Business Law

Published by the Business Law Section of the Washington State Bar Association Volume 37, Number 2 • Fall 2016

Securities-Based Crowdfunding Scorecard

By Eugenie D. Rivers

In 2014, proponents of broad-based, crowdfunded securities offerings were excited by the adoption of Title III of the JOBS Act. Title III allows businesses to raise up to $1 million in a 12-month period through the sale of securities to an unlimited number of non-accredited, small investors. However, actually conducting any of these offerings was subject to the SEC adopting rules to implement Title III. After an agonizing two years, the SEC finally adopted its Title III crowdfunding rules (Reg CF), effective on May 16, 2016. The SEC also adopted issuer guidance which gives a good overview of Reg CF.[1]

This article will take a brief look at state crowdfunding offerings and then look at what has occurred in this new federal marketplace during the first three months of Reg CF's existence.

State Crowdfunding Rules

While waiting for the SEC rules, over half of the states adopted rules permitting securities-based crowdfunding offerings to small investors residing solely within the issuer's state, in reliance on the federal "intrastate" exemption from registration.[2] These state crowdfunding rules vary widely in their requirements and have met with varying degrees of success in permitting securities-based crowdfunding offerings to get to market. According to the North American Securities Administrators Association (NASAA), as of June 20, 2016, a total of 179 state crowdfunding offerings had been filed, and 166 had been cleared/approved by state regulators.[3] Unfortunately, Washington's crowdfunding rules[4] are among the most restrictive in the country. As of June 2016, only one Washington crowdfunding offering had been approved after a two-year approval process.[5]

For federal Title III crowdfunded offerings, NASAA has issued a proposed model rule and draft uniform notice form to the states. In July 2016, Washington substantially adopted those rules and notice form.[6]

Reg CF Offering Activity

Through August 24, 2016, approximately 86 offerings had been filed with the SEC under Reg CF on the new Form C. WeFunder Portal (the most active Title III funding portal) reports that 24 of those offerings had met their minimum funding targets required to release the funds from escrow.[7] Those funding targets ranged from a low of $27,612 to three offerings achieving the maximum $1 million. If you don't count those three largest offerings, the average fully funded offering size was approximately $163,000.

The types of companies that have successfully funded include a number of brewery/spirits/coffee companies, several indie film companies, several hospitality companies, and a number of health/medical device companies. Of the fully funded offerings, 18 of the 24 were conducted through WeFunder.

Offering Platforms

One unique feature of Reg CF is its requirement that all offerings must be exclusively conducted through one online platform operated by a broker-dealer or one of the new "funding portals" authorized by the JOBS Act. Currently 16 funding portals have registered with the SEC and FINRA. These platforms charge fees based on a percentage of the offering amount, ranging from 3 to 10 percent, and several also receive 2 to 5 percent of the securities issued. These commissions add significant cost to conducting a federal crowdfunded offering. A review of filed Form Cs, through August 24, 2016, estimates funding portal activity and commission rates as follows:

Platform	Filing #	Fee %
WeFunder (Portal)	33	3%
StartEngine (Portal)	13	7%
UFundingPortal (Portal)	9	5%
FlashFunders (Portal)	6	5%
Venture Co Brokerage (B/D)	4	7%
TruCrowd (Portal)	4	7%
SeedInvest (Portal)	4	5%
OpenDeal (Portal)	4	5%
NextSeed (Portal)	3	5-10%
Jumpstart Micro (Portal)	3	6%
CrowdsourceFunded (Portal)	2	7%
Bankers Direct (B/D)	2	10%
LocalStake Marketplace (B/D)	1	5%

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Securities-Based Crowdfunding Scorecard *continued*

As shown above, most of the registered crowdfunded offerings through August 24, 2016 were done through the new funding portals, with only seven being done through platforms operated by three registered broker-dealers.

Types of Securities Offered

Federal crowdfunded offerings include both equity and debt securities. A review of filed Form Cs, through August 24, 2016, estimates the types of securities being offered as follows:

Security Offered:	#
Common Stock	32
"SAFES"	24
Debt	14
LLC interests / units	8
Preferred Stock	8

The high number of SAFE (Simple Agreements for Future Equity) offerings as a percentage of the total crowdfunded offerings to date is a significant concern from an investor protection perspective. SAFES were developed in 2013 for startups as an alternative to issuing convertible notes before their first venture capital round. SAFES are a contract granting the investor the right to purchase equity at a future date when the startup sells its first round of priced stock. If no equity round is issued, they will never convert into stock. But, since they are not debt, the company generally is not obligated to repay the invested amount unless there is a liquidity event, and, in the repayment hierarchy of a bankruptcy or dissolution, the investors will fall behind creditors.

Also of concern is that five of the debt offerings were "revenue sharing" or "revenue participation" agreements, rather than traditional convertible notes. These arrangements are basically promissory notes repaid based on a percentage of the issuer's revenues, rather than an amortized basis. If the issuer has no profits, no payments are required until maturity, and the investor has no right to exchange the amount due for equity.

A sampling of the Form Cs for several of revenue sharing and SAFE offerings showed a lack of adequate disclosure of the significant risks these alternative securities pose to investors as compared to traditional equity and debt securities.

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Offering Materials

A sampling of the filed Form Cs reflects a wide range of disclosure quality, ranging from materials clearly prepared by securities counsel, to fluffy materials that read like the company's website and which contain little real risk disclosure.

The funding portals provide the issuers with online interface for completing the SEC's Form C filing. They also offer forms of common and preferred stock subscription agreements and convertible promissory notes, plus forms of revenue sharing agreements and SAFES, all complex securities instruments. The funding portals generally advise the issuers to work with qualified legal counsel. However, the volume of legal advice and legal forms provided on these funding portals, when combined with their high commissions and the do-it-yourself paradigm inherited from the non-equity crowdfunding world, would appear to create a strong disincentive for cash-strapped issuers to engage adequate legal advice on their federal crowdfunded securities offerings.

