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The Historic Santa Barbara Courthouse:
The First in a 2018 Cover Photo Series

Santa Barbara County Bar Association

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Santa Barbara County Bar Association

The mission of the Santa Barbara County Bar Association is to preserve the integrity of the legal profession and respect for the law, to advance the professional growth and education of its members, to encourage civility and collegiality among its members, to promote equal access to justice and protect the independence of the legal profession and the judiciary.

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Articles

Sections

On the Cover

The Santa Barbara Courthouse, photo by Mike Lyons.

Strategic Use of Judicial Council Coordinated Proceedings Implemented in Utility-Caused Wildfire Litigation

By Jill Friedman, Attorney at Law

The Thomas Fire and Flood came on the heels of a series of fires in Northern California's wine country (the "Wine Country Fires") in October, which claimed more than 10,000 homes and killed 43 people. Litigation has already commenced in connection with the Wine Country Fires, with thousands of cases having been filed in multiple counties alleging that Pacific Gas & Electric's ("PG&E's") power lines started the fires. Several lawyers, including those with the California Fire Lawyers, took the lead in filing a Petition for Coordination with the Judicial Council. The Petition sought pre-trial coordination of all of the Wine Country Fires cases in San Francisco County's Complex Litigation Department.

For those unfamiliar with Judicial Council Coordinated Proceedings ("JCCP"), California Code of Civil Procedure sections 404 and 404.1, in concert with California Rules of Court, Rule 3.521, provide authority for management of large, complex actions. JCCPs provide a coordination trial judge the ability to manage hundreds or thousands of cases through coordinated discovery, omnibus motion practice, and uniform, pre-trial rulings applicable to all of the cases. It also provides a safeguard against the potential for inconsistent rulings and venue shopping within a case that arises out of the same incident.

> Many Myers Widders' clients, as well as one of its associates and a named partner, Erik Feingold, lost their homes due to the blaze.

For example, and *absent* coordination, lawyers on both sides may feel that one judge may be more likely to rule in favor of their positions on certain issues and may therefore seek to "push" the case forward in one county over another. Accordingly, this mass tort JCCP vehicle allows judges familiar with complex proceedings to control the pace and manage the litigation through the creative use of case management orders and other tools to steer the case towards an efficient and just resolution.

On January 4, 2018, the Honorable Curtis Karnow, one of two Complex Litigation judges in San Francisco Superior Court, ruled in favor of the Petitioners. Judge Karnow granted the Petition seeking coordination of the actions as one JCCP to be situated in San Francisco Superior Court. This was done over the strong objection of PG&E's counsel who requested that five separate JCCPs be created and overseen by five separate judges. Ultimately, Judge Karnow found that despite there being approximately 30 fires across more than five counties, "each of the fires shares, at least at the pleading stage, a common core allegation: PG&E's alleged lax maintenance and failure to prepare for a foreseeable weather event."[1] Recognizing that this common allegation would lead to common, core discovery, he also noted that the common issues,

Jill Friedman

"include PG&E's policies and practices, including those regarding (a) the electrification of lines during high wind conditions, (b) the sorts of maintenance required of vegetation and of lines and poles, (c) training practices that apply to the multiple PG&E inspectors responsible for various types of maintenance. All the fires started in the same region under the same or similar (high wind) weather conditions. There is likely to be a substantial overlap as among the PG&E witnesses and documents, as well as the experts, as among all the cases."[2]

Shortly after the Thomas Fire broke out, a few firms rushed to the Ventura courthouse to file class action lawsuits against Southern California Edison, the City and County of Ventura, and various water districts. History with other disasters in California has shown that class actions may not be the right vehicle for this type of litigation because class certification has routinely been denied. To prevail on a motion for class certification, "[t]he party advocating class treatment must demonstrate the existence of an ascertainable and sufficiently numerous class, a well-defined community of interest, and substantial benefits from certification that render proceeding as a class superior to the alternatives."[3]

While there will be a lot of talk and press about out-of-town lawyers, the reality is that wildfire litigation is a specific, niche practice in which very few firms have

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The National Task Force on Lawyer Well-Being Part One:
Creating a Movement to Improve Well-Being in the Legal Profession

By Robin Oaks, Attorney at Law

Robin Oaks

In August of 2017, the National Task Force on Lawyer Well-Being (the "National Task Force") issued a seventy-three page report entitled, "The Path to Lawyer Well-Being: Practical Recommendations for Positive Change" ("the Report").[1] The Task Force was formed by the ABA Commission on Lawyer Assistance Programs ("CoLAP"), the National Organization of Bar Counsel ("NOBC"), and the Association of Professional Responsibility Lawyers ("APRL"), together with a collection of participating entities within and outside the American Bar Association.

This article is the first installment of three on well-being in the legal profession, highlighting excerpts from the Report of the National Task Force. The Report emphasizes the premise that to be a good lawyer, one has to be a healthy lawyer. The problem is that well-being has not been an identified priority, nor considered correlated with competence or success. The National Task Force asserts, "Sadly, our profession is falling short when it comes to well-being. Recent studies conducted of lawyers reveal that too many lawyers and law students experience chronic stress and high rates of depression and substance use. These findings are incompatible with a sustainable legal profession, and they raise troubling implications for many lawyers' basic competence."

I am providing these articles as my small contribution to raise awareness, to create a local task force, and to enlist others from the legal community to take action towards a common goal that will promote well-being in the profession of which we are all a part. I have been an attorney for over thirty years, currently practicing as an attorney-investigator and conflict resolution mediator, and I have had my share of challenges maintaining health and balance responding to the ever-changing and stressful demands of working in the legal profession. Over the past two decades, in response to these challenges, I explored another path of learning that involved studying the latest scientific and ancient wisdom from health and healing experts around the world. I have become certified as a practitioner of a number of techniques that optimize cognitive functions, build resilience, and foster emotional and physical health. Many of these approaches and interventions are reflected in the recommendations set forth in the National Task Force's Report.

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In the second and third installments of this article, I will summarize the empirically-based and carefully-considered recommendations made by the National Task Force, as well as describe some additional techniques that individuals and organizations can implement towards the goal of encouraging a culture of well-being. The following summarizes the research and reasons articulated for why it is important to act now.

Recognizing the Problem: The Call for Change

The National Task Force boldly states that, as a profession, we are at a critical juncture. "The legal profession is already struggling. Our profession confronts a dwindling market share as the public turns to more accessible, affordable alternative legal service providers. We are at a crossroads." The Report cites compelling evidence that everyone has a responsibility to "act now" in order "to maintain public confidence in the profession, to meet the need for innovation in how we deliver legal services, to increase access to justice, and to reduce the level of toxicity that has allowed mental health and substance use disorders to fester among our colleagues." It continues, "[c]hange will require a wide-eyed and candid assessment of our members' state of being, accompanied by courageous

commitment to re-envisioning what it means to live the life of a lawyer."

Nowhere in my legal education was I ever warned about the inherent hazards of the trade nor counseled about how to maintain well-being or healthy work habits that would sustain my competence or success. The National Task Force asserts throughout the Report the inevitable consequences of a culture that turns a blind eye to widespread health problems or encourages suffering in silence when mental, physical, and cognitive health are impaired. That there are stressors inherent in our work as lawyers is a given, but recognizing and responding effectively to these realities is a choice.

Everyone is called upon to take a leadership role within their own spheres of influence to change the profession's mindset from passive denial of problems to proactive support for healthy change. Included in the Report are checklists for action, strategies for raising awareness and inventorying specific work climates, and ideas for each of us to implement a step at a time.

Leaders can create and support change through their own demonstrated commitment to core values and well-being in their own lives and by supporting others in doing the same. The National Task Force members note that the recommendations provided were made "after extended deliberation" and based on a review of overwhelming research to support their conclusions.

