GP|Solo Law Trends & News
Practice Area Newsletter

A service of the ABA General Practice, Solo & Small Firm Division

May 2007 • Volume 3, Number 1

Dear Division Member:

Below is the first issue of *Law Trends* for this bar year. I am sorry for the delay but, like vintage wine, it is well worth the wait. As with prior issues, this e-newsletter includes articles, checklists, and other valuable practice information and practical tips, all from each of our substantive practice areas in the Division. This issue highlights some emerging areas such as some new Bankruptcy issues, some interesting checklists to use in real estate issues as well as use of e-discovery in various applications, and many more. Thus, I am delighted to attach your first edition of *Law Trends* for this bar year.

With this issue, *Law Trends* is now three years old. We hope you agree that with each edition, *Law Trends* continues to provide meaningful articles for each of you and continues to improve. We trust that this edition, like the others, continues to be helpful to you in your daily practice. I encourage you to take just a few moments to read the list of articles included. Of course, it is yours to download and keep as a reference for the future. And, as in the past, you can either download specific articles or you may download the entire newsletter by clicking the PDF link.

There are many Division members integrally involved in putting this e-newsletter together. Their hard work and dedication are certainly present. I thank them for producing this issue for the Division.

I hope each of you enjoy this issue of *Law Trends*. The publication will continue quarterly and we hope you continue to find it as a source of valuable information. If you are interested in either writing an article for the summer issue or participating in the production of the newsletter or are interested in getting involved in any way, please contact Jim Schwartz, at attyjls@aol.com. Jim can direct you to the proper practice area if you would like to submit an article to be considered for publication in one of these newsletters or help you get involved in publishing it. Also, if you have any questions, comments or suggestions about this issue or other things you would like to see in the future, please contact Jim or me.

I hope to see you at the GP|Solo 2007 Spring Meeting in Washington, D.C.

Best regards,

John P. Macy

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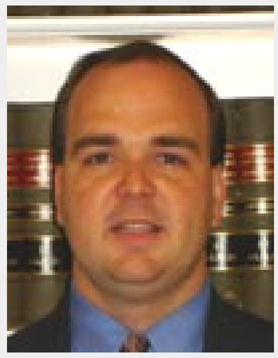
Scott Laufenberg
Business Law Group Coordinator



Scott received his undergraduate degree from the University of Wisconsin – Platteville, and he received his J.D. and a master's degree in public administration from Drake University. After clerking for the Kentucky Court of Appeals upon graduation, he currently practices with the firm of Kerrick, Stivers & Coyle, P.L.C. in Bowling Green, KY. He is also an adjunct professor at Western Kentucky University where he teaches an upper-level course on legal principles to students pursuing degrees in business-related majors.

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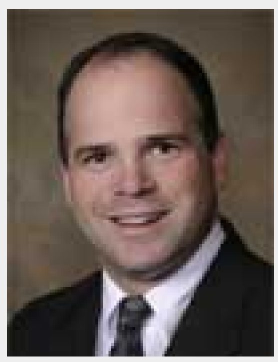
Henry M. DeWoskin
Litigation Group Coordinator



Henry M. DeWoskin is a partner at the law firm of Alan E. DeWoskin, P.C. in St. Louis, Missouri. His practice consists of wills, estate planning, military law, probate, domestic relations, social security and general civil litigation. Henry holds multiple positions in the GP Solo & Small Firm Division and the YLD of the American Bar Association and the Bar Association of Metropolitan St. Louis. In addition, he is a Major in the Judge Advocate General's Corps in the United States Army Reserves. Henry received his B.A. from Bucknell University in 1992 and his J.D. from Temple University in 1996.

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Answering the Call: The Role of Lawyers in the Fight Against AIDS

By Seth D. Levy, Esq.

June 5, 2006 marked the twenty-fifth anniversary of the first AIDS diagnosis in the United States. Twenty-five years, and there remains no cure for AIDS. New infections occur daily; another generation is being victimized; and, of the more than 1,000,000 people living with HIV in the United States, it is estimated that nearly one-third remain unaware of their infection.

Great progress has been made in understanding HIV -- the virus that causes AIDS -- and in developing medical interventions and social services programs that enable people to live productive lives with the disease. Despite this progress, however, the stigma and discrimination that people living with HIV/AIDS must face in nearly every aspect of their lives create obstacles to securing treatment, construct barriers to obtaining services, and engender fear in their communities. It is widely believed among experts that this fear, coupled with the rampant stigma and discrimination that manifests in communities large and small, urban and rural, in red states and in blue, results in individuals not availing themselves of HIV testing to learn whether they have been infected. Absent knowledge of their disease, infected persons may unknowingly pass the virus to others. HIV thus continues to spread.

