Real progress emanates from the political process

Continued from page 1

in her view, all California county clerks are under the supervision of the director of the Department of Public Health & State Registrar of Vital Statistics under California law. Some clerks, however, are likely to refuse or disagree. They could argue that the trial court's judgment does not apply to anyone but the two couples who brought the case. *Hollingsworth* was not a class action, and even though the trial court's judgment purports to invalidate Prop. 8, a trial court's judgment ordinarily binds no one but the parties. Still, the trial court's judgment purports to be broader than that, and same-sex advocates will argue that it is too late to correct what is likely a legal error. Prop. 8 supporters could bring new litigation seeking to block same-sex marriages in California. They will claim that because the *Hollingsworth* case only involved two couples, Prop. 8 continues to apply to all other same-sex couples. They will argue Prop. 8, a state constitutional amendment, trumps any provisions of state law that suggest that county clerks must follow the contrary directions of the governor, attorney general, or other state officials.

These conflicting legal claims raise complicated questions without clear answers. It will take a long time for the legal dust to settle.

Let me put my own cards on the table. I support same-sex marriage. Even putting the important questions about the imperative of equality aside, it is plain to me that same-sex marriage is wise social policy. The law should offer favorable treatment to relationships that enhance social stability — this is why the law protects the relationship between husband and wife, or parent and child. Surely we should promote stable, monogamous same-sex relationships, rather than unstable and promiscuous ones. Offering same-sex couples the stability of marriage helps to produce this wholesome — and quite conservative — result.

I confess that I have serious doubts about the legal soundness of the Supreme Court's ruling that Prop. 8's proponents lacked standing to appeal. But as a supporter of same-sex marriage, I am glad that the Supreme Court has not held that the Constitution compels the states to recognize same-sex marriage.

To be sure, the legal arguments against Prop. 8 were strong. I worry, however, that in the long run, the cause of equal rights for gays and lesbians will not be advanced if gay marriage is imposed on unwilling states by judicial fiat.

It is no easy feat to produce changes in social mores by judicial decision. In 1903, the Supreme Court heard a case in which it was alleged that a massive conspiracy was underway in Alabama to disenfranchise African American voters — allegations that were undoubtedly true. Yet, the African American plaintiffs lost their case. In *Giles v. Harris*, Justice Oliver Wendell Holmes wrote: "Unless we are prepared to supervise the voting in that State by officers of the court, it seems to us that all the plaintiff could get from equity would be an empty form. ... [R]elief from a great political wrong, if done, as alleged, by the people of a State and the State itself, must be given by them or by the legislative and political department of the government of the United States."

Today, some claim that *Giles* reflects Holmes's latent racism. I disagree. Those were the days when the country could barely stomach the idea of President Theodore Roosevelt inviting Booker T. Washington to dinner at the White House. A judicial decision ordering that African Americans be permitted to vote would surely have provoked massive resistance at a time when the nation was not yet prepared to make the promise of equal rights real. My best guess is that the court's caution in 1903 made it possible for the court to be taken seriously when it ordered an end to racial segregation a half-century later.

Even though the court's 1954 decision invalidating racially segregated public schools in *Brown v. Board of Education* was eventually, if reluctantly, enforced by the federal government, the history of the civil rights movement makes plain how little progress was made after *Brown*. It was not until Congress made a decision to enlist the federal government as a full partner in the fight for civil rights through the Civil Rights Act of 1964 and the Voting Rights Act of 1965 that the promise of equal rights began to be kept.

Associated Press

California Attorney General Kamala Harris discusses the U.S. Supreme Court ruling on Prop. 8 in Los Angeles, June 26.

We may well have made more progress on gay rights by 2013 than we had made on racial equality by the time of *Brown*. Still, there is much work to be done. Including California, 36 states have banned same-sex marriage, 31 by constitutional amendment. A judicial decision forcing all states to recognize same-sex marriage would surely provoke a fierce backlash.