The Research: Evidence Supporting the Reason for Change

Headlines provide anecdotal evidence about lawyers and addiction, and, tragically, the high suicide rates in our profession. As I write this article today, a recent shooting is being reported involving one partner gunning down his two legal partners, and then killing himself in their prominent Long Beach law firm.[2]

In 2016, the American Bar Association Commission on Lawyer Assistance Programs and the Hazelden Betty Ford Foundation published their study that involved nearly13,000 practicing lawyers. It found that almost a third of those participating qualify as problem drinkers, and that "approximately 28 percent, 19 percent, and 23 percent are struggling with some level of depression, anxiety, and stress, respectively." Other difficulties reported include thoughts of suicide, social alienation, work addiction, sleep deprivation, job dissatisfaction, a "diversity crisis," complaints of work-life conflict, incivility, a narrowing of values so that profit predominates, and negative public perception. There was evidence that revealed surprisingly that those new to the profession, younger lawyers only in the first ten years of practice, experience the highest rates of problem drinking and depression.

Additionally, over 3,300 law students from fifteen law schools nationwide participated in the Survey of Law Student Well-Being in 2016. Well over fifteen percent claimed to have experienced some level of depression and anxiety, with six percent reporting serious suicidal thoughts in the previous year. "The results from both surveys signal an elevated risk in the legal community for mental health and substance use disorders tightly intertwined with an alcohol-based social culture." Although, on the bright side, the majority of legal professionals who participated did not appear to have significant mental health or substance use problems, overall many lawyers noted experiencing "profound ambivalence" about their work, and varying levels of dissatisfaction with practicing law.

As Dr. Martin Seligman, the psychologist known for pioneering the field of positive psychology, stated in his article, "Why Are Lawyers So Unhappy?,"[3] even though law is a prestigious and remunerative profession, "there is compelling evidence that lawyers are in remarkably poor mental health," in addition to feeling disenchanted. He cites three causes for lawyer unhappiness: 1) pessimism, 2) high job demand coupled with low decision latitude, and 3) a win – lose environment. "This produces predictable emotional consequences for the legal practitioner: he or she will be depressed, anxious and angry a lot of the time." Recent research continues to explore what factors contribute to professional satisfaction or dissatisfaction.[4]

The Report emphasizes that well-being is not limited to: 1) an absence of illness, 2) feeling happy all the time, or 3) intra-individual processes. Social science research reviewed by the Task Force suggests that five factors constitute the key elements of well-being: career, social relationships, community, health, and finances. "Well-being is a continuous process toward thriving across all life dimensions: Occupational, Intellectual, Spiritual, Physical, Social, Emotional." This multi-dimensional understanding underlies the approach applied by the National Task Force.

Many experts in the fields of psychology, change management and resilience building, mind and body healing arts, medicine, neuroscience, and nutrition, along with the National Task Force members, provide solutions to the problems identified about our profession and its potential future. With an understanding of the root causes and motivation to act, we are being offered practical recommendations for positive change, if we but take the step.

Reasons for Taking Action Now

As if the research cited is not convincing enough that

fostering "well-being" should be a stated goal of the legal profession, the Report provides three compelling reasons to take action now: 1) organizational effectiveness (*It's good for business*), 2) ethical integrity (*It's good for clients*), and 3) humanitarian concerns (*It's good for lawyers, their families, and those who work and interact with legal professionals*). The Report states, "[f]or law firms and corporations, lawyer health is an important form of human capital that can provide a competitive advantage." The costs of turnover, absenteeism, and impaired cognitive functioning are obvious factors creating a human and financial cost.

Lawyers have an ethical duty to provide competent representation, and diligence in client representation, and with persons other than clients.[5] Lawyers suffering in silence and struggling with physical, mental, emotional, and stressful conditions may have impaired executive functioning affecting competence and their own personal lives, as well as the lives of others. The Report cites research confirming that "some types of cognitive impairment persist in up to sixty percent of individuals with depression even after mood symptoms have diminished, making prevention strategies essential."

It is a fact that the legal profession heavily emphasizes "thinking, and analytic skills," and yet few of us are educated about how to maintain our most precious resources – our mind and our bodies. None of the experiences I had working in large law firms, small law firms, government positions, or as a federal court law clerk ever equated competence with whether I engaged in, learned about, or fostered healthy mental or physical habits that would help preserve my cognitive abilities, build resilience, and develop emotional intelligence. I hope that by sharing the more than forty-two empirically based recommendations provided by the National Task Force, and some techniques I have learned along the way, this information will serve others and help create a sustainable work environment.

The goal is not to point fingers at who needs help, who is unhappy, or who appears unhealthy. "Genuine efforts to enhance lawyer wellbeing must extend beyond disorder detection and treatment. Efforts aimed at remodeling institutional and organizational features that breed stress are crucial, as are those designed to cultivate lawyers' personal resources to boost resilience."

The Report reminds us that although "our profession prioritizes individualism and self-sufficiency, we all contribute to, and are affected by, the collective legal culture. Whether that culture is toxic or sustaining is up to us. Our interdependence creates a joint responsibility for solutions."

The next installment of this article will highlight the recommendations that are "for all stakeholders." The final installment will focus on the recommendations relevant to the specific stakeholder categories of judges, regulators, legal employers, law schools, bar associations, professional liability carriers, and lawyer assistance programs.

In the meantime, I invite you to explore what well-being means to you. Consider, in your own sphere of influence, where there may be a need for change that will help encourage healthy functioning and "sustainability," both individually and for the profession as a whole. The National Task Force is asking all of us to take action now. "We invite you to read this Report, which sets forth the basis for why the legal profession is at a tipping point, and we present these recommendations and action plans for building a more positive future. We call on you to take action and hear our clarion call. The time is now to use your experience, status, and leadership to construct a profession built on greater well-being, increased competence, and greater public trust." ■

Robin Oaks has been an attorney for over thirty years, and for over twenty years has focused her legal practice exclusively on conducting workplace investigations and providing conflict resolution services for public and private sector clients. She has studied a wide range of mind-body techniques and healing arts geared toward fostering health and well-being and helping professionals thrive personally and professionally. In addition to her work as a workplace investigator, mediator, well-being coach, and instructor of how to conduct investigations and prevent discrimination, she also offers work environment climate assessments, and witness preparation stress-reduction support. Contact her at: Robin@RobinOaks.com or 805-685-6773.

ENDNOTES

1 *The Path to Lawyer Well-Being: Practical Recommendations for Positive Change; The Report of the National Task Force on Lawyer Well-Being,* The American Bar Association, August 2017.

2 Eileen Zimmerman, *The Lawyer, The Addict*, New York Times, July 2015 wo17; David Ovalle & Jay Weaver, *Top Miami Civil Lawyer Ervin Gonzalez Found Dead at His Home*, Miami Herald, June 9, 2017; The Associated Press, *2 Dead – One Hurt – in Southern California Law Firm Shooting,* New York Daily News, December 29, 2017.

3 Martin E.P. Seligman, Paul R. Verkuil & Terry H. Kang, *Why Lawyers are Unhappy*, 23 CARDOZA LAW REVIEW 33 (November 2001).

4 J. M. Organ, *What Do We Know About the Satisfaction/Dissatisfaction of Lawyers? A Meta-Analysis of Research on Lawyer Satisfaction and Well-Being*, 8 U. ST. THOMAS L. J. 225 (2011); L. S. Krieger & K. M. Sheldon, *What Makes Lawyers Happy? Transcending the Anecdotes with Data from 6200 Lawyers*, 83 GEO. WASH. L. REV. 554 (2015).

5 Rule 1.1, Rule 1.3, and Rules 4.1 through 4.4 of the ABA's Model Rules of Professional Conduct.

Every Litigator Can Be a Mediator

By Molly E. Thurmond, Attorney at Law

Molly Thurmond

I can't count how many mediators have said to me, in utter frustration: "We're not here to talk about the law or facts; we're here to talk settlement." I didn't listen, and I didn't care. I was impatient to discuss the law, and could not understand why nobody was interested in my presentation of it. I also wanted to quickly get to discussing dollars. The seemingly empty chitchat drove me to distraction, and I was convinced that mediators just shuttled back and forth between rooms relaying information without thought or analysis. Mediations were unsatisfying, and I often felt as if I had wasted an entire day. But then I completed a 100-hour mediation course that radically changed my approach to litigation.