We may well have to wait until the failure of one of the companies with the largest crowdfunding raised in order to see how the SEC and FINRA will respond to the funding portals' current practices.

Eugenie D. Rivers provides entrepreneurs, business owners and investors with practical legal and business advice on securities offerings, equity plans and executive compensation, real estate investment LLCs and transactions, strategic entity structuring, business purchase and sales, and bank and commercial finance transactions. Ms. Rivers is Of Counsel with Wong Fleming, P.C., through her firm, Rivers Business Law, Inc., which she founded in 2003. She also has served as General Counsel for a healthcare technology company and a community bank. Previously, Ms. Rivers was a corporate finance partner at Davis Wright Tremaine in Seattle. She is a member of the Securities Committee of the Washington State Bar Association.

1 SEC issuer guidance: https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm

2 Rule 147 under the federal Securities Act of 1933.

3 http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2014/12/Intrastate-Crowdfunding-Slides-7-18-16.pdf

4 WAC 460.99C

5 http://www.bizjournals.com/seattle/blog/techflash/2016/06/first-washington-startup-gets-through-crowdfunding.html

6 WAC 460-18A-210 - Notice filing requirements for federal crowdfunding offerings.

7 See https://wefunder.com/stats for continuously updated funding statistics.

Navigating the Treacherous Waters Created by *Ambac v. Countrywide*: Advice for M&A Lawyers When Communicating With Each Other After a Deal Is Signed

By Andrew R. Escobar and Eric Franz

Introduction

New York's highest court recently sent reverberations through the mergers and acquisitions ("M&A") world with its decision in *Ambac v. Countrywide*.[1] Once parties sign a merger or acquisition agreement, M&A attorneys often expect that important legal communications between one party and the other party's attorneys are privileged. However, *Ambac* upset these expectations, long held in Delaware and many federal circuits, by holding that parties to a merger do not share a common legal interest that protects their shared privileged communications from waiver, unless the communications relate to pending or anticipated litigation.[2]

With an ever-growing number of successful in-state businesses, M&A practice is an increasingly important area of law in Washington state. Yet Washington law on the common interest exception is relatively undeveloped. In this article, we evaluate the current state of Washington law, and argue against Washington courts adopting *Ambac*'s restrictive view of the common interest exception.

What Is the Common Interest Exception?

The common interest exception allows a party to avoid waiving attorney-client privilege by disclosing an otherwise privileged communication to a third party, when that third party shares a common legal interest.[3] The common interest exception began as a "joint defense" exception to waiver in criminal cases.[4] It has since expanded to cover a broader set of legal communications. As an exception to waiver, the common interest exception does not shield any communications that would not have been covered by the attorney-client privilege in the first place.[5]

The exception has special significance to companies in merger negotiations, particularly after the merger or acquisition agreement is signed, but before the parties close the deal. Companies negotiating a merger or acquisition must communicate often about regulatory and other legal requirements to ensure that the surviving entity is fully compliant when the deal closes. For that reason, parties often communicate not only with their own attorneys, but exchange privileged and confidential information with the other party's attorneys as well.

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Navigating the Treacherous Waters Created by **Ambac v. Countrywide…** *continued*

Conveying privileged information to another party's counsel is a third-party disclosure that normally waives the attorney-client privilege.[6] But after signing a merger or acquisition agreement, the parties to the deal have a plausible argument that they share a common legal interest in closing the deal and complying with regulations, and therefore privileged communications should not be waived by disclosing them to the other company's attorneys. The success of this argument will vary by jurisdiction.

In Delaware and in many federal circuits, the common interest exception has a broad scope that includes all communications on matters of common legal interest.[7] However, at least 17 states and one federal circuit limit the exception to communications that relate only to pending or anticipated litigation.[8] In those jurisdictions, absent litigation, communications with the other party's attorneys during merger negotiations constitute waiver of the attorney-client privilege, even if the communications are legal in nature.

Whether the common interest exception applies to post-signing communications can have significant consequences. In recent years a significant percentage of mergers and acquisitions were the target of merger objection suits.[9] Many of these cases settle, but some cases result in extremely large judgments.[10] Therefore, companies negotiating a merger or acquisition have a critical interest in retaining their attorney-client privilege during the pre-closing process.

New York Restricts the Common Interest Exception

The *Ambac* court held that in addition to the common legal interest requirement, the common interest exception is also subject to a litigation requirement: The exception does not apply to legal communications between a corporation and another corporation's lawyers unless those communications relate to "pending or anticipated litigation."[11]

In *Ambac*, Bank of America and Countrywide Insurance publicly announced a merger plan on January 11, 2008, and closed on July 1, 2008.[12] The issue was whether the companies shared a common legal interest between those dates such that the common interest exception applied and shielded from discovery their communications with the other company's lawyers.[13] The court held that the common interest exception required the presence of "pending or anticipated" litigation, and because Bank of America and Countrywide did not provide evidence of such, the exception did not apply and the attorney-client privilege was waived.[14] The court rejected Bank of America's argument that the constant threat of litigation in mergers met the anticipated litigation requirement.[15]

Ambac May Chill Communications During Merger Negotiations

Many jurisdictions—including Delaware—take an alternative approach.[16] The *Ambac* dissent made a forceful case against mandating a litigation requirement for the common interest doctrine, arguing that it may chill communication between companies in merger negotiations in a way that will make it more difficult to comply with statutory and regulatory requirements.[17] The dissent pointed out that "clients often seek legal advice specifically to comply with legal and regulatory mandates," not to avoid them.[18] The dissent reasoned that "[e]ffective representation furthers the goal of compliance with the law, thus benefitting not only clients but society in general."[19]