Justice Ruth Bader Ginsburg has frequently mused that when the Supreme Court recognized a right to abortion in its 1973 *Roe v. Wade* decision, it may have moved too far and too fast. The resulting backlash has never really abated. She wonders whether abortion rights would be more secure if they had been won through the political process. So do I.

History suggests that civil rights are most secure when they are come through the political process — when they are produced by the people's representatives, rather than imposed by an unelected judiciary. If gay rights are to be secure, there is no easy alternative to a hard political fight for the hearts and minds of the majority.

California faces years of more gay-rights litigation. A new governor or attorney general might one day instruct county clerks to stop issuing same-sex marriage licenses. There is only one sure route to equal citizenship for gay and lesbian couples. Same-sex marriage should return to the 2014 ballot, where it will likely enjoy a resounding victory. Democracy, it is true, has many vices, but one of its virtues is that rights won through the democratic process are rarely taken away. Once it gains a foothold, equality is surprisingly resilient.

Real progress toward equal rights for African Americans was not possible until racism became politically unacceptable. Real progress on equal rights for women was not possible until sexism became politically unacceptable. Real progress toward equal rights for gays and lesbians is likely to run along the same course.

Lawrence Rosenthal *is a professor of law at Chapman University School of Law*

How Biglaw reallocates money and governance power, pt. 2

By Edwin Reeser

Once upon a time it was thought the Tower of London had the best "tools" for the task at hand. It is beginning to look like the Tower keeper could take a few lessons from law firms.

Here's the rest of the "Dungeon Master's Dozen" from the Tower of Biglaw that you can expect to be applied with increasing frequency — and force — to reallocate money and governance power within law firms as the unrelenting pressure of the Great Recession continues. Not all law firms employ them, and some tools do have a proper place. It is when good tools are put to a bad use that the problems abound. Without getting into the evaluation of motives behind them, let's take a look at the tools laid bare upon the table before the partners:

Part Two in a Two-Part Series

10. Nonequity partner profit participation. Not an equity partner? No problem. The firm will tie a percentage of your annual budgeted compensation to a profit share. Say 20 percent. If the firm hits budget, you get it. If the firm does better than budget, you get more. If the firm doesn't make budget, you get less. Meanwhile, if that had been salary, it would have been paid out twice per month in level payments through the year. Now, the firm gets the cash flow deferral benefit of the aggregate of 20 percent of income partner compensation. When combined with the technique of the aspirational budget (see #14), it frequently results in a shortfall to budget and reduced compensation for the income partner class.

11. Guaranteed contract distribution. This tool can have a wide range of uses and applications. It may mean a contractual commitment to pay a partner a sum certain irrespective of actual firm performance. It may mean a promise to pay in the future any shortfall of performance to actual allocable share for the partner. It may mean a regular draw distribution that is higher than that normally given to partners. It may mean that notwithstanding a standard draw (every partner regardless of rank gets the same draw amount, say $20,000 monthly), when distributions from surplus accumulated earnings above the draw levels are made, they are made disproportionately with priority to certain partners over others. The opportunities for mischief abound in this category.

12. Modified cash basis accounting manipulation. This topic gets about as much air time as discussions on medical experiments conducted upon prisoners of war. We know it happened, but nobody wants to know it happened, or in this instance, is ongoing. Suffice it to say that a certain amount of adjustment to correctly reflect the actual financial condition of the firm is a good thing. Deliberate adjustment to incorrectly reflect a much healthier condition for the firm than is the actuality is a bad thing. The number of adjustments and the extent to which they are applied rarely come to light, even in failed firms. Even aggressive application is hard to detect for outsiders, and most partners in firms that use such techniques usually have no idea that it is going on. For a 4-part series detailing this tool, see: http://www.jdsupra.com/legalnews/super-fuel-for-the-profits-per-partner-d-12701/.