The change wasn't easy, and it happened slowly. All of my training and experience over the past thirty-five years focused on pinpointing the issues, articulating a position, and advocating it in the face of all dispute. The mediation professor recognized this immediately, and often used me as the (unwitting) example of how to sabotage a mediation session. I struggled to understand the benefit of willingly conceding any issue, or to giving up a position that was well supported by the facts and the law. I wanted to win. I insisted on advocating. If the facts and law were not favorable, I was eager to settle, but I did not want to waste time on anything other than the amount. So, when I did participate in mediation, my primary goal was to force the other side to accept my position and concede the weaknesses in theirs. I prepared for mediation in the same way I prepared for trial: State my client's position; support it with facts and law; and identify and emphasize the weaknesses in the other side's position. Mediations were rarely successful.

Eventually, however, I began to realize, and appreciate, that there is often a wide spectrum of outcomes which do not include wholesale acceptance of either side's position or forced acquiescence in demands. One side does not have to "win," and the other side does not have to "lose." And, most of the outcomes along that spectrum result in some form of "win" for all involved. Even I had to admit that this is a better outcome than even a win at trial. So the question becomes: how do you reach the better outcomes?

Although mediators rely on many theories, psychological studies, and technical terms, the strategies and techniques are not difficult. They can be used effectively by advocates, not only during mediation but throughout the litigation process. It mostly comes down to applying some simple tools to a relationship of trust and respect, even when you disagree wholeheartedly about the issues. The tools and techniques that make mediations successful can be employed throughout a case to enhance an understanding of the issues and better respond to the opponent's allegations and demands.

> Focus on interests, rather than on positions. When the focus is on interests, there is little to attack, since interests are personal to the parties. And, when the discussion centers around interests, it encourages the other side to actively listen in order to understand, rather than listening just to form a rebuttal.

First and foremost, you need to listen. I mean ***really*** listen, actively listen, to what the other side is saying. Many attorneys listen only to prepare a rebuttal, hearing those things which can be rebutted, and ignoring the rest. But, when you actively listen, you hear things that reveal important information about the other side's case. Once I learned to actively listen, I realized that I had never really listened to mediators, or heard many things that would have impacted my analysis of the case. Even though I made eye contact, and nodded my head as if I understood, I was actually busy preparing my rebuttal.

The real value of active listening became apparent about halfway through my course, during a particularly difficult mediation of a high-value case. I noticed that I was not frustrated over the process (*i.e.*, establishing trust without directly discussing the issues), but I was actually enjoying the discussions. Then, I realized the mediator was actively listening to me, and repeating my position back to me reframed in a manner that focused on my client's inter-

ests, rather than on my position. It stopped me cold, and I listened back. It was fascinating. I realized that by really listening and focusing on interests instead of positions, I was not so quick to form a rebuttal. I was forced to consider my own interests in light of the competing interests of the other side, which naturally led me to a consideration of alternatives, rather than dispute and rejection.

I came to realize, and appreciate, that when I listen carefully and focus on interests instead of positions, I am not so quick to form a rebuttal. A more open-minded evaluation of interests also exposes weaknesses that are often overlooked in the optimistic overconfidence with which many litigants prepare for trial. It reveals clues about the existence of hidden, or subconscious, motivations that might be driving the litigation. It gives rise to a larger bargaining zone, and paves the way for a resolution somewhere between "win" and "lose." So, almost without realizing it, I began to utilize the mediator's tools as an advocate during mediation. The changes were slow and small at first, but more of my cases settled during mediation, and when they didn't actually resolve, I still came away not angry or frustrated, but with a much better understanding of the other side's interests. Not only is this approach a lot more fun than the aggressive assertion of a hard-line position, the results are much more satisfying.

Then, little by little, and oh so slowly, I began to use mediation techniques and strategies to prepare a case from the very beginning. The results have been noticeable. When I evaluate a case, I consider the other side's interests, instead of preparing to attack their position. I reframe the issues to focus on my client's interests, rather than some esoteric legal position. I emphasize evidence that supports my client's interests, and I try to avoid evidence that attacks, or belittles, the other side. I examine and analyze hidden issues that might be driving the dispute or impeding resolution, and I make a real effort to look at my case from the opposing position. It feels odd. It's a leap of faith, certainly, and it goes against everything I was taught as a lawyer and all my experience with litigation, but I cannot deny that more cases settle, and the settlements more accurately reflect the true value of a case. Although I don't have enough data to know, I believe that even juries will respond positively and will prefer presentations that focus on mediation strategies and techniques.

It's not perfect, and there are times when mediation strategies are just not going to be successful, in mediation or in the courtroom. There are times when position simply outweighs interest, and when personal biases, optimistic overconfidence, and simple stubbornness will continue to drive a dispute, and impede a mutually beneficial resolution. There are times when I recognize these issues but just don't care enough to change my approach. But those times are becoming fewer and farther between. I keep trying. If nothing else, it's fun to utilize mediation techniques and strategies on the dinosaurs who continue to believe that an effective trial strategy requires an aggressive, scorched earth, take-no-prisoners presentation.

It's not easy. Mediation techniques are not natural litigation tools. But they are effective. Just try these simple strategies on your next case:

- Be prepared, and prepare by actively listening. A good start is to consider the hidden interests that may affect both sides' positions.
- Establish and maintain trustworthiness and credibility by agreeing not to play games with the other side, and live up to your promise. This also means being respectful and polite.
- Listen again.
- Focus on interests, rather than on positions. When the focus is on interests, there is little to attack, since interests are personal to the parties. And, when the discussion centers around interests, it encourages the other side to actively listen in order to understand, rather than listening just to form a rebuttal.
- Keep listening.
- Show that you are reasonable.
- Be firm, but don't humiliate or intimidate.
- Continue listening.
- Make eye contact. You cannot consider problems and interests by looking away.
- Present your case in human terms, not just legal ones. It leads to a more open-minded, patient, conciliatory approach, which in turn leads to consideration of the problem rather than the person causing the problem.
- Validate some aspect of the other side's presentation.
- Listen!

Try these. They work. ■

Molly E. Thurmond recently retired as a partner in Hall, Hieatt & Connely, but continues to serve as of counsel to the firm. She specializes in the defense of public entities and employment litigation, and wishes she had gotten her mediation credentials many years ago.

Welcome to the

PHILANTHROPY CORNER

By Jenn Duffy, Editor

Featuring Local Non-Profit Organizations

This month's featured organizations are

The Junior League of Santa Barbara (JLSB), and Women's Economic Ventures (WEV).

Both organizations focus on women. You can learn more about them on the next two pages. JLSB's Signature Project is to open the first therapeutic residential shelter in Santa Barbara for victims of sex trafficking. For over 25 years, WEV has worked diligently to create an equitable and just society through the economic empowerment of women.

Junior League of Santa Barbara, Inc.

WEV WOMEN'S ECONOMIC VENTURES

Law Firm Making a Difference

NordstrandBlack PC is hosting a **Socks and Toiletries Drive** for **Transition House**. The drive runs through March 15, 2018. For more information: https://www.nordstrandlaw.com/blog/law-firm-news/nordstrandblack-pcs-socks-toiletries-drive/

Local Attorney Helps to Create Support Network for Mudslide Victims

Attorney **Tara Haaland-Ford**, along with other local residents, has spearheaded the **Santa Barbara Support Network** for mudslide victims. Its mission "is to support the immediate needs of families impacted by the recent mudslides who have lost: *homes *loved ones *belongings" by making a direct connection between families in need and families who can support those needs. At press time, there are 30 families being helped through this network. To add a family to the list, provide direct support for a family, or for more information: http://www.signupgenius.com/go/60b0e4daeac22a5f58-must

Thank you to our community and first responders!