Additionally, the *Ambac* dissent argued that it does not make logical sense to impose a litigation requirement on an exception to waiver of the attorney-client privilege when the privilege itself has no litigation requirement.[20] The dissent also argued that existing methods for preventing obstruction of discovery—including the crime-fraud exception—adequately protect against misuse of the common interest exception.[21]

The *Ambac* dissent further relied on the fact that the *Restatement (Third) of the Law Governing Lawyers*, Weinstein's *Federal Evidence*, and "the majority of federal courts that have addressed the issue, and a significant number of state jurisdictions… have held that the privilege applies even if litigation is not pending or reasonably anticipated."[22]

Washington Law on the Common Interest Exception Is Unclear

The scope of the common interest exception is unclear under Washington law. Washington does not limit the common interest exception by statute, and Washington state courts have not yet addressed whether the exception requires the threat of pending or anticipated litigation. The only examples of the common interest exception thus far in Washington involved actual or potential co-parties in litigation.[23] For example, in *State v. Emmanuel*, the court held that the exception applied when two parties and their counsel communicated for the purposes of pursuing a common defense.[24]

No Washington opinion, however, expressly requires pending or anticipated litigation, and some opinions describe the privilege in a way that suggests pending or anticipated litigation might not be required.[25] For example, in *Sanders v. State*, the Washington Supreme Court upheld the trial court's application of the common interest exception to communications related to litigation, but described the common interest exception to apply if "the third person is necessary for the communication, or has retained the attorney on a matter of 'common interest.'"[26] This broader language suggests that Washington may not follow *Ambac*'s narrow requirement that the communications must be related to litigation in order for the exception to apply.

In the absence of clear Washington law, M&A attorneys are left to speculate as to whether Washington courts would follow Delaware's broad approach or New York's restrictive approach. The fact that Washington looks to Delaware on some shareholder litigation issues may suggest that Washington would adopt a broad exception.[27] For example, a recent unpublished Washington Court of Appeals opinion stated that "[b]ecause the Delaware courts have significant experience with the law of business entities, the courts of this state often look to Delaware decisions as persuasive authority."[28]

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On the other hand, there are potential signs that Washington may adopt a more restrictive exception, like New York. First, at least one practitioner argues that "Washington is not a 'Delaware state.'"[29] Second, courts generally interpret privileges narrowly in the interest of robust discovery.[30] Third, in at least one recent case, the Supreme Court of Washington acknowledged "Delaware's influential jurisprudence" but ultimately looked to New York law instead to interpret a Washington dissenter's rights statute.[31]

Washington should not adopt the litigation requirement, particularly in the merger context. It is in the interests of the parties to the merger *and* the public if the parties can speak freely with each other's attorneys about regulatory compliance without subjecting those legal communications to overbroad discovery when the inevitable shareholder suit is filed. As the *Ambac* dissent notes, parties to a merger most often communicate with each other's attorneys in order to comply with laws and regulations, not to avoid them. Additionally, even with no litigation requirement, the crime-fraud exception adequately roots out any illegal activity during merger negotiations.

Practice Tips for M&A Attorneys in Washington

Uncertainty over the scope of the exception will remain until the issue is litigated or the state legislature steps in. Unless and until Washington state courts determine whether the common interest exception carries a litigation requirement, corporate attorneys representing clients in merger discussions in Washington deals should be aware that some legal communications between their clients and the other company's attorneys may be discoverable. The following practice tips provide some guidance amidst the uncertainty:

- *First*, practitioners with clients in multiple jurisdictions should research the scope of the common interest exception carefully in each of those jurisdictions. Shareholders generally file merger challenges in the state of incorporation or the target's headquarters, so both corporate attorneys and litigators should know how the exception functions in each client's particular jurisdiction, in addition to the relevant federal circuit.

- *Second*, practitioners with clients incorporated in Washington should counsel those clients to exercise caution when communicating on legal issues with the other company or their attorneys after a deal is signed but before it is closed. Until Washington clarifies the scope of the common interest exception, what may seem like a deal post-signing may result in waiver of the attorney-client privilege.

- *Third*, because the common interest exception requires that parties share a common legal interest, companies negotiating a merger might consider including a common interest agreement as part of the deal documents. The common interest agreement should include a statement that the parties share a common legal interest in the surviving entity complying with all applicable laws and regulations. A common interest agreement is not a silver bullet to avoid waiver, but it will improve the facts for your client should shareholders file suit after the deal is announced.

- *Fourth*, practitioners should keep in mind that the common interest exception only shields *privileged* communications from discovery, and the attorney-client privilege does not cover non-legal business communications. Practitioners should also keep in mind that legal communications disclosed to third parties that *do not* share a common legal interest are not privileged in *any* jurisdiction.

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1 *Ambac Assurance Corp. v. Countrywide Home Loans, Inc.*, 27 N.Y.3d 616 (June 9, 2016).

2 *Id.* at 620.

3 *See Morgan v. City of Federal Way*, 166 Wn.2d 747, 757 (2009) ("The presence of a third person during the communication waives the privilege, unless the third person … has retained the attorney on a matter of 'common interest.'") (citations omitted).

4 *See Chahoon v. Commonwealth*, 62 Va. 822, 841-42 (1871) (reasoning that the exception was justified because the parties "had the same defen[s]e to make").

5 For example, business communications without a legal component are generally not covered by the attorney-client privilege.

6 *See Sanders v. State*, 169 Wn.2d 827, 854 (2010) (absent exception, disclosure to third-party attorney waives the attorney-client privilege).

7 *See, e.g.*, D.R.E. 502(b) (attorney-client privilege extends to statements by the client to a lawyer "representing another on a matter of common interest"); *Continental Oil Co. v. United States*, 330 F.2d 347, 350 (9th Cir. 1964).

