LOS ANGELES
Daily Journal
www.dailyjournal.com

VOL. 127 NO. 28 TUESDAY, FEBRUARY 11, 2014

GUEST COLUMN

How firms double down on bad bets

By Edwin B. Reeser

"Re-equitization." It is a term, and more importantly a process, which relates to law firm partnership and capitalization structure. The concept is to convert salaried attorneys to partial-profit-participation minority owners. Several firms appear to have adopted the practice, suggesting that somebody is spreading it — possibly even getting paid well to sell it.

It is one of the most singularly bad ideas since lending your last $5,000 to Cousin Frank so he could pursue his "double-down-on-losing-bets" strategy on blackjack.

See Page 5 — RE-EQUITIZATION

EDWIN B. REESER
Pasadena

DAILY APPELLATE REPORT

CRIMINAL LAW

Criminal Law and Procedure: Juror's failure to disclose that he knew defendant through his daughter, who was defendant's neighbor, does not affect attempted murder conviction. *Smith v. Swarthout,* U.S.C.A. 9th, DAR p. 1638

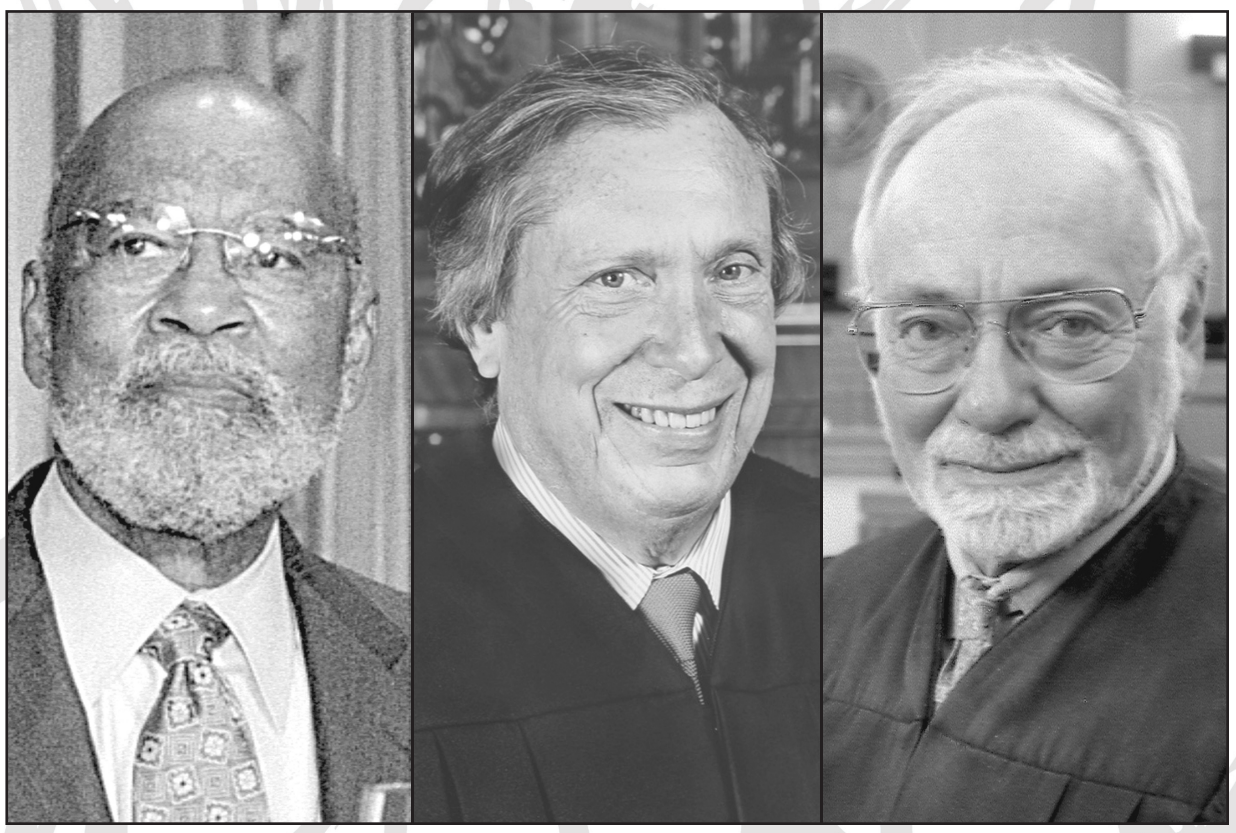
Criminal Law and Procedure: Offender who used LimeWire's peer-to-peer file-sharing program to download child pornography receives sentence increase for distribution. *U.S. v. Vallejos,* U.S.C.A. 9th, DAR p. 1631