Our community has suffered extreme devastation over the past two months, bringing all of us to our knees. The loss of loved ones, homes, and belongings seems too great to bear, while our local businesses continue to suffer significantly in the wake of evacuations. The *Santa Barbara Lawyer* Magazine offers its heartfelt condolences to our members who have been impacted by this unprecedented tragedy, and we say thank you to those who have stood up to assist. As Mr. Rogers's said, "Look for the helpers." We have unending gratitude to those helpers; the first responders, community leaders, neighbors, friends, and members of the community who have reached out with open arms and hearts to provide for others. #805Strong.

If you have volunteer opportunities you would like to have listed in the Philanthropy Corner, please contact Jenn Duffy at (805) 963-0755 or JDuffy@fmam.com.

THE JUNIOR LEAGUE OF SANTA BARBARA

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OUR MISSION

The Junior League of Santa Barbara, Inc (JLSB) is an organization of women committed to promoting voluntarism, developing the potential of women, and improving the community through the effective action and leadership of trained volunteers. Its purpose is exclusively educational and charitable.

OUR MEMBERSHIP

480 Total Members

50 Provisional Members

115 Active Members

315 Sustaining Members

OUR FOCUS AREA

Improving the lives of **at-risk young women** by educating & empowering them to reach their full potential while working to **prevent exploitation and injustice** in our community.

@JlSantaBarbara

OUR SIGNATURE PROJECT

S.A.F.E. House Santa Barbara

The JLSB will aim to facilitate the opening of a **6-bed, residential shelter** in Santa Barbara County for girls who have been **victims of sexual exploitation and sex trafficking**.

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Changing the Face of Business

WEV provides a continuum of comprehensive services – training, loans, and consulting – to help women entrepreneurs start and grow thriving businesses.

WEV Services

More than 800 women and men walk through WEV's doors each year in Santa Barbara and Ventura Counties to learn more about entrepreneurship, and over 350 receive significant services in the following programs:

Explore

A 4-week program that helps prospective entrepreneurs assess their readiness to start a business.

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A 14-week course to help early stage entrepreneurs learn sound business practices and write a business plan.

Thrive

A long-term consulting and coaching program that helps established businesses stabilize and grow.

WEV en Español

SET and Thrive are available in Spanish to help those more comfortable learning in their native language.

WEV Loans

Provides startup and expansion capital of up to $100,000 to small businesses that can't qualify for traditional bank financing.

Volunteer Opportunities

You can help WEV achieve our mission of creating an equitable and just society through the economic empowerment of women in the following ways:

Guest Speakers and Consultants
Share your business or professional expertise as a speaker or consultant in our classroom or working one-on-one with clients.

Community Advisory Committees and Board of Directors
Help ensure WEV's long-term sustainability by participating on a Community Advisory Committee or joining the Board of Directors to help map long-term strategy.

Go to http://www.wevonline.org/support-wev/guest-speaker/ for more information and to complete a volunteer form.

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Locally owned businesses make our communities unique and contribute more to the economic vitality of our region by circulating a greater share of their revenues locally than national chains. Local businesses have experienced devastating financial losses due to the Thomas Fire and need your patronage more than ever.

There are many local options for:

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- Personal services
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- And much more...

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- Diane de Mailly
DDM Metering Systems

Through the Thrive program, WEV partnered with me to ensure I had strong financial literacy, effective and authentic leadership skills, and a network of support that wanted to see me succeed.

- Claudia Cordova Papa,
Aqua Skin & Nail Care

Who would've thought a $15,000 loan from WEV would result in a company with 8 employees that's helped raise over $750,000 for local schools and non-profits?

- Karim Kaderali,
Santa Barbara Axxess

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The Jury and Forensic Evidence—Part II: Jurors and the Folk Heuristic

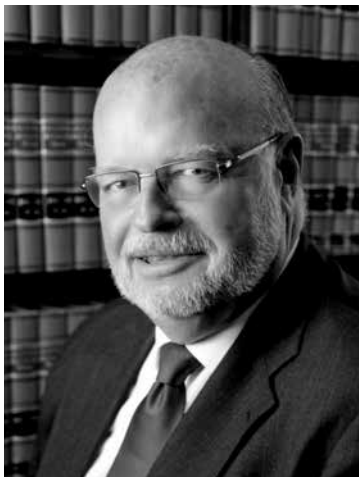
By Robert Sanger[1]

In this month's *Criminal Justice* column, Part II of *The Jury and Forensic Evidence*, we will look at the effort to numerically quantify forensic evidence and how it is or is not compatible with the jury's heuristic, "folk Bayesian analysis." In last month's column, we discussed the ideal concept of how jurors decide cases and the efforts to determine how they actually decide cases. Ultimately, we focused on how jurors decide cases *on a good day* in an effort to determine the best practices in presenting forensic evidence to the jury.

We will start with a discussion of numerical-quantification efforts in forensic science. These efforts have had two primary sources, the advent of Random Match Probabilities in ABO (blood type) testing and then DNA comparisons in the 1980s. We will then discuss the current efforts in Europe, particularly the Netherlands, to quantify forensic opinions using a Bayesian analysis where DNA may or may not be a component. We will observe the differences between the Anglo American criminal court system and that of the European courts and, finally, we will determine whether or not quantification is appropriate at all in light of the American jury's "folk Bayesian analysis."

DNA and the Quantification of Forensic Opinions

Numerical quantification of expert testimony became popular in paternity cases using ABO blood-typing. When DNA analysis developed, the numerical conclusions became, at times, astronomical and seemed to be conclusive. Of course, issues arose with regard to what the conclusions meant. Paternity testing, usually involving clinically-obtained samples, was much different than comparing collected evidence to a data base. The "prosecutor's fallacy" became all the more significant, that is, whereby the witness for the prosecution opined that the numerical probability of a random match of the evidence profile being contributed by someone not the defendant was the same as saying that the defendant was likely guilty by that same numerical probability. In addition to this fallacy, the numerical quantification, even if stated correctly, was based on a variety of assumptions that may or may not have been true in the particular case.



Robert Sanger

For instance, the random match probability was dependent on the assumption that the data base to which the evidence was compared accurately reflected the population that may have been in the area at the time. Consanguinity, ethnicity, and other factors could have a significant effect. In addition, the numerical quantification was based on the assumption that the sample was not contaminated, including by trace evidence of the subject's own sample being held in the same lab. It did not take into account subjective interpretation, such as allelic drop in or drop out, or the many problems associated with interpreting a mixed sample. It also did not take into account cognitive bias, dry-labbing, or planting of evidence. Finally, it did not take into account the possibility that DNA was found at the scene even though it had no bearing on whether the defendant committed the crime.

Consider the case of Lukis Anderson, a homeless man arrested for a home invasion murder of a millionaire at his residence in Silicon Valley. Anderson's DNA was found in the fingernail scrapings of the decedent. However, Anderson was in the Santa Clara Valley Medical Center on the night of the homicide where he had been taken by ambulance after passing out drunk in downtown San Jose. But that was not enough for prosecutors, who were convinced that DNA evidence was dispositive. It turned out that the paramedics who tried to revive the millionaire had earlier transported Anderson and used the same oxygen-monitoring probe on the fingers of both subjects.[2] In other words, the likelihood that someone other than Anderson was the source of the DNA was astronomical, however, Anderson being the source of the DNA had nothing to do with his guilt.

In essence, numerical quantification, even of something so apparently scientific as DNA, has to be put in the context of all of the evidence. One way to do that, at least on a simplistic level, is to use a Bayesian analysis, the "folk" version of which we claim jurors use on a good day. In a true Bayesian analysis, each individual piece of evidence can only account for a likelihood ratio relating to the strictly-accounted-for variables in that analysis. The primary inquiry in Anderson's

case, the DNA, can only give a probability based on one variable (*e.g.*, that given the allelic profile, the defendant or some random person was the source of the DNA). As demonstrated by the Anderson case, to be relevant to guilt, that DNA probability can only be considered as a part of the rest of the evidence in the case. To do a simplistic multi-factor analysis, Bayes Theorem is used to compute the effect of the other identifiable pieces of evidence called the "prior probabilities." That is, Bayes Theorem calculates the probabilities of each other piece of evidence in the case and relates those prior probabilities to the main single factor analysis (the likelihood that Anderson or someone other than Anderson was the source of the DNA). The result gives a numerical posterior probability that Anderson was the killer in the violent home invasion robbery.