8 States that impose a litigation requirement by statute include Alaska, Hawaii, Kentucky, Maine, Mississippi, New Hampshire, North Dakota, Oklahoma, South Dakota, Texas, and Vermont. States that impose a common-law litigation requirement include: Tennessee, Maryland, New Jersey, Virginia, Florida, and New York. The 5th Circuit requires a "palpable threat" of litigation. *See In re Santa Fe Int'l Corp.*, 272 F.3d 705, 711 (5th Cir. 2001). Even in jurisdictions with a broader common interest exception, it likely will not apply *before* the merger or acquisition agreement's execution, given that the parties are still negotiating at arm's length.

9 Ravi Sinha, Cornerstone Research, *Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2015 and 1H 2016 M&A Litigation*, at 1 (between 2011 and 2014, over 90 percent of deals valued over $100 million were subject to shareholder

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Navigating the Treacherous Waters Created by **Ambac v. Countrywide**

suits, although that number declined to 64 percent in the first half of 2016).

10 *See, e.g.*, *Am.'s Mining Corp. v. Theriault*, 51 A.3d 1213 (Del. 2012) (affirming judgment for shareholders of over $2 billion in damages and over $304 million in attorney's fees); *In re S. Peru Copper Corp. S'holder Derivative Litig.*, C.A. No. 961-CS, slip op. at 104 (Del. Ch. Dec. 20, 2011) (awarding $1.347 billion, plus interest and attorney's fees).

11 *Ambac*, 27 N.Y.3d at 620.

12 *Id.*

13 *Id.* at 628.

14 *Id.* at 629.

15 *Id.* at 628–29.

16 *See, e.g.*, D.R.E. 502(b) (attorney-client privilege extends to statements by the client to a lawyer "representing another on a matter of common interest"); *Continental Oil*, 330 F.2d at 350.

17 *Ambac*, 27 N.Y.3d at 637 (Rivera, J., dissenting) (reasoning that a broad exception "encourages parties committed to a merger to disclose confidential information to avoid submission of incomplete or noncompliant documents").

18 *Id.* at 633.

19 *Id.*

20 *Id.* at 637.

21 *Id.* at 640.

22 *Id.* at 635.

23 *See, e.g.*, *State v. Emmanuel*, 42 Wn.2d 799, 815 (1953) ("Where two persons having a common interest in certain pending litigation had a conference with the attorney representing one of them, it was held the communications between the attorney and the client were privileged and could not be shown to a third party.") (citing *Hartness v. Brown*, 21 Wash. 655 (1899)).

24 *Id.*

25 *See, e.g.*, *Sanders v. State*, 169 Wn.2d 827, 854 (2010).

26 *Id.* ("The presence of a third person during the communication waives the privilege, unless the third person is necessary for the communication, or has retained the attorney on a matter of 'common interest.'") (quoting *Morgan v. City of Federal Way*, 166 Wn.2d 747, 757 (2009) (*en banc*)).

27 For example, in *In re F5 Networks, Inc.*, the Supreme Court of Washington held that Washington follows Delaware's demand-futility standards. 166 Wn.2d 229 (2009).

28 *Goldberg Family Inv. Corp. v. Quigg*, 184 Wn. App. 1019 (2014) (unpublished) (citing *In re F5 Networks, Inc.*, 166 Wn.2d at 239–40).

29 *See, e.g.*, Buckley, Brian D., *Debunking the Myth that Washington Follows Delaware on Issues of Corporate Law* (August 22, 2012) (noting that the Washington Business Corporations Act ("WBCA") is based on the Model Business Corporations Act ("MBCA"), not Delaware law, and "[t]he legislative history of the WBCA expressly directs Washington courts to look for guidance from other states that have adopted the MBCA," of which Delaware is not one; adding "Washington is not a 'Delaware state' and the Washington courts have never in fact demonstrated a tendency to refer to or rely on Delaware corporate law"). Available at https://www.fenwick.com/publications/pages/debunking-the-myth-that-washington-follows-delaware-on-issues-of-corporate-law.aspx (last visited July 21, 2016).

30 *See Baer v. Abel*, 637 F. Supp. 343, 345 (W.D. Wash. 1986) (explaining, in a different context, that "courts have strictly confined the privilege within the narrowest possible limits consistent with its purpose") (overturned on separate grounds by *Coit Indep. Joint Venture v. Fed. Sav. & Loan Ins. Corp.*, 489 U.S. 561 (1989)).

31 *Sound Infiniti, Inc. v. Snyder*, 169 Wn.2d 199, 208–09 (2010).

What Non-Insurance Lawyers Need to Know About Insurance

By Bruce Winchell

Insurance is heavily relied upon by businesses yet it is poorly understood because of technical jargon and little-known industry standards. This article highlights some key considerations attorneys should know about liability and property and business income insurance.

1. Limits.

Many small to medium-sized businesses give little thought to the limits of insurance they should acquire and may be surprised when those limits are inadequate. It is not uncommon for purchasers to acquire liability insurance of $1 million or less, property replacement cost insurance that is insufficient to make replacement, and business income insurance with time limits that are inadequate to allow for a full restoration of business activities.

With respect to liability insurance, purchasers should realize that one serious injury can easily result in a claim of $5 to $10 million. Purchasers should bear in mind that limits become less expensive as more insurance is purchased.

With respect to property insurance, nearly all policies cover the cost to repair or rebuild property following a loss up to the limit of insurance. Many purchasers fail to determine realistically what it would cost to rebuild their property. They sometimes assume that their agent or broker is taking care of this for them. Purchasers should obtain information on standard construction costs for their type of structure and ensure that limits increase annually for inflation.

Business income insurance typically covers lost profits and ongoing expenses of a business that loses its ability to operate because of a covered loss. Under many policies, the important time limitation on the amount of this coverage is 12 months. However, rebuilding a business often takes longer than that, and businesses should consider obtaining the longest available "period of restoration" for such losses.