13. Draw schedule reduction. The firm with a 55 percent draw schedule to partners cuts it back to 50 percent. A simple increase in immediately available cash flow by almost 10 percent of previously ongoing distributions to partners. For a firm with $180 million in annual partner profits, and a $99 million draw package, that is $9 million in cash flow. It also increases the amount of the forfeiture of accrued but undistributed income to departing partners.

14. The aspirational budget. This technique is the cornerstone of many gambits, and amplifies the effectiveness of others. Basically the budget as presented looks great, and the partners are made happy with the excellent looking future. Moreover, the capital account requirements of all those partners getting all that extra forecast distribution goes up. So the firm rakes in 35 percent of the forecast "raises" at the beginning of the year — though not from upper tier partners already at the "max" contribution level. But when the firm falls short of budget because of all those unpredictable things (lower hours, poor collections, inadequate business development), the reality is that the actual effective capitalization ratio was not 35 percent, but 40 or even 45 percent. But that money is not returned to the partners. It also serves to reduce compensation to all persons in the "profit sharing" formula.

15. "Bonus" or guarantee clawback. There are two aspects, one is firm performance, and the other is individual performance against a target. Fall short against either, or withdraw from the firm, and it has to be paid back. An effective leverage tool, and a means of subsequently applying a compensation reset as well. Indeed, even if the individual meets their targets, the firmwide shortfall can be used to force a compensation reduction notwithstanding. Give notice before the end of the year, you are not awarded the bonus. Give notice after the end of the year, give it back.

> This topic gets about as much air time as discussions on medical experiments conducted upon prisoners of war. We know it happened, but nobody wants to know it happened, or in this instance, is ongoing.

16. The deferred pension contribution default. This comes from the deduction at year end from every equity partner for their contribution to the 401k or other qualified pension plan to which they participate. The problem arises from the fact that while contributions are reflected as an accounting entry, and withheld from partners, the money may in fact not be there, as it is not immediately distributable. Indeed, it may have been used to pay for expenses for operations, or even draws in the first quarter of the following year. As the money does not have to be deposited to the plan until the firm files its final tax return, including extensions, this can become a pool to cover operating costs and any other cash flow need for the firm. Thus it is not uncommon for failed law firms to have not made these deposits — unbeknown to the majority of the partners — but to have spent them.

17. The retired partner noncompete. It is legal in most states to have a noncompete against a partner who has an interest in an unfunded pension plan. Through an astute use of the de-equitization strategy, followed by a compensation reset in a year or two, the partner of 20 years of service but only 55 years of age is put into the vice of "leave early to earn more current income as the market will pay elsewhere," but in so doing forfeit the plan benefits to which he or she has supported, funded and vested into for much of his or her career. The firm can extract value from the partner held hostage to the expectation of a retirement annuity, but which — as Dewey proved — can actually turn out to be totally illusory with the failure of the enterprise, or which can be significantly reduced in value with certain caps on benefits and the flood of entrants into the plan. The partner may then choose to leave and forfeit the plan benefits because they have current obligations, like children in college, to pay for and the firm will not waive the noncompete/forfeiture provision.

18. The tri-party capital loan arrangement. The partner makes their upfront capital contribution with a 100 percent financed loan from the firm's lender. It is personal and full recourse. But the firm, the lender and the partner confirm that in the event the partner withdraws, all distributions from the firm to the partner will first be directly applied to the repayment of the loan and any accrued but unpaid interest. The naive impression is that when the partner leaves, all the capital is repaid, and goes to the lender, and the loan is paid off. But as several firm failures have demonstrated, that isn't the case. And there are plenty of situations not involving firm failures where that is not the case. Instead the firm terms out the repayments, let's say to five years. The lender by the terms of the loan is in a position to declare the loan immediately due and payable in full, and demand it from the partner. The loan will be repaid and the partner will be collecting its capital from the firm over the term of years. If they have it. And the partner will have to take out a new loan to fund their capital contribution to their new firm. Thus the partner can effectively be held hostage to a concession with the old firm, to get the old loan repaid in exchange for other consideration.