Of course, that is problematic because, in Anderson's case, how do you properly numerically quantify the probability that the astronomical odds relating to the DNA comparison is totally irrelevant in determining who killed the millionaire because the DNA was transferred by the paramedic crew? There is no way to mathematically account for the probabilities associated with all possible evidence. And, as to some possibilities, like the unexplained transfer of DNA in Anderson, or unexplained contamination of a sample, actual dry-labbing or planting of evidence, the mathematical conclusion is that – if these conditions exist – the numerical value of the DNA random-match probability has nothing to do with the posterior probability of guilt.

Moreover, in the simplistic version of Bayesian analysis, prior probabilities, even if they are (or may be) relevant, are either dependent or independent. If they are independent, they are multiplied, and if they are dependent, they are added. Of course, this does not reflect reality. The California Supreme Court considered the significance of this and other failings of Bayes Theorem in the *Collins*[3] case in 1968. In argument, the prosecutor assigned odds of someone else possessing the following characteristics of the defendant, his car and his companion:

A. Partly yellow automobile 1/10
B. Man with mustache 1/4
C. Girl with ponytail 1/10
D. Girl with blond hair 1/3
E. African-American man with beard 1/10
F. Interracial couple in car 1/1000

The prosecutor then multiplied them as independent variables coming up with an astronomical likelihood that the defendant was the perpetrator.[4] The Court rejected the purported Bayesian analysis.

Scientists would not use Bayesian analysis to interpret a complex situation. When they do use something of the sort, it would be a Bayesian Network or probabilistic-directed acyclic graphical model. In essence, this acknowledges that any posterior probability is based on the interrelationship of almost infinite nodes that may or may not be conditionally variable with some, none, or all of the other nodes. These probability functions are mapped graphically. To do computations that have some scientific significance requires sophisticated software, intense data input, a lot of assumptions, and a high-powered computer. More importantly, at its best, such a program is ill suited to making guesses as to past events and is better suited to a process of repeated adjustments as to present events in order to make another guess at an unknown but verifiable-present event. In other words, a Bayesian network is best suited to, say, determining the unknown location of a body in space after it is calibrated to locate a known body in space and then recalibrated to find the unknown body.

Quantification in Europe and the Netherlands

Nevertheless, for all the potential failings, the idea of Bayesian analysis is trying to make a comeback. This is particularly true in Europe.[5] There, individual experts are called to numerically quantify the likelihood of phenomena as prior probabilities and then an overall Bayesian expert is called to relate the individual prior probabilities and compute a posterior likelihood ratio for "all of the evidence." An example was given at a National Institute of Standards and Technology Technical Colloquium in May of 2015 in Gaithersburg, Maryland by Marjan Sjerps, a professor and member of the Netherlands Forensics Institute.[6] Dr. Sjerps presented an actual case in which she had testified as an expert in the Netherlands regarding tire marks which were found in the grass in front of a crime scene. A suspect was detained not far from the scene in a Peugeot automobile with two different make tires on one side of the vehicle. Dr. Sjerps used a data base comprised of the wheelbase lengths of all cars known to be in the Netherlands and a further data base of the brands of tires that she observed in a local IKEA parking lot as well as a data set of tires observed in 40 other parking lots in the Netherlands. The expert's conclusions were that a certain model Peugeot (the same as the suspect car) roughly corresponds to the wheelbase of the car that left the marks in the grass and the tire marks are consistent with the tires found on the suspect car.[7] Her conclusion was that it was between 1 and 50,000 and 1 and 5,000 times more likely that the suspect's car left the marks than that they were made by any other random Dutch car.

This was a fairly crude form of Bayseian analysis. It did not take into account other issues relating to guilt or innocence. The data base (counting tires in an IKEA park-

ing lot) was also suspect.[8] Nevertheless, this analysis was presented to the court in the actual prosecution of the driver of the Peugeot. One big difference between Dutch practice and that of the United States is that the audience for this presentation in court was a panel of three judges who are appointed for life, not a lay jury. Theoretically, professional judges would be able to learn from case to case, or through formal education, about Bayesian analysis and its limitations. They also could be more able to process numerically-quantified data as a part of an overall determination of guilt or innocence without being unduly influenced by the expert opinion. But that is not the case with lay juries who are called in randomly to hear a single case in the United States.

The Inter-relationship between Quantification and the Jury's "Folk Bayesian Analysis"

As discussed in last month's *Criminal Justice* column, the jury, on a good day, does a non-numerical "folk Bayesian analysis." Jurors are not given procedural guidelines except to choose a foreperson and not decide by lot. Left on their own on a bad day, they can, and do, decide based on bias, prejudice, or even caprice. The jury is a complex adaptive system, meaning that it is something whose growth and development emerges over the time of its existence in a non-linear fashion. That a jury would decide a case in anything close to a rational Bayesian or Bayesian network fashion is a reductionist interpretation.[9] Such a process would also be beyond the capability of an actual jury even on their best day. The point made last month is that, if the jury is following a "folk Bayesian analysis," one thing of which we can be fairly certain is that it is not a strict mathematical calculation of prior probabilities and their products resulting in a posterior-likelihood ratio which is then mathematically compared to a numerically-quantified standard of proof.

If that is the case, then we must ask how jurors are expected to integrate mathematically-quantified opinions of experts into the non-numerical folk Bayesian analysis, which is what is going on in the jury deliberation room on a good day. This is not a superficial question of whether the expert's opinion is given too much (or too little) weight because the witness is an "expert" or because the opinion is too opaque, whether numerically quantified or not. This is the more fundamental question of how -- in this emergent jury deliberation system that uses a non-quantified folk Bayesian analysis – jurors can integrate quantified data about part of the evidence into the holistic non-numerically quantified decision-making process.

Put another way, we are trying to put a square peg in a round hole. When an expert numerically quantifies her opinion, she presents the jury with numbers. The jury is otherwise analyzing the evidence in the case in a non-numerical fashion. On a good day, we want to think that jurors are weighing the rest of the evidence in a metaphorical fashion, not with numbers but in this folk Bayesian analysis whereby they intuitively attempt to decide how "strong" or "weak" the case is or how much metaphorical "weight" to give it. This is a quantification, but it is a non-numerical one.

From this non-numerical quantification, jurors, on a good day, compare the strength or weakness (or weight) of the evidence as a whole to a metaphorical scale of proof. They are instructed that they must determine if the evidence convinces them by a preponderance, by clear and convincing evidence, or beyond a reasonable doubt. The scale is not numerical with the possible exception of a "preponderance," which could be construed as anything over 50%. Yet, that is not actually numerical because there is no corresponding numerical-quantification-of-evidence strength or "weight" such that it can be compared to the purported 50% scale. Of course, proof by clear and convincing and proof beyond a reasonable doubt are assigned no numerical point on a scale at all.

Whatever the standard of proof, we cannot expect a rational jury to devise a method to convert their intuitive evaluation of the strength or weight of each aspect of the evidence into numbers, let alone how to compute the effect of each variable on the others. In other words, we cannot expect them to convert their overall "folk Bayesian analysis" into numbers. To do this would require ascribing numerical Bayesian-likelihood ratios to prior probabilities, multiplying or adding those probabilities, and then deriving a numerical posterior-probability ratio. In fact, if a jury did that, we would consider it to be misconduct (using a mathematical process not presented in evidence and probably imposed on eleven jurors by the one juror who was a statistician and who brought her computer with her into the jury room).[10]

Conclusion

There are different ways to try to approach this problem. Europe, of course, has professional judges who can be trained to understand the relationship of numerical to non-numerical analyses. Whether that is effective or not is still a question. Nevertheless, it is not an option in the United States where the jury system involving lay *ad hoc* jurors is apparently here to stay. It would be impossible, and really counter to the folk theory of juries, to try to educate jurors in statistics to the extent that they could consciously do a numerically-quantified Bayesian analysis, and it would be impossible to prepare them to do a complex computer-

driven Bayesian Network analysis. Even if there were some way for juries to numerically quantify the evidence, how could that be translated into a numerical scale for, say, proof beyond a reasonable doubt?