2. Tendering a Claim.

Tendering a claim involves reporting a risk to the insurance carrier. A common error by insureds is not to tender claims that are asserted or threatened. This can have serious consequences for the insured. If the policy is a claims-made policy and a claim is tendered after the expiration in the policy that

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What Non-Insurance Lawyers Need to Know About ***Insurance*** *continued*

was in place at the time of the claim, there will be no coverage. *Safeco Title Ins. Co. v. Gannon,* 54 Wn. App. 330, 333-35, 774 P.2d 30 (1989). These types of policies generally cover professionals and directors and officers. A claim is typically a demand for money and does not require a lawsuit. With respect to an occurrence policy (which provides coverage based upon the date of the damage-causing event rather than the date of the claim), late reporting is likely to result in the assertion of coverage defenses by carrier and, if defense costs have been incurred before reporting, might result in a denial of those pre-tender costs. *See Griffin v. Allstate Ins. Co.,* 108 Wn. App. 133, 142, 29 P.3d 777 (2001) (pre-tender costs allowed); *Unigard Ins. Co. v. Levin*, 97 Wn. App. 417, 425-31, 983 P.2d 1155 (1999) (pre-tender costs not allowed). However, a complete loss of coverage is unlikely.

Frequently, insureds and their attorneys do not recognize that a claim potentially is covered under a liability policy. This is particularly true of claims of a commercial nature. Unless insureds and their attorneys are absolutely certain there is no coverage under a liability policy, the claim should be tendered at the time it is made. Coverage, particularly for defense costs, frequently is much broader than insureds realize and a tender can result in unexpected benefits.

With respect to occurrence policies, it is important to tender to every carrier that might provide coverage. If the events that are alleged to give rise to liability, or to have caused damage, span multiple policy periods, tender should be made to the carriers for each of those policy periods.

Particular attention should be paid to the issue of whether there are contractual indemnity agreements or additional insured agreements that might trigger coverage under another entity's policy. There are frequently substantial delays in identifying other potentially applicable insurance policies, and care should be taken early on to seek out such agreements or policies.

3. Duty to Defend.

Washington law is extremely favorable for insureds with respect to the duty to defend. The rules as to when a carrier must provide a defense are summarized in the case of *Woo v. Firemen's Fund Insurance Co.,* 161 Wn.2d 43, 164 P.3d 454 (2007). The carrier must provide a defense if there is any conceivable scenario under which the allegations of the complaint might, if proven, establish coverage. Any uncertainties must be resolved in favor of the insured. Investigation by the carrier can be used to confirm the existence of coverage, but may not disprove the existence of coverage for a defense. If a carrier fails to defend a potentially covered claim, it will likely lose any coverage defenses.

4. Reservation of Rights.

In many cases a carrier defends under a reservation of rights. This means the insurance company reserves the right to deny coverage following a settlement or a trial. The insurance company is required to send the insured a letter outlining its reasons for reserving its rights, and its failure to do so might result in a loss of its ability to deny coverage on otherwise valid grounds. The well-known case of *Tank v. State Farm Fire & Casualty Co.*, 105 Wn.2d 381, 715 P.2d 1133 (1986), sets forth some of the obligations of an insurance company defending under a reservation of rights.

An insurance carrier is required to investigate the claim thoroughly and to retain competent counsel to defend its insured. It must recognize that the attorney it appoints to provide a defense has only one client – the insured. Any conflicts between the carrier and client must be resolved in favor of the insured. The insurance company must keep the insured fully advised of all developments affecting coverage and the potential for settlement. It must not elevate its interests above those of its insured. Decisions as to whether to settle belong to the insured because it is the insured that might ultimately have to pay the settlement. If a carrier fails to provide a good faith defense, it likely will be estopped from denying coverage even if coverage otherwise would not have existed. *Safeco Ins. Co. of Am. v. Butler*, 118 Wn.2d 383, 392-94, 823 P.2d 499 (1992).

5. Dealing With Defense Counsel Appointed by a Carrier.

Insurance companies typically have long-standing relationships with defense attorneys whom they appoint to defend their insureds. Personal counsel to an insured can play a helpful role in monitoring retained defense counsel to ensure that the client's legitimate expectations are met. Retention of a monitoring attorney is relatively inexpensive and can be instrumental in achieving a good outcome, particularly in a situation in which there might be serious coverage issues. The key components to effective monitoring include the following:

a. Agree with defense counsel that all communications with opposing counsel and with the carrier, whether written or oral, will be disclosed promptly to the monitoring attorney.

b. Any limitations placed by the carrier on defense counsel should be disclosed, including limitations contained in litigation-handling guidelines. Such limitations are prohibited under the Washington Rules of Professional Conduct.

c. A written plan should be established for investigation and the conduct of discovery with reasonable deadlines. The monitoring attorney also should include an agreement that attorneys with appropriate experience will perform these tasks.

d. Status reports to the carrier should be reviewed by monitoring counsel before they are provided to the carrier. Many defense counsel take the position that they are to give no consideration to coverage issues in their reporting. It may fall to monitoring counsel to evaluate such coverage issues and ensure that accurate reporting is consistent with the goal of obtaining coverage.

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What Non-Insurance Lawyers Need to Know About Insurance *continued*

6. Settlement Considerations.

When there are significant coverage problems, the insured will be highly motivated to obtain a settlement with insurance proceeds. Where limits are inadequate, the best option for the insured is to elicit a settlement demand from the plaintiff that is within coverage limits. The insured can then demand that the insurer settle the case for the amount of the demand. If the demand is reasonable, the carrier is obligated to settle the case. If it fails to do so, it likely will be responsible for any reasonable settlement in excess of limits. *Besel v. Viking Ins. Co. of Wis.*, 146 Wn.2d 730, 736, 49 P.3d 887 (2002).

7. Considerations for Property Loss Claims.

Property loss claims generally involve three major elements: real property loss, personal property loss, and business income loss.