***

You may observe that 18 tools is a dozen and a half — not a dozen! In the realm of the Dungeon Master, extra pain costs you no more. Also note the additional six "free experiences" are not the end of what is available in the Dungeon Master's toolkit. There are more — indeed, many more. These are just among the more common in the industry. There is no need to supply the aspirants to the position of Tower keeper with more creative ideas, tools and techniques than they already have. There is a need of those potentially at the business end of the iron claws and thumbscrews to be aware that these and other techniques are likely to become a lot better known and experienced in the industry over the next couple of years as firms under distress turn their efforts in the direction of efficiency at maintaining profits for certain partners through reallocations of a stagnant or shrinking profit pool, over developing effectiveness at delivering service to clients that will generate more profits — which can be much harder to achieve.

The tools can be applied to grind down the income of both individuals and even entire classes of partners and employees who stay in the firm, in order to enhance the income of other groups of partners. They can be used to extract concessions, discounts and even forfeitures of income, capital and retirement benefits from withdrawing or retiring partners, who are held hostage to them. They can be used to attract new talent from the lateral market and then tie them up, notwithstanding failure of the firm to meet forecast, or even promised expectations.

As Sergeant Phil Esterhaus of Hill Street Blues said every morning: "Let's be careful out there."

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.*

EDWIN REESER
Pasadena

SUBMIT A COLUMN
The Daily Journal accepts opinion pieces, practice pieces, book reviews and excerpts and personal essays. These articles typically should run about 1,000 words but can run longer if the content warrants it. For guidelines, e-mail legal editor Ben Armistead at ben_armistead@dailyjournal.com.

WRITE TO US
The Daily Journal welcomes your feedback on news articles, commentaries and other issues. Please submit letters to the editor by e-mail to ben_armistead@dailyjournal.com. Letters should be no more than 500 words and, if referencing a particular article, should include the date of the article and its headline. Letters may not reference a previous letter to the editor.

Daily Journal

Charles T. Munger, Chairman of the Board
J.P. Guerin, Vice Chairman of the Board
Gerald L. Salzman, Publisher / Editor-in-Chief
Robert E. Work, Publisher (1950-1986)

David Houston, Editor

Ben Armistead, Legal Editor
Jill Redhage Patton, San Francisco Editor

Ben Adlin, Associate Editor, *Los Angeles*
Jason Armstrong, Associate Editor, *Los Angeles*
Jean Yung, Associate Editor, *Los Angeles*
Craig Anderson, Associate Editor, *San Francisco*

Los Angeles Staff Writers
Blake Edwards, Ryne Hodkowski, Caitlin Johnson, Andrew McIntyre, Henry Meier, Chase Scheinbaum, Omar Shamout

San Francisco Staff Writers
Hamed Aleaziz, Emily Green, Laura Hautala, Hadley Robinson, John Roemer, Joshua Sebold, Fiona Smith, Saul Sugarman

Bureau Staff Writers
Dominic Fracassa, Kevin Lee, David Ruiz *Palo Alto*, Katie Lucia, *Riverside*
Don J. DeBenedictis & Alexandra Schwappach, *Santa Ana*,
Paul Jones, *Sacramento*
Pat Broderick, *San Diego.*

Laura Chau, Israel Gutierrez, *Designers*

Rei Estrada, *Video Editor*
John Michael, *Editorial Assistant*

Rulings Service
Seena Nikravan, *Rulings Editor*
Connie Lopez, *Verdicts & Settlements Editor*
Karen Natividad, Michael Lee, *Legal Writers*

Advertising
Audrey L. Miller, *Corporate Display Advertising Director*
Monica Smith, *Los Angeles Account Manager*
Len Auletto, Michelle Kenyon, *San Francisco Account Managers*
Kari Santos, *Display Advertising Coordinator*

Art Department
Kathy Cullen, *Art Director*

The Daily Journal is a member of the Newspaper Association of America, California Newspaper Publishers Association, National Newspaper Association and Associated Press