Another way to approach this problem is simply to preclude all numerical quantification from expert testimony. This sounds radical but, as long as we choose to have a jury system, this seems to be the logical consequence of that choice. Experts can still testify to a verbal, but non-numerical, quantification. After all, jurors, on a good day, weigh the evidence in a non-numerical fashion. Experts could opine that it is highly probable, probable, somewhat probable, unlikely, or not possible. This is a quantification in verbal disguise. However, so is proof beyond a reasonable doubt, and so is the argument that evidence has "strength" or "weight." Essentially, verbal quantification in an expert opinion is a folk Bayesian contribution to the jury's overall folk Bayesian analysis.

I suppose the lesson is that we choose to have juries. As Jerome Frank said, "It is extremely doubtful that, if we did not now have the jury system, we could today be persuaded to adopt it."[11] However, if the jury system continues as adopted, we must be realistic about what jurors can actually do. It seems a lot less scientific to withhold numbers in this "scientific" age, but numerical quantification is not logically consistent with the actual folk Bayesian analysis we expect from actual jurors on a good day. The best practice then is to ban numerical quantification entirely. ■

Endnotes

1 This essay is part of a larger project which is intended to be published in law review form later this year. A portion of this article will also be the subject of a presentation to the American Academy of Forensic Sciences in Seattle, February 2018. ©Robert M. Sanger.

2 *See*, Tracy Kaplan, *Monte Sereno Murder Case Casts Doubt on DNA*, San Jose Mercury News, June 28, 2014.

3 *People v. Collins,* 68 Cal. 2d 319 (1968), opinion of Justice Sullivan.

4 The prosecutor "graciously" offered that the jury could accept a lesser posterior probability. Aside from having racist overtones, it turns out that the testimony did not support the prosecutor's argument at all, and he appeared to have made up the odds and presented them in a chart of his own making at closing. Nevertheless, the court addressed some of the failings of simplistic Bayesian analysis, including whether the listed factors were dependent or independent.

5 Yvonne McDermott and Colin Aitken, *Analysis of Evidence in International Criminal TrialsUusing Bayesian Belief Networks*, 16 Law, Probability and Risk, 111-129 (September 2017); *See also*, Arthur Dyevre, Wessel Wijtvliet, Nicolas Lampach, *The Future of European Legal Scholarship: Empirical Jurisprudence*, SSRN Electronic Journal (October 2017), DOI10.2139/ssrn.3050486; Henry Prakken, *Argument Schemes for Discussing Bayesian Modellings of Complex Criminal Cases*, in A. Wyner and G. Casini (Eds.), Legal Knowledge and Information Systems 69, IOS Press (2017).

6 Her presentation can be seen on video at: https://www.nist.gov/news-events/events/2016/05/ibpc-technical-colloquium-quantifying-weight-forensic-evidence.

7 Note that Dr. Sjerps relied on a tire-mark expert to make a comparison of the tire marks to know tires. She took his information as a part of her Bayesian analysis.

8 Suffice it to say that this presentation was the subject of considerable criticism during the remainder of the Technical Colloquium.

9 This is why we settled in last month's column on what a jury would do "on a good day." *See, e.g.*, Nelson Fernandez, Carlos Maldonado, Carlos Gershenson*, Information Measures of Complexity, Emergence, Self-Organization, Homeostasis, and Autopoiesis*, in Guided Self-Organization: Inception (9 Emergence, Complexity and Computation) 19-51 (2013): "[R]eductionism—the most popular approach in science—is not appropriate for studying complex systems, as it attempts to simplify and separate in order to predict. Novel information generated by interactions limits prediction, as it is not included in initial or boundary conditions. It implies computational irreducibility, *i.e*. one has to reach a certain state before knowing it will be reached. In other words, *a priori* assumptions are of limited use, since the precise future of complex systems is known only *a posteriori*." *Id*. at 20 (internal citations omitted).

10 Since Bayesian analysis breaks down in real-life situations, a statistician would probably tell the fellow jurors that they must use a Bayesian Network, which would require a more sophisticated software program, a more powerful computer, and more data than could be presented during a trial.

11 Jerome Frank, Courts on Trial, (Princeton University Press, 1949) at 139. Frank's ideal formula is R x F=D, that is Rules times Facts equals Decision. *Id.* at 110.

Friedman, *continued from page 6*

experience. It requires a combination of specific expertise, national and local presence, and commitment to the community.

Many clients and members of the legal community have lost their homes due to the fire, including one of its associates and a named partner, Erik Feingold.

"I lost my own home in the Thomas Fire. My family and friends are personally aware of the devastation that our community is feeling," said Erik Feingold, Immediate Past President of the Ventura County Bar Association. ■

Jill Friedman is a partner with Myers, Widders, Gibson, Jones & Feingold, LLP, which has joined forces with California Fire Lawyers to provide legal representation and help for victims of the Thomas Fire and Flood. Jill was the Editor of SB Lawyer Magazine in 1994 and 1995 when it was known as "The Quibbler."

ENDNOTES

1 Coordination Order, p.5.
2 Coordination Order, p.4.
3 *Sav-On Drug Stores, Inc. v. Superior Court* (2000) 34 Cal.4th 319, 326.

Have you renewed your membership in the Santa Barbara County Bar Association?

If not, this will be your last issue of the *Santa Barbara Lawyer*!

See page 30 for the 2018 SBCBA Renewal Application

The *Estate of Giustina*: The Ninth Circuit Obliterates the 35% Barrier on the Minority Share Discount for Lack of Marketability

By James Lisi, CVA, MBA

Some commentators have expressed confusion over how to apply the *Estate of Giustina* decision which advanced to conclusion from 2011 to 2016[1]. Others declare it a confirmation of Revenue Ruling 59-60 and the valuator's role in selecting between valuation approaches. Still others call it irrelevant, seen as a unique decision for a specific set of facts and a windfall for the taxpayer. However, none of these positions address the core issue. The case strikes right to the heart of discounts on minority interests, not to discrepancies in economic models and experts' selection of valuation approaches.

The valuation subject is a minority interest in a company with great assets, but little earnings. It is not uncommon. Car dealerships, retail stores, construction companies, and asset holding companies all often fit this rubric. What these analysts have missed is that the Ninth Circuit decision indicates that fair value for a minority interest is highly dependent on its distributions and return on investment. Why else buy it? When you stand back and look at the result, an 86% discount for lack of marketability (DLOM) is evident in the facts of the case.

Background

The Giustina family business began as a construction company created for the rebuild of San Francisco after the 1906 earthquake. Later, the company moved to Oregon, bought a lumber mill, and began acquiring timberland and additional mills in the Eugene, Oregon vicinity. The Giustina family eventually sold all of its mills, and the timberland was the foundation for a profitable tree-farming operation, harvesting and selling logs. In 1990, the family's business holdings were split into three new partnerships, each of which was owned by a separate set of Giustina family members. One of the partnerships was the Giustina Land & Timber Company Limited Partnership ("GLTC"), in which Natale Giustina held a 41% interest.

Natale Giustina died on August 13, 2005. At the time, GLTC employed 12 to 15 people, and owned approximately 48,000 acres of timberland outside of Eugene, Oregon. The valuation issue had to address a highly asset-intensive business that could be liquidated for more money than it was worth as an investment.

James A. Lisi

The Estate and Commissioner were in agreement on the value of the underlying assets. The value of the 48,000 acres of timberland was approximately $238,000,000. This value was discounted 40% for the 'delays attendant in selling' the interest to $143,000,000. An additional $8 million of current and fixed assets were ascribed to the operating business, yielding a total asset value of approximately $151,000,000. The premise of this value was essentially liquidation value, as no Goodwill was ascribed to the business portion.