Real property losses are determined by first agreeing on the scope of the loss. Many insureds are unfamiliar with this process and do not recognize that there is an inherent tension in determining whether a part of a structure has been damaged and how it needs to be repaired. It is important that the insured employ an experienced contractor or licensed public adjuster to determine the scope of the damage. Failing to do so could result in only partial coverage for necessary repairs. Once the scope of the loss is established, the pricing is relatively straightforward. Debris removal and compliance with new building codes generally have separate limits.

Assembling an inventory of personal property can involve an overwhelming amount of detail. Insureds should employ qualified professionals to prepare these inventories. These professionals have specialized spreadsheets to accomplish this task and are adept at obtaining replacement cost pricing from online sources and at supplying depreciation percentages to calculate actual cash value of personal property. (Actual cash value, or market value, is paid before replacement is made.) Insurance companies sometimes will request information that is unavailable or practically impossible to provide, such as receipts for the purchase of old items. An inability to provide such information does not affect the insured's entitlement to coverage.

With respect to business income losses, it is important to employ a qualified professional to establish the amount of the loss. Insurance carriers commonly use one of a handful of accounting firms that specialize in this field. The key factor in determining the amount of a business income loss relates to assumptions that are made about future sales levels.

Nearly all property policies contain a requirement that any suit be filed within one or two years from the date of loss. With certain exceptions, these time limits are enforceable. In claims where the insured is represented by an attorney, the carrier is not required to provide advance notice that the deadline is about to run.

8. Entitlement to Attorneys' Fees.

In a litigated coverage matter in which the insured prevails, the insured normally will be entitled to recover its attorneys' fees. This can occur in one of three ways. The first is under *Olympic Steamship Co. v. Centennial Insurance Co.*, 117 Wn.2d 37, 811 P.2d 673 (1991), which explicitly provides that, where an insured prevails in a coverage dispute, it shall receive its attorneys' fees. However, *Olympic Steamship* fees are not recoverable in disputes relating to the amount of coverage. The second way to obtain attorneys' fees is by establishing a violation of the Consumer Protection Act ("CPA"). This is most commonly done by showing a violation of Washington Insurance Regulations set forth at WAC 284-30-330 through 380. *Indus. Indem. Co. of the N.W. v. Kallevig*, 114 Wn.2d 907, 921-25, 792 P.2d 520 (1990). The third way to establish entitlement to attorneys' fees in a coverage case is to show a violation of the Insurance Fair Conduct Act ("IFCA"), which was adopted in 2007. RCW 48-30-010 *et seq*. IFCA establishes a right to recover attorneys' fees if the insured can show an unreasonable denial of coverage or a violation of Washington Claims Handling Regulations. Some federal courts require a coverage denial in any case seeking relief under IFCA.

9. Assignment of Insurance Coverage.

Insurance policies often contain clauses prohibiting assignment of the insured's rights to a third party. With respect to an assignment that takes place in connection with a settlement, these clauses are generally unenforceable. *Public Util. Dist. No. 1 of Klickitat County v. Int'l Ins. Co.*, 124 Wn.2d 789, 800-02, 881 P.2d 1020 (1994). However, in a normal business transaction, insurance policies may not be assignable from an acquired entity to the acquiring entity without the consent of the insurer. Attorneys who draft such transactions need to be aware that if reliance will continue to be placed on the acquired party's insurance, the consent of the carrier may be needed.

Conclusion

The insurance world is full of traps for inexperienced clients and attorneys. Whenever coverage is in doubt or claims are complex, it is best to consult with an attorney or other professional who specializes in the area.

Bruce Winchell is a shareholder with Mills Meyers Swartling. He practices in the areas of business litigation and insurance coverage litigation representing policyholders. Mr. Winchell is a past Chair of the Litigation Section of the Washington State Bar Association. He is a co-author of chapters on property insurance and duty to defend in the Lexis-Nexis Practice Guide, Washington Insurance Litigation, and has spoken frequently at insurance seminars.

Legal Opinions Committee Update

The Business Law Section's Legal Opinions Committee is currently drafting a new legal opinion report that integrates, amends, and restates its 1998 and 2000 reports. We are confident that it will be a valuable resource for lawyers engaged in giving and receiving third-party legal opinion letters in the State of Washington. In the meantime, we write to update you regarding the work we have been doing, as well as to highlight some evolving trends in legal opinions practice nationally and in the State of Washington.

When the 1998 report was initially published, opinion letters were customary in a wide variety of commercial transactions, including business acquisitions. For this reason, the Committee in its 1998 report provided an annotated illustrative opinion letter that was broad enough for use in a variety of transactions, such as commercial loans, stock purchases, or mergers. Then, in light of the unique issues that arise in secured lending transactions, the Committee later issued the 2000 report, setting forth an illustrative form of opinion that was tailored to grants of real and personal property security.

But much has changed in the years following publication of the prior reports, including the frequency with which third-party legal opinions are requested and received in certain types of transactions. In particular, there has been a dramatic decline in the use of opinion letters in mergers and acquisition transactions over the last decade. According to one recent study, the percentage of mergers and acquisition transactions in which legal opinions of seller's counsel are required as a condition of closing has declined from 68 percent in 2011 to 16 percent in 2015.[1] Meanwhile, opinion letters continue to be commonly requested and given in secured lending transactions.[2] For this reason, we have chosen to focus the new report's annotated illustrative opinion letter on a secured lending transaction; however, we remain confident that most of the guidelines and principles explored in the report apply to opinions given and received in a wide variety of commercial transactions.

Although we are hard at work redrafting, we also continue to monitor an ever-evolving national dialogue on legal opinions. For instance, the Working Group on Legal Opinions and the Legal Opinions Committee of the American Bar Association's Business Law Section recently released its *"Statement of Opinion Practices (March 31, 2016 Exposure Draft),"* which builds upon the highly influential *Statement on the Role of Customary Practice in the Preparation and Understanding of Third-Party Legal Opinions*.[3] We believe it is important to review and integrate these and other important updates into the new report, as this is the only way we can ensure that the guidance we provide takes into account aspects of customary practice that are commonly understood and accepted throughout the country.