Criminal Law and Procedure: Foreign citizen does not need verbal notice of additional allegations against him at initial hearing, when he was already in custody for illegally reentering U.S. *U.S. v. Vasquez-Perez,* U.S.C.A. 9th, DAR p. 1635

Criminal Law and Procedure: Thief makes criminal threats by yelling 'shoot him' at victim's dog, intending to scare victim into leaving with dog so he could steal his bike. *People v. Lipsett,* C.A. 5th, DAR p. 1628

Juveniles: Juvenile court incorrectly determines teenager was competent to stand trial based solely on his attorney's input and without aid of an expert. *John Z., a Minor,* C.A. 1st/2, DAR p. 1623

State gets more time to trim prison roll



Daily Journal file art

From left, Senior U.S. District Judge Thelton E. Henderson, 9th Circuit Judge Stephen Reinhardt, and U.S. District Judge Lawrence K. Karlton serve on a panel that granted the state an extension in cutting its prison population.

By Hamed Aleaziz
Daily Journal Staff Writer

A judicial panel's order Monday granting California a two-year extension to cut its prison roll could cede more control of the state's prison population reduction measures to an independent, court-appointed official, experts say. Under the order, a compliance officer will track whether the state meets interim deadlines and benchmarks on the prison population cap. Those deadlines are set for this June, next February, and the final compliance date of February 2016. The officer will have the power to release inmates if the state does not comply with the benchmarks.

"It's ceding authority over an important aspect of the prison system's responsibilities to somebody who is not the state in order to purchase this two year extension," said, Margo Schlanger, a professor and prison law expert at University of Michigan Law School.

Michael Bien, a partner at Rosen, Bien, Galvan & Grunfeld LLP and an attorney for the inmates, said the court's order was disappointing.

"The three-judge court is rewarding the state's recalcitrance and resistance to population reduction and there's already been an extraordinary number of extensions," he said. "There is insufficient acknowledgement of the harm that goes on daily in the prison system to our clients who remain in an overcrowded, dangerous system that is not delivering the appropriate mental and medical health care because of persistent overcrowding."

In 2009, a federal three-judge panel ordered the state to reduce its prison population to 137.5 percent of so-called design capacity in order to improve the level of medical and mental health care. The U.S. Supreme Court affirmed the order in 2011. A previous compliance date of December 2013 was extended after the court ordered negotiations between inmates' attorneys and the state.

The state now has two years to meet the capacity level. The court's order acknowledges that the state will meet the order partly by increasing capacity at an in-state private prison and other facilities, but demands it to "not increase the current population level of approximately 8,900 inmates housed in out-of-state facilities." In addition, the court demands the state to immediately implement a series of population reduction measures that state attorneys proposed last month. The state has also said it will provide $81 million toward recidivism reduction efforts.

Gov. Jerry Brown said in a statement that the order was encouraging.

"The state now has the time and resources necessary to help inmates become productive mem-

See Page 2 — STATE

Students detail harm of teachers

Plaintiffs want to change educator employment laws, including tenure

By Chase Scheinbaum
Daily Journal Staff Writer

LOS ANGELES — An ineffective teacher turned an ambitious student into a nervous and demoralized ball of nerves. That was the message from Joe Macias, the father of 13-year-old Los Angeles Unified School District student Julia Macias, a plaintiff in a potentially game-changing educational lawsuit in trial in Superior Court here.

Macias' testimony and that of other plaintiffs Monday was the first time that the public heard sworn statements from the plaintiffs: nine public school children and their families. They claim that teacher employment laws including lifetime tenure and last-in, first-out layoff rules prevent the firing of bad teachers.

The testimony marks an important moment in the lawsuit because plaintiffs' attorneys will be required to demonstrate that the student plaintiffs have been harmed by the statutes. Up to this point, other witnesses have testified only generally about how the statutes disproportionately burden poor and minority students with bad teachers.

According to Joe Macias, his daughter, a student from Reseda who dreams of attending Harvard University, became intimidated in class and grew afraid of asking questions when she was put in the care of a bad teacher.

"She never behaved like that before," he said, being in class with "Teacher A," as attorneys referred to the instructor in court. After Julia moved to another classroom with a different teacher, whom lawyers called "Teacher B," she "returned to that child I knew who enjoyed school," he testified.

The plaintiffs began taking the stand after two weeks of testimony from plaintiffs witnesses who include school administrators like LAUSD Superintendent John E. Deasy and academics who research teaching quality.

The complaint charges that the statutes deny all students an equitable right to education, thus violating the equal protection clause of the state constitution.