Since GLTC was a profitable going-concern business and had no expectation of being sold or liquidated, the Estate argued that GLTC's value was limited by its earnings capability, even though liquidation of the company would be considered the highest and best economic use of the assets. The Estate determined value using a capitalization of Cash Flows ("CCF"), which is an income approach that values based upon earnings. The adjusted CCF value proposed by the Tax Court for the business was $52 million. The premise of value for the CCF was going-concern value, as the $44 million premium above the $8 million in business assets represents the intangible value of Goodwill in the business.

Before appeal to the Ninth Circuit Court, the Tax Court wrestled with multiple issues regarding entity value, discounts, and how they apply. Analysts have reviewed the path to the Tax Court's valuation through manipulations of economic models for control, liquidity, marketability, and risk premiums on assets versus earnings, but these models do not wrestle with value in respect to what buyers might pay for it. Explaining an opinion by adjusting variables in an excel spreadsheet does not make the result fair nor tie it to the subject or factual data. The main issue is that the high control interest value was unfair to the minority interest, and under the established mindset that marketability discounts somehow have a limit of 35%, a solution was infeasible.

On appeal, the Ninth Circuit Court reviewed the case. At a loss to reconcile the testimony from two experts, the Ninth Circuit applied its own perspective on value to find a fair answer. We interpret this outcome so that it may be applied for future valuations.

Valuation problem

In the *Giustina* outcome, we have 'ignored data' and deeply ingrained valuation community assumptions. The large spread between liquidation value and going-concern value has to do with the land and its crop, which are both non-operating assets. This case demonstrates the weakness of financial models where a key variable has been ignored, specifically, here, how non-operating assets affect value-versus-operating assets. In the valuation profession, the distinction is often lost in the trend toward economic modeling because the source data usually does not distinguish performance on this variable.

Starting with the control value – the value of the entire entity, we use the operating business valuation result, and recognize two non-operating assets; the timber crop as inventory, and the land as real estate. Note that neither valuation included all value components. Both experts were inaccurate. The Asset Approach ignored the Goodwill of the operating business, while the Income Approach ignored the value of the non-operating assets. The Court, not being a valuation expert, had no way to discern the errors. Both valuations were proposed to represent the control interest, the value before discounts apply to minority interests. The control interest, however, should have been represented as the highest total value, that of both the going-concern operating business and the non-operating assets of its timber inventory and real estate.

Proper Control Interest Baseline

Let's reconstruct the control interest value. This reflects the full value of the assets. We use round numbers, as the point here is to explain principles. The Tax Court found the following value for the operating business:

Capitalized Cash Flow 000s	
Normalized Cash Flow	6,334
Capitalization Rate	12.25%
Equity Value	52,000

Here is the side-by-side comparison of positions. We value the timber crop at $2,000 per acre, leaving the remaining cost for land value. We will use these data points later.

Comparison of Expert's Control Values 000s		
Asset	IRS	Estate
	Liquidation Asset Approach	CCF Income Approach
Operating Business Assets*	8,000	8,000
Goodwill		44,000
Timber Crop	96,000	
Land	142,000	
Liquidity Discount	(95,000)	-
Control Value	151,000	52,000

*Operating Assets, Working Capital & Debt

Now, once we define the real estate as a non-operating asset, we need to identify the effect of removing it from the business operations. In this case, we adjust the business cash flow for the economic rent that would be paid for the land. We use a 1% rent rate, the U.S. national average for cash rents in farming. This changes the cash flows and CCF value as follows:

Capitalized Cash Flow 000s	
Original Cash Flow	6,334
Rent Adjustment	(1,420)
Normalized Cash Flow	4,914
Capitalization Rate	12.25%
Equity Value	40,000

Combining the three analyses, we get the following for the actual control value of the business. This represents the going-concern operating business, and the non-operating assets related to the timberland.

GLTC Control Value 000s	
Operating Business Assets*	8,000
Goodwill	32,000
Timber Crop	96,000
Land	142,000
Total Asset Value	278,000
Liquidity Discount	(95,000)
Control Value	183,000

*Operating Assets, Working Capital & Debt

One other balance sheet item affects the value, and was overlooked by both experts. This is the effect of contingent liabilities. In the timberland, we have highly appreciated assets which have a built-in capital gain tax liability. If the timberland were to be sold, capital gain tax would be due on the appreciation. For simplicity once again, we calculate the approximate tax due on the land value, assuming 10x appreciation from book value, as $50 million. We then identify the Net Asset Value of the business before any discounts are applied for the next steps. This gives us the following Net Asset Value, which is equivalent to Equity:

GLTC Net Asset Value 000s	
Operating Business Assets*	8,000
Goodwill	32,000
Timber Crop	96,000
Land	142,000
Built-in Gain Liability	(30,000)
Net Asset Value	248,000
Liquidity Discount	(95,000)
Control Value	153,000

*Operating Assets, Working Capital & Debt

The Ninth Circuit Review

On appeal from Tax Court, the Ninth Circuit Court excluded the consideration of the asset approach, the highest value presented, and remanded for determination of the minority interest value based only upon the going-concern value. The court essentially declared that the minority interest is only valued based upon its ability to produce economic results that flow to the holder of the interest. Asset value is excluded because the minority interest has no path to unlock the larger liquidation value.

Key Point

When the Ninth Circuit excludes the use of the liquidation value as consideration of finding the minority interest value, it is NOT indicating that the control interest would be appraised in the same manner. The Ninth Circuit principally states that no hypothetical buyer would purchase the minority-based interest upon the asset liquidation value if they had no realistic opportunity to benefit from liquidation of the company.

So, how do we resolve the high Net Asset Value to the minority interest value found in the 2016 conclusion? A Discount for Lack of Marketability ("DLOM"). The value impairment for lack of control, illiquidity, and marketability is all DLOM deducted from the control position.

Valuation of the Minority Interest

In reality, a liquid market for minority interests in closely-held business as conceived by the Fair Market Value standard does not exist. It is a variety of situations from no market at all, to one that may attract other shareholders, or develop into secondary trading markets if the prospects for appreciation in value and recapture of the investment basis are attractive. DLOM is the idea that value impairment exists for control, liquidity or marketability versus a similar security with established liquidity, control, and 'market-rate' economic features. In this regard, evaluation is both a comparative and theoretical exercise between the control interest and the minority interest because we have no similar transactions to compare.

Factors Affecting the GLTC Discount

Giustina's 41% interest requires a discount from control interest to a minority interest because inherently the minority interest is not saleable at the pro-rata control price. This is what the Ninth Circuit Court identified, without being presented a framework with which to express the disconnect. The Ninth Circuit reasoned that the Tax Court could not consider the control value because the minority interest had no path to liquidate the entity. They said:

In order for liquidation to occur, we must assume that (1) a hypothetical buyer would somehow obtain admission as a limited partner from the general partners, who have repeatedly emphasized the importance that they place upon continued operation of the Partnership; (2) the buyer would then turn around and seek dissolution of the partnership or removal of the general partners who just approved his admission to the partnership; and (3) the buyer would manage to convince at least two (or possibly more) other limited partners to go along, despite the fact that no limited partner ever asked or ever discussed the sale of an interest.

The Ninth Circuit discussed this error further:

Alternatively, we must assume that the existing limited partners, or their heirs or assigns, owning two-thirds of the partnership, would seek dissolution. We conclude that it was clear error to assign a 25 percent likelihood to these hypothetical events. As in Estate of Simplot v. Commissioner, 249 F.3d 1191, 1195 (9th Cir. 2001), the Tax Court engaged in "imaginary scenarios as to who a purchaser might be, how long the purchaser would be willing to wait without any return on his investment, and what combinations the purchaser might be able to effect" with the existing partners. See also Olson v. United States, 292 U.S. 246, 257 (1934). We therefore remand to the Tax Court to recalculate the value of the Estate based on the partnership's value as a going concern.

This is hugely important – and correct. The security is illiquid, has no control over liquidation, and has a relatively low cash return. The Tax Court applies improbable scenarios, which by legal precedent and generally-accepted accounting principles, should be excluded in any determination of value. The Ninth Circuit corrects the Tax Court to the Fair Market Value ("FMV") standard, where value is based upon what the minority interest would sell for in an impartial market.

