than answers. Primarily where exactly is the privacy line in this social media age?

The ACLU complained to the Maryland Department of Public Safety after hearing Mr. Robert Collins' experience causing Maryland legislation to be proposed prohibiting an employer from seeking social network login information. Illinois has followed suit with similar

Continued...

**PRIVACY continued...**

proposed legislation.

If passed, the answer to the dilemma of employees, both present and potential in these states may be answered, but not before this issue has caught fire on a larger scale. Just recently on my own Facebook page I noticed this status update:

> "According to CNN, employers can ask you for your Facebook password... and they can deny you the job if you refuse to give it. They say it's totally legal as long as they don't discriminate on race, gender etc..."

The debate may be shaping into different definitions of privacy between public and private employees, but the thought of sharing your personal thoughts, pictures and connections seems improper in either realm. The conflicting viewpoints are posed as a question of safety versus privacy. But does someone's private Facebook profile really indicate if they are a safety risk in a work environment? How far can potential employers reach into an individuals' private life when making hiring decisions? For instance, it would never be appropriate for a potential employer to put a camera in your home or read your personal mail as part of the employment screening process. It only follows that reading personal Facebook profiles is only steps behind what would be considered very inappropriate behavior by any potential employer.

While there is presently no case law or legislation directly on point to resolve this growing issue, some believe that employers are overreaching while they have the opportunity. Facebook allows individuals to post a wealth of information on their profile, much of which an employer would be forbidden by Federal law to ask, or consider, during the interview process. For example, it can easily be determined from a user's Facebook page age, race, political affiliations, marital status and/or religious beliefs. In addition, a Facebook page is ripe with other sensitive information, such as an individuals' desire to start a family or simply someone's private hopes and dreams.

Facebook continues to decry these practices and continues to remind all Facebook users that employers requesting passwords or "shoulder surfing" are a violation of its terms of use, but in reality the terms have no significant legal weight. However, the issue may soon get the necessary weight from our legislature. The issues were recently taken up by Senator Charles Schumer (D. N.Y.) and Senator Richard Blumenthal (D. Conn.) who requested the U.S. Department of Justice investigate whether an employer asking for Facebook passwords violates the Stored Communications Act or the Computer Fraud and Abuse Act. In addition, the pair asked the EEOC to examine these practices. Senators Schumer and Blumenthal have indicated they will propose a bill to protect any areas not covered by current laws.

So, although the scenarios are not hypothetical, the answer to the line of privacy in a social media age will remain hypothetical until a lawsuit to clarify the new meaning of privacy is filed, unless our legislators clarify the issue first.

Reneé Bergmann is Counsel at Becker Meisel, practicing commercial litigation in Pennsylvania, New Jersey, and New York.

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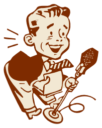

## NEWS AND ANNOUNCEMENTS...

- A Joint YLD/BLS Happy Hour is scheduled for Tuesday, May 22, from 5:30 – 7:30 p.m. at The Black Sheep Pub. Look for future announcements for this special event.

- YLD awards five Diversity Scholarships of $500 to diverse law students. The BLS agreed to contribute $250 towards additional scholarships and will award scholarship recipients membership in BLS. Scholarships will be awarded at a June 14 reception of the YLD.

- The BLS, Business Litigation Committee is hosting the Annual Commerce Court Reception Wednesday, May 16, 2012, from 6 to 8 p.m. at the Westin Philadelphia Hotel at 99 South 17th Street. The cost to members is $85, and to non-members, $95.00. The reception is to include wine and beer and "heavy hors d'oeuvres." Registration can be done online no later than May 11.

- The BLS is seeking to revive the Advisory Board composed of past Chairs. The Advisory Board Charter is available on the BLS website. The purpose for the Board is stated as follows: One of the great difficulties faced by any Bar Association is the loss of institutional memory, which too often leads to the periodic reinvention of the wheel, or projects fading before fruition because those invigorating and leading them leave their post after a year. We believe that the Advisory Board will be a means to preserve institutional memory and worthwhile projects, and that it will allow us to move more expeditiously toward tangible, working, achievements.

- Welcome to new Executive Committee Members: Phyllis Horn Epstein, Heather Tashman Fritts & Peter Cripps to one-year terms, starting January 2012.

- Sarah Woods, Executive Director of VIP, thanked the BLS for its recent generous contribution of $5,000. In her words: "We truly appreciate your sustained commitment to VIP's success and the unwavering support of the entire Section. The Section's support enables us to continue our work of connecting volunteer attorneys with small business and non-profit organizations that serve the low-income community."

- Reneé F. Bergmann, Counsel at Becker Meisel LLC in Cherry Hill, N.J., has been named to the Sunshine Foundation National Board of Directors. Reneé is a business litigator resident in the Cherry Hill office of Becker Meisel, a premier mid-market firm serving the New York, New Jersey and Philadelphia corridor. The Sunshine Foundation's sole purpose is to answer the dreams of chronically ill, seriously ill, physically challenged and abused children ages three to eighteen, whose families cannot fulfill their requests due to financial strain that the child's illness may cause.

- *US News and World Report/ Best Lawyer* recognized Craig Tractenberg, leader of the franchise and distribution team at Nixon Peabody LLP, as Franchise Lawyer of the Year for New York, and recognized Nixon Peabody LLP as the Franchise Law Firm of the Year in the United States, the first award ever given in this category. Craig is a regular contributor to the *Legal Intelligencer* and a past chair of the Franchise Law subcommitees of the Philadelphia and Pennsylvania Bar Associations.

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## BUSINESS LAW SECTION: WHO ARE WE?

As the largest substantive law section in the Philadelphia Bar Association, the Business Law Section, through its many committees, promotes the objectives of the Association and the interests of business law practitioners in the fields of corporate, banking, securities, intellectual property, municipal finance, and related areas of the law.

The Section, made up of in—house, government and private practice business lawyers, sponsors numerous committees which provide important networking and continuing legal education opportunities for Section members. The Business Law Section advocates legislative changes in Harrisburg under the umbrella of the Association.

Please join The Business Law Section's LinkedIn group, formed as another way for our members to communicate with each other.

### MEMBERS:

**Chair:** Wanda E. Flowers
**Vice Chair:** Barbara Sicalides
**Treasurer:** Michael D. Ecker
**Secretary:** Shelley R. Goldner
**Executive Committee:** Curtis L. Golkow; Rachel E. Branson, Graham Laub, Anne Aaronson, Phyllis Horn Epstein, Heather Tashman Fritts, and Peter Cripps
**Immediate Past Chair:** Sandra A. Jeskie

## MISSION STATEMENT

It is the mission of the Communications Committee of the Business Law Section of the Philadelphia Bar Association to foster improved communication among its members in the furtherance of the goals of the Section. To this end, *The Insider* provides a forum for professional and open exchange among the Section membership on all issues related to its members.


## EDITORIAL POLICY

*The Business Insider* is a publication of the Business Law Section of the Philadelphia Bar Association. The purpose of the publication is to facilitate communication among the membership of the Section on topics and events of general interest to business law practitioners. The editors of *The Insider* reserve the right to accept or reject any submission and to edit any submission to ensure its suitability for publication, its adherence to the Mission Statement of the Communications Committee, and its furtherance of the objection of the Business Law Section.

**Applause, Applause...**The help and creative initiative of Becker Meisel's Marketing Associate, Stephanie Michael, has made this edition possible. Our deepest gratitude.

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