Six of the plaintiffs are student of color and three are from schools with poverty-stricken students.

Brandon DeBose Jr., 17, a senior at Oakland Unified School District's Skyline High School, also took the stand Monday, telling jurors that he knew the harm of being assigned an "extremely bad teacher" firsthand.

He said the way his own teacher treated him was hurtful and disrespectful. "She pulled me to the side and told me I wouldn't amount to anything. ... It hurt me to the point where I thought it was true."

DeBose plays football and baseball and wrestles. He also teaches younger children to play guitar. He said he aspires to go to college and to enter a career where he can devote himself

See Page 3 — STUDENTS

Orange County Bar Foundation receives record $15.3 million

By Alexandra Schwappach
Daily Journal Staff Writer

SANTA ANA — The Orange County Bar Foundation has received a $15.3 million pledge, the largest in its 45-year history and one of the largest ever to a California bar group.

The money, which beginning this year will be distributed in 5 percent increments, was pledged by the Jeffrey M. Carlton Foundation. Carlton's company, Press Forge Co. in Paramount, is the nation's largest metal forging servicer and supplier. He died in 2012 at age 61 of heart disease.

Unlike most bar groups, the Orange County Bar Foundation is a direct services provider. Bar officials said the money is coming at a time when federal grants have been scaled back because of budget constraints.

"This is a huge lifesaver for us," said Eric V. Traut, president of the organization. "We intend to spread [this donation] across the board and make very good use of it."

Roughly 89 percent of the Orange County Bar Foundation's resources go toward program activities, Traut said. Among the programs the money will benefit is Shortstop, one of the oldest juvenile detention programs in Orange County. In the program, juvenile offenders ages 11 to 17 and their parents participate in several courtroom sessions where volunteer attorneys, legal professionals and parolees use dramatization to present "the legal facts of life."

Also benefiting from the contribution is Project SELF, in which local high school students participate in paid internships at law firms and other professional environments, and the Higher Education Mentoring program, which helps high school students with plans for college and graduate school. The after-school mentoring program works with about 40 students each year, providing monthly workshops, guest speakers and local college campus tours, all geared toward academic growth.

Bar groups are generally not recipients of huge philanthropic awards.

Justice Gap Fund, which distributes funds provided by grants from the California Bar to legal aid organizations, last year received one of the largest donations in its history: $10,000 from venture capitalist Qatalyst Partners.

The San Diego County Bar Foundation received a $1 million contribution last year, the largest in its 35-year history. The money came from a company that the foundation could not name, and will go toward indigent criminal defense, said Briana Wagner executive director of the San Diego County Bar Foundation.

The Carlton gift will bring the Orange County foundation's annual budget to $2 million a year. Collie F. James, immediate past president of the foundation, said he could not

See Page 4 — ORANGE

Cross on county seal should pass muster

By William J. Becker, Jr.

Daily Journal

The Los Angeles County seal adopted in 1957, left, was replaced in 2004 by a seal without a cross.

Last month, the Los Angeles Board of Supervisors restored the image of a Christian cross on its official seal, reversing a decision made Sept. 14, 2004, barely a decade ago. The 3-to-2 vote showed the power of patience as well as the impermanence of political power grabs. What two lawsuits (one of which I initiated, for full disclosure) and multiple attempts to mount a ballot initiative failed to achieve was accomplished simply by replacing a strict constitutional separationist board member with a realist. Not overnight, to be sure, but nonetheless.

The rationale for the board's decision was a logical one. The current seal features a Franciscan mission shown from the rear, thus concealing the cross generally featured on the front. It replaced an image of the Hollywood Bowl shell, two stars and a cross. Attorneys for the American Civil Liberties Union deemed the mission backside a suitable image in 2004 when they agreed to withdraw their threatened lawsuit. It appears to have been adopted as a compromise, allowing the seal to continue symbolically acknowledging the region's religious roots but without calling attention to Christianity per se. With the entryway appropriately depicted, including a cross merely reflects both historical and architectural accuracy.

But this argument fails to satisfy ardent opponents of government symbols acknowledging religion's cultural significance. A Los Angeles Times editorial in 2004 saw the challenge to the cross as too "silly" to warrant the attention of county government officials and a colossal "waste of time." The Times' contempt for government resisting the ACLU's legal extortion efforts has only intensified. Recent editorials have referred to it as a "pointless diversion of focus and resources," "the most contentious, attention-grabbing but substantively empty debate of the last two decades," and a "maddening distraction." But distracting and maddening to whom?