Vocational Blindness

Unfortunately, the IRS and Estate experts in the case were applying *valuation approaches* where *discount analysis* was required. Being stuck on a theory of "standard marketability discounts" of 25% to 35% left them blind to the solution. Instead, they argued over the control-interest value as opposed to looking at what a willing buyer might offer for the 41% interest. Only one control interest value applies. Disregarding the liquidation value would not have been possible if the interest had been 51% instead of 41%. This setting - where the entire case was argued around the wrong aspects of the valuation problem - did not offer relevant material for the Ninth Circuit to find a solution other than the one proffered - excluding the asset-liquidation value.

On top of using the wrong valuation objective, the Tax Court added to the folly by basing its conclusion upon investment value (investor specific) and not fair market value. How the Tax Court can make this error is a little frightening. The Tax Court took it upon itself to make assumptions regarding the minority interest's ability to force liquidation and to diversify the Partnership's asset holdings. How many cases throughout the IRS purview are challenged based upon poor fundamentals like these?

In the end, the proceedings arrived at a minority interest value of approximately $13,955,000.

Expectations for DLOM Shattered

What does this really mean for future valuations? It means that the Tax Court should respect DLOM's much greater than 35% when the facts dictate. In some ways, this is a "Back to the Future" case, where *Mandelbaum v. Commissioner* stood in 1995 to correct the valuation community for mindlessly applying average DLOM of 25% to 35%, the practice of which we can see is alive and well again.

Here is the true DLOM representing both the operating business and its timberland.

Marketability Discount 000s	
Net Asset Value (NAV)	248,000
41% Interest of NAV	101,680
Final 41% Interest Value	13,955
DLOM	**86.3%**

Because the subject interest had no power to implement the Tax Court's assumptions, the Ninth Circuit found an expedient solution. On remand, the Tax Court found a DLOM, close to 90%, resoundingly breaking the implicit 35% barrier that the valuation community proffers as its threshold for IRS challenge.

This is not a unique case, nor a taxpayer windfall. Although awkward in its execution, it demonstrates that facts may allow for substantial discounts to value. Estates should not be intimidated into over-paying taxes by conforming to IRS expectations for DLOM. As *Mandelbaum* set out in 1995, the Ninth Circuit has intuitively restated that average discounts unrelated to the subject by the valuation expert are irrelevant – "Present your case!" ■

James A. Lisi is Managing Director for Central Coast California at The Mentor Group Inc., and owner of Santa Barbara Valuations Inc. He has over fifteen years of valuation experience and twenty years in executive and strategic positions at Fortune 100, Private Equity, and his own personally held businesses, and extensive operating experience in manufacturing, distribution, rental, and youth services.

Jim's valuations focus on closely-held companies, asset holding entities, and start-up growth companies. He has worked with clients in technology, internet, aerospace, industrial distribution, consumer goods and services, franchises, food and beverage, and financial services. Jim brings the structured approach of engineering analysis together with the proper application of finance and market principles in his valuations. His reports have been used in support of business sales, ESOP, IRA distributions, 409a, estate and gift matters, founder exit negotiations and uncertainty discounts. The IRS has accepted all his reports to date.

Jim is a member of the National Association of Certified Valuators and Analysts (NACVA), holding the Certified Valuation Analyst (CVA) designation, and formerly taught Finance in Antioch University's MBA program.

ENDNOTES

1 *Estate of Natale B. Giustina v. Commissioner*, T.C. Memo 2011-141 (2011), *Estate of Natale B. Giustina v. Commissioner*, 586 Fed. Appx. 417 (9th Cir. 2014), *Estate of Giustina v. Commissioner*, 111 T.C.M. 1551 (2016).

Santa Barbara County Bar Association

The Santa Barbara County Bar Association Proudly Presents:

A Conversation with the CA Supreme Court Chief Justice Tani Cantil-Sakauye

Moderated by Santa Barbara Superior Court Presiding Judge Patricia Kelly

Thursday, February 22nd, from 5:30 pm to 7:00 pm
At the Santa Barbara Courthouse Mural Room

Call the SBCBA at (805)569-5511 or email sblawdirector@gmail.com to RSVP. Attendance is limited to SBCBA members only and the first 100 to RSVP.

Event is free to attend. There will be a Pre-Conversation Reception with hors d'oeuvres, and wine and beer.

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Meets at noon on the first and third Tuesdays of the month at 330 E. Carrillo St. We are a state-wide network of recovering lawyers and judges dedicated to assisting others within the profession who have problems with alcohol or substance abuse. We protect anonymity. To contact a local member go to http://www.otherbar.org and choose Santa Barbara in "Meetings" menu.

The Intellectual Property/Technology Business Section and In-House Counsel & Corporate Law Section of the Santa Barbara County Bar Association present:

Winning Trade Secrets Cases:

Proving or Disproving Misappropriation of Confidential Business Information

Trade secrets range from customer lists and financial information to proprietary formulas. The federal Defend Trade Secrets Action was signed into law in May 2016, providing plaintiffs the option to litigate trade secret misappropriation cases in federal court. Courts in DTSA cases, however, frequently look to law established in state court litigation under the Uniform Trade Secrets Act, particularly as to three key issues: 1) Is the information at issue a trade secret? 2) Has the information been misappropriated? and 3) What are the appropriate remedies—seizure, injunctions, damages, attorney fees—when misappropriation is established? Join us to learn how federal and state trade secret law and procedure can be used to stop and punish the theft of confidential business information or to defeat false claims of trade secret misappropriation.

Speaker: J. Patrick Huston

Attorney Patrick Huston is an expert in the law of trade secrets. He is the author of the 2016 treatise *The Law of Trade Secret Litigation Under the Uniform Trade Secrets Act,* which organizes, analyzes, and synthesizes all published court opinions (state and federal) of the 48 states that have adopted and construed the UTSA. A graduate of Northwestern University Law School, he heads The Huston Law Firm in North San Diego County.

Date and Time

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Reserve via email to Chris Kopitzke,
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Virginia Fuentes, Attorney at Law, is pleased to announce that she will be expanding her current business and employment consulting practice into the areas of consulting and investigating sexual harassment and Title IX issues. She has been assisting small to medium businesses in various areas, including preparing employee handbooks, providing termination counseling, and performing audits for best practices. Virginia is the current Title IX Coordinator for the Colleges of Law and will now provide compliance advice, training, and investigative services to colleges and universities in the areas of campus sexual assault, sexual harassment, and dating/domestic violence. Virginia is also now providing training, investigation, and consulting services for discrimination and harassment in the workplace.

Local attorney **Diana Lytel** is featured on the cover and inside of the most recent issue of *Verdict* Magazine, the publication of the Association of Southern California Defense Counsel. According to the Magazine, "The cover for this edition of the Verdict magazine is intended to showcase some of the association's outstanding young leaders." Diana's career is highlighted, along with those of five others, in an article called, "Young Guns: Stars of the Wild West," in which she is playfully branded as Diana "Dynamite" Lytel. The Magazine refers to these six attorneys as "fearless, talented and their moral compass is always pointed in the right direction." Diana is a Partner in the firm of Lytel & Lytel, LLP.

If you have news to report, the Santa Barbara Lawyer *editorial board invites you to "Make a Motion!" Send one to two paragraphs for consideration by the editorial deadline to our Motions editor, Mike Pasternak at pasterna@gmail.com.*

Brownstein Hyatt Farber Schreck is pleased to announce that **Hillary Steenberge** has been named a Shareholder in the Santa Barbara office, effective January 1, 2018. Hillary is a member of the firm's Energy & Natural Resources Department, specializing in a wide range of environmental, land use, and real property issues. She regularly represents clients on complex permitting, development, and zoning matters. She also provides strategic legal advice on all aspects of regulatory compliance and enforcement, environmental litigation, and contaminated site management. ■

If you have not renewed, this will be your last issue of Santa Barbara Lawyer!

Santa Barbara County Bar Association

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