In a similar way, we continually track and also participate in discussions within the opinion bar regarding whether and to what extent recent judicial opinions impact legal opinions practice. For instance, in the wake of the 2011 decision in *Fortress Credit Corp. v. Dechert LLP*,[4] in which a New York court found that the listing of certain clearly customary assumptions allowed a law firm to obtain dismissal of the claims against it, some attorneys have wondered whether it is sufficient for opinion givers to rely on customary, rather than express, assumptions, qualifications, exclusions, and other limitations. The Committee, along with many national and influential state legal opinions committees throughout the country, continues to consider many assumptions and other limitations to be customarily included in opinion letters, whether or not stated expressly. As we monitor the debate, we are reassured by the published comments of some of the most prominent voices in legal opinions practice reiterating the importance of streamlining opinion letters.[5]

We are also pleased to see that the national legal opinion literature has moved closer toward a consensus regarding factual confirmations. In the past, transactional opinion letters often included a "no litigation opinion" covering the existence of legal proceedings against the opining lawyer's client. Although often referred to as an opinion, the no litigation confirmation was different from other opinions normally included in an opinion letter because whether a company had been sued or threatened with a lawsuit was a purely factual matter that required no legal analysis. In light of the widely publicized *Dean Foods Co. v. Papthanassiou*[6] ruling, which held a Massachusetts law firm liable for $9 million in damages and costs because its opinion that, to its knowledge, there were no pending or threatened investigations against its client turned out to be inaccurate, many opinion givers have become increasingly resistant to giving no litigation confirmations. The national literature—including recent surveys and reports conducted by the Legal Opinions Committee of the ABA Section of Business Law—has acknowledged these trends and echoed the overall sense that factual confirmations are not appropriate subjects for most transactional opinion letters.

Stay tuned for the release of our new report, which we hope to complete in 2017. In the meantime, if you have any suggestions, comments, or questions for the Committee, please e-mail me at ScottMacCormack@dwt.com.

***Chair**: Scott W. MacCormack* ***Committee**: Joel N. Bodansky, Diane Lourdes Dick, Troy J. Hickman, Brian D. Hulse, Berrie J. Martinis, Shannon J. Skinner, Keith A. Trefry, W. Scott Wert, David Zielke.*

1 SRS Acquiom M&A Deal Terms Study (March 2016), slide 49.

2 There are, of course, a number of other specialized contexts in which legal opinions continue to be requested and given, such as "true sale" opinions, bankruptcy nonconsolidation opinions, audit letters, and opinions on behalf of issuers in venture capital financings and other securities offerings. However, such opinions are beyond the scope of the Committee's reports.

3 63 Bus. Law. 1277 (2008).

4 89 A.D. 615, 934 N.Y.S.2d 119 (2011).

5 Donald W. Glazer and Stanley Keller, Recent Developments—Opinion Practice Implications of the Fortress Decision, 11 Legal Opinion Newsletter (ABA Section of Business Law, Committee on Legal Opinions), Spring 2012, at 8-9.

6 2004 WL 3019442 (Mass. Super. Ct., Dec. 3, 2004).

Highlights of Key State Court Cases of Interest

By Bryan C. Graff

Self-Insured Employers May Recoup Overpaid Benefits Resulting From Innocent Misrepresentations.

On September 16, 2016, the Washington Supreme Court held that under the Industrial Insurance Act, Title 51 RCW, the Department of Labor and Industries ("Department") (and a self-insured employer) may recoup previously overpaid benefits caused by clerical error, mistake of identity, innocent misrepresentation, "or any other circumstance of a similar nature," provided it requests the adjustment of benefits within one year of the date of the incorrect payment. *Birrueta v. Dep't of Labor & Indus.*, No. 92215-2 (Wash. Sept. 15, 2016) (*en banc*). In so doing, the court reversed a published opinion of the Court of Appeals, *Birrueta v. Dep't of Labor & Indus.*, 188 Wn. App. 831, 843, 355 P.3d 320 (2015), which had held that the Department was barred from recouping an overpayment following a final order.

The case involved an employee ("Birrueta") who suffered a workplace injury resulting in his total disability. An unknown person helped Birrueta complete a report of industrial injury and the report mistakenly stated that Birrueta was married. Birrueta signed the report, declaring the statements therein to be true, but he was in and out of consciousness at the time. Thereafter, the Department issued a compensation order providing that Birrueta was married and it became final in 2009 pursuant to RCW 51.52.050. Birrueta made no effort to correct the mistake until completing a questionnaire in 2011 that accurately reported his unmarried status. The Department thereafter issued orders assessing an overpayment and changing his marital status for compensation purposes.

Birrueta appealed to the Board of Industrial Insurance Appeals, which affirmed the Department's orders. On further appeal, however, the Superior Court reversed, concluding as a matter of law that the Department lacked authority to issue the recoupment order and could not change Birrueta's mistaken marital status. The Court of Appeals unanimously affirmed the Superior Court, holding "only nonfinal orders are subject to a claim that benefits were underpaid or overpaid as a result of clerical errors, mistake of identity, or innocent misrepresentation." *Birrueta*, 188 Wn. App. at 843.

The Supreme Court reversed. The Department, a self-insured employer, or an injured worker, may seek correction of erroneous payments based upon clerical errors, mistakes of identity, or innocent misrepresentations within one year of payment pursuant to RCW 51.32.240(1)(a). This is true regardless of whether an underlying compensation order is temporary, or final and binding. However, a final order will preclude an injured worker's right to seek adjustment of underpaid benefits, or the Department's (or a self-insured employer's) right to recoup overpaid benefits if the mistake is based upon an "adjudicator error," *i.e.*, an error in applying the law to the facts, insufficiency of evidence, or errors of law.