It is undoubtedly maddening for constitutional separationists to be knocked sideways when a controversy presumed to have died and been buried is resurrected. That a matter of intense public debate concerning government's establishment of religion is somehow merely a distraction from more exigent civic matters is logically inconsistent. If the cross isn't such a big deal, it is the ACLU's litigiousness the Times should single out for rebuke, not the public or its representatives for having to defend constitutional principles. Had it existed in 1789, one can only imagine the Times heaping scorn on James Madison for wasting time deliberating the language of the First Amendment. *Doesn't Congress have better things to do then to worry about all this silly religion stuff?*

Spanish missionaries indisputably founded Los Angeles. The city was named to commemorate the Jubilee of Our Lady of the Angels of Porciuncula, the Umbrian church where Saint Francis of Assisi created the priestly order named after him, the Franciscans. *Senora de Los Angeles.* Our Lady of the Angels. Does the symbolic memory of that historical fact compel or coerce Angelenos to carry rosary beads? The evidence is out. As a non-Catholic, I am neither offended by the reminder of our city's historical roots nor feel compelled or coerced to attend weekday Mass at the Cathedral of Our Lady of the Angeles, situated directly across from the Los Angeles County Hall of Administration. And as a Protestant Christian, I have never felt as though I was receiving better treatment by county government than any other citizen. No compulsion. No coercion. No preferential treatment. No feeling of inclusiveness. Of course, the county's primary purpose is not to establish a local religion, the cross on the bell tower of a mission does not have the primary effect of establishing a local religion, and the county is not excessively entangled in the sponsorship of religious activities. That just about covers all of the Establishment Clause signposts of any real threat to religious freedom.

Perhaps in 2004, Los Angeles County counsel might have been somewhat justified in arguing that the odds of success that an ACLU constitutional challenge to the cross remaining on the seal were great. But the next year, those odds shifted in the other direction. In 2005, the Supreme Court found that religious symbols bearing "undeniable historical meaning" transcend their religious significance in the Ten Commandments case of *Van Orden v. Perry* (2005). "Simply having religious content or promoting a message consistent with a religious doctrine does not run afoul of the Establishment Clause." In his concurrence, Justice Stephen Breyer explained: "[T]he Establishment Clause does not compel the government to purge from the public sphere all that in any way partakes of the religious. Such absolutism is not only inconsistent with our national traditions, but would also tend to promote the kind of social conflict the Establishment Clause seeks to avoid." He further noted that the removal of a religious symbol based primarily on its religious nature would "lead the law to exhibit a hostility toward religion that has no place in our Establishment Clause traditions" and "create the very kind of religiously based divisiveness that the Establishment Clause seeks to avoid."

The current Supreme Court would likely uphold the seal's constitutionality because an image of a California mission bearing a cross is historically accurate. The depiction of a mission's backside is nothing more than a bow toward political correctness and arguably reveals hostility toward religion. Ten years later, the ACLU has fulfilled its promised threat of suing the county. This time, it isn't guaranteed ultimate success before the courts. And if it reaches the high court, it is easy to imagine a new precedent being created — one that favors the government's symbolic acknowledgement of a region's religious history. Will the ACLU's madness never cease?

William J. Becker, Jr., *is founder of Freedom X, a Los Angeles-based non-profit dedicated to protecting the freedom of religious, political and intellectual expression of Christians and conservatives. He was plaintiffs' counsel in* David Horowitz vs. County of Los Angeles *(2004) and is plaintiff's counsel in* Santa Monica Nativity Scenes Committee v. City of Santa Monica *pending appeal before the 9th Circuit Court of Appeals. His web site is www.freedomxlaw.com.*

WILLIAM BECKER, JR.
Freedom X

Re-equitization: doubling down with someone else's money

Continued from page 1

So why doesn't it work?

Hypothetical Firm A has gone through a program over several years of removing all "underproductive" equity partners, as recommended by consultants and lenders, and incented to do through self interest by reducing the net income pool for sharing among fewer partners. Firm A has also gone through extensive effort to be as efficient as it can.

The problem is that with a flat demand market and rising costs, the net income pool for distribution will still shrink. Reallocation of profits within the profits pool will enable "increased" distributions for some at the top — at the expense of the mid-level and junior partners — but there are obvious limits to this tool: Partners previously deemed worthy of retaining their equity status, because they have portable business, would be incentivized to leave the firm to be paid more fairly for their contribution. In addition, the highest paid partners would have to match increases in compensation with additional capital contributions — effectively giving back much of what the after tax net income from the increase is for the first year.

In a zero-sum game of profit pool allocation, those that get "more" have to replace the capital of those who get "less."

The driver of change is that those who want more want it now — so change the rule: just have a "cap" on the capital that equity partners have to make. For example, if the standard ratio is 35 percent capital to forecast income, once a partner's compensation gets to $2 million, and thus $700k of paid in capital, the capital contribution is deemed "enough." Unfortunately, when a reallocation within the profit pool moves a $2 million compensation level partner to $3 million under this zero-sum scenario, and thus other partners below the threshold move down $1 million, the mid-level equity partners are collectively entitled to a return of $350k of capital. But there is not a corresponding infusion of capital from the top to replace it because of the cap. The firm doesn't need many partners above the $2 million threshold to work a substantial "undercapitalization" pressure and thus cash drain.

Where would Firm A get the money if it did this?

Reverse course: make all of the "income" or "non-equity" partners a new tier(s) of hybrid equity partners. Have the tiers "stair step" in equity percentage based on compensation level, for example, working up from the entry level of $200k at 15 percent equity in increments of 5 percent for every $100k of scheduled compensation. Capital contributions would be tied to the equity percentage of scheduled compensation that is dependent on firm "profit," as is the distribution level, which would be reduced for year-end profits distribution "holdback." This strategy has the nifty benefit of reducing monthly cash flow for what were formerly salaried W-2 employees, who now become Form K-1 reporting "partners." They also get to pay their share of employer-side taxes, and perhaps are no longer reimbursed for things like health insurance. This very simple twist will effectively put millions of dollars of capital into the law firm, but will only marginally increase the *overall* capital of the firm.

The real impact is hidden by the "cap" on required partner capital. What is really happening is the junior hybrid equity partners are putting up the capital that the most highly compensated partners would have been required to put in as they take larger shares of the profit pool.

> What is really happening is the junior hybrid equity partners are putting up the capital that the most highly compensated partners would have been required to put in as they take larger shares of the profit pool.

The efficient application of this gambit is to structure the program so that the re-equitization at each promotion — between income distribution holdback and increased capital contribution — puts the hybrid partner in a position where the net cash impact to them is essentially neutral. Yet it will in fact cause many to be in a cash position worse than when they were salaried non-equity partners. That is, to get the buy-in capital, many will need bank loans. Moreover, some may need to take out personal "revolver" loans to cover their living expenses that they could previously fund from their net salaries. Of course, the change in status is not elective to the attorney, so it has the real feel of "buying your job." But it is much more dangerous than that: If the firm fails, those loans are still a personal liability, while the capital is lost; and distributions received as a partner may be subject to disgorgement claims.

There are other potential terrible consequences, but it is enough to note that none of this strengthens the firm; it just pushes the risk and consequences of loss on people that have the least ability to bear it, have little or no voice in the direction of the firm, or the decisions made, or meaningful information on what is going on.

The real lesson, however, is that poor leadership decisions hurt everyone else much more. When a leader makes a mistake, or worse deliberately pursues a failing strategy, it can have an impact on everyone in the firm — and beyond: It can wipe out entire law firms of iconic stature with a legacy of success that has been sustained for many decades.

This re-equitization nonsense may or may not have been invented by law firms. But wherever it was birthed, it is likely being spread by consultants and banks. It is an "answer" that firms are willing to "buy" to support an outcome they already want. Interestingly, this leads to the following sales pitch: "You have too much debt, so here is the solution: push debt down to the full recourse individual level, and have those people put in fresh capital. Then you have cash to distribute. If you don't have enough people to contribute, then add more people to the partnership."

Note that such a program is unlikely to raise more than 7 to 15 percent of the total capital balance of the law firm, because the infusions from each partner are likely to be relatively small, perhaps ranging at the $15-25k amount at the entry level, and slowly working up towards a full share. That is not such a substantial amount, so how can it be a solution to a capital inadequacy problem for the operation? The answer, of course, is that it can't. It was not motivated by that need and it is not intended to fill that need.

The flip side of the coin gives the answer. This program has a cap on the capital. Once adopted, every partner over the cap has a capital return of the overage. Which means the net capital of the firm is not increased, and the capital raised for the buy-in by the new junior partners flows right through to a distribution to the senior partners to return their "over capitalization." They are "cashing out" a substantial portion of their equity with new partner money. And they get to take out 100 percent of the raises they vote themselves in the future. It is a solution to a problem. It just isn't the problem you might have thought it was. And unless you are an "over-the-cap" partner, now it has become your problem.

That's right, you just gave somebody else's Cousin Frank your money for the new double-down-on-losing-bets strategy.

Edwin B. Reeser *is a business lawyer in Pasadena specializing in structuring, negotiating and documenting complex real estate and business transactions for international and domestic corporations and individuals. He has served on the executive committees and as an office managing partner of firms ranging from 25 to over 800 lawyers in size.*