Do Not File Suit on a Rejected Creditor's Claim in a Probate Proceeding.

The Court of Appeals has clarified that a claimant's suit on a rejected creditor's claim must be brought as an ordinary civil action and should not be filed in a proceeding under the Trust and Estate Dispute Resolution Act ("TEDRA"). *Sloans v. Berry*, 189 Wn. App. 368, 375, 358 P.3d 426 (2015). A business or other claimant who has a claim rejected by the deceased's estate is not a proper "party" under TEDRA. "It is only after a judgment in a civil action establishes the amount of an allowed claim that the claim becomes subject to the rules of estate administration." *Id.* at 375.

In *Sloans*, the claimant alleged that the deceased breached real property maintenance obligations and failed to pay property taxes in breach of an agreement. She timely filed and served creditor's claims with the deceased's estate, but the estate rejected her claims. The claimant then filed (and later amended) a "Petition on Rejection of Creditor's Claims" against the estate's co-administrators under the probate cause number for the estate. The estate moved to dismiss the petition for lack of subject matter jurisdiction and failure to state a claim, arguing a judicial proceeding under TEDRA is an inappropriate vehicle for establishing a creditor's claim. *Id.* at 373. The Superior Court Commissioner agreed, dismissed the claimant's suit with prejudice, and ordered her to pay the estate's fees.

On appeal, the Court of Appeals agreed that the claimant was not a proper party to a judicial proceeding under TEDRA. While acknowledging that it is understandable why a claimant may prefer to proceed under TEDRA, with its provisions for mediation, arbitration, and resolving matters expeditiously, a claimant without a judgment does not fit within TEDRA's definition of a "party" (RCW 11.96A.030(5)). *Sloans*, 189 Wn. App. at 375. A claimant's suit on a rejected creditor's claim must, therefore, be brought as an ordinary civil action, governed by the civil rules, where the parties may have a right to a jury trial and are subject to a lengthy case schedule. *Id.* However, the Court of Appeals held that, in *Sloans*, the error was procedural, not jurisdictional, and harmless because the claimant filed her action in the Superior Court within the 30-day statute of limitations, paid the filing fee, and timely served the estate. *Id.* at 377-79. Accordingly, the Court of Appeals reversed the trial court's dismissal and remanded the case to the Superior Court to be treated as an ordinary civil action and placed on an appropriate civil calendar. *Id.* at 379.

All businesses, and particularly those who may find themselves more regularly dealing with a creditor's claim against a decedent's estate (*e.g.*, hospitals, long-term care facilities, and lending and financial institutions) should be cognizant of this procedural development and proceed accordingly.

Membership in a Voluntary Association May Give Rise to a Duty to Arbitrate.

Think you cannot be compelled to arbitration absent proof

... continues ...

of your signature on a written arbitration agreement? Think again. Membership in a voluntary association whose bylaws contain a duty to arbitrate has the same effect as an executed arbitration agreement. *Marcus & Millichap Real Estate Inv. Servs. of Seattle, Inc. v. Yates, Wood & MacDonald, Inc.*, 192 Wn. App. 465, 469, 369 P.3d 503 (2016).

In *Marcus & Millichap*, the parties were each members of the Commercial Broker's Association ("CBA"). CBA's bylaws contained an arbitration clause that provided that "[i]t is the duty of the members of this Association (and each so agrees) to submit all controversies involving commissions, between or among them to binding arbitration by the Association…." *Id.* at 470. CBA's bylaws further authorized its board of directors to amend the rules and procedures governing CBA arbitration. CBA did not maintain records dating back to the time that Marcus & Millichap applied for and became a member. Accordingly, no writing containing Marcus & Millichap's signature and manifesting its assent to the arbitration provision could be produced. The evidentiary record also did not establish what form of arbitration provision existed at the time Marcus & Millichap became a CBA member, but rather only the arbitration clause that existed at the time the underlying dispute arose. Accordingly, Marcus & Millichap asserted that it was under no duty to arbitrate. Marcus & Millichap filed suit seeking a declaratory judgment that no agreement to arbitrate existed and moved to stay an arbitration proceeding that Yates, Wood & MacDonald, Inc. ("Yates") had commenced against it. The trial court denied Marcus & Millichap's motion for a stay, granted Yates's motion to compel arbitration, and dismissed Marcus & Millichap's lawsuit.

The Court of Appeals affirmed, holding that "[u]nder Washington law, an express agreement to arbitrate is not required." *Id.* at 474. "Absent an express bilateral contract, voluntary membership in a professional organization establishes assent to an arbitration agreement contained in that organization's bylaws." *Id.* at 475. A signed arbitration agreement is not necessary. Moreover, insofar as CBA's bylaws explicitly authorized its board to amend the rules and procedures governing arbitration, it was not necessary to establish how the arbitration clause read at the time Marcus & Millichap became a member. Rather, Marcus & Millichap, a voluntary member of the association, was bound by the arbitration provision extant when the underlying dispute arose. *Id.* at 482. The Washington Supreme Court denied Marcus & Millichap's petition for review on August 3, 2016. *Marcus & Millichap Real Estate Inv. Servs. of Seattle, Inc. v. Yates, Wood & MacDonald, Inc.*, 185 Wn.2d 1041, 377 P.3d 764 (2016).

Those who do not wish to arbitrate disputes should carefully consider the articles, bylaws, and rules of any voluntary associations they have joined. Arbitration provisions contained therein are binding and may be amended over time.

Bryan Graff is a Member at Ryan, Swanson & Cleveland, PLLC. Mr. Graff has broad litigation and appellate experience, which includes transportation, insurance coverage and regulatory matters, employment, class action and intellectual property cases, as well as construction defect, landlord/tenant and various other business disputes.

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