Lawyers have a critical role to play in reducing the spread of HIV. Indeed, overcoming stigma and discrimination is precisely what the law enables society to do; providing instruments to vindicate the rights of those who are discriminated against and to combat stigma with principles of fairness and logic. By using the law effectively to overcome the stigma and discrimination faced by this community, lawyers can help to reduce the fear associated with HIV/AIDS. With less fear, people can be more easily encouraged to get tested, and thus obtain the services they need and the education that will assist in preventing further transmission of the virus.

The U.S. Centers for Disease Control and Prevention (CDC) recognized this important intersection between law and public health, when in its *Revised Guidelines for HIV Counseling, Testing and Referral*,[1] it recommended that "Clients who test positive should be referred to legal services as soon as possible after learning their test result for counseling on how to prevent discrimination in employment, housing, and public accommodation by only disclosing their status to those who have a legal need to know."[2] The CDC adopted this guideline primarily to combat pervasive fear of AIDS-related stigma and discrimination, documented as a significant barrier to HIV testing, which is an essential element in breaking the chain of new infections.

Lawyers experienced in AIDS discrimination cases had proposed the new guideline. They argued that, because AIDS discrimination typically begins with clients' unnecessary disclosure of their HIV status to employers, landlords, or others, prompt referral to legal services following a positive HIV test prevents such disclosures and thus prevents discrimination. Specifically, preventing discrimination accomplishes two vital public health goals: 1) to preserve clients' access to employment, housing, health insurance, and health care, all of which are crucial to maintaining their well being in dealing with HIV; and 2) to increase the number of persons coming forward to be tested -- a critical CDC goal, because once people learn their HIV status, HIV prevention counseling can be given, resulting in fewer additional infections. Thus, prompt legal services play a central public health role in preventing HIV infection.[3] Never before had the CDC recommended an immediate referral to legal services based on someone having been diagnosed with a particular disease. This extraordinary recommendation underscores the unique challenges faced by people living with HIV/AIDS as well as the importance of legal services to stopping the spread of the disease.

In fact, people living with HIV/AIDS face a wide array of legal challenges, many of which may not immediately jump to mind for those that are unfamiliar with the disease and its impact. In addition to issues highlighted by the CDC, such as employment discrimination and access to health care, many must deal with considerable challenges in areas such as bankruptcy and debt counseling, immigration, privacy and confidentiality, government benefits, family law, and a host of others. If it is difficult for unwary attorneys to identify these issues, then one can easily understand why people living with the disease and who do not have the training to predict their own legal needs only do so once significant problems develop.

To answer the CDC's call for prompt legal services as an HIV prevention measure, the American Bar Association is undertaking a new initiative to educate people with HIV/AIDS about their legal rights and give them the resources and advocacy tools they need to protect those rights. A central feature of this initiative involves a public service project developed by the ABA Young Lawyers Division, titled *Answering the Call*; a project that has now found a permanent home with the ABA's AIDS Coordinating Committee and AIDS Coordination Project.

Answering the Call is an ambitious project by any measure. It was designed to educate young lawyers nationwide about AIDS and the law, and to encourage them to reach out to the community of persons living with the disease[4]. One of the ways in which lawyers are encouraged to reach out is by implementing *HIV Legal Check-Up*, a diagnostic legal needs assessment program that bridges the gap between the CDC's recommended referral to legal services and the effective delivery of those services by the legal community. With *Check-Up*, an attorney provides a consultation to identify the legal needs of someone living with HIV/AIDS and to thereafter refer the individual to appropriate services. *Check-Up* has been successfully used to identify and address the legal needs of many people living with HIV/AIDS before these issues manifested into more serious problems. The program has been lauded for its unique capacity to identify, on average, one to two previously unrecognized legal issues for each person it is used to serve. *Check-Up* is a flexible program that can be readily tailored to suit the needs and resources of any community. It is a powerful mechanism for identifying incipient legal needs before they become problematic; for promoting the more effective use of legal services resources; for reducing stigma and discrimination; and for ensuring access to treatment and prevention counseling.

There are any number of ways in which lawyers, law firms, bar associations, and other entities in the legal community can use the tools and resources at their disposal to assist those living with HIV/AIDS. Such assistance is vital to curtailing the spread of the disease, and ultimately, to ending the epidemic.

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He is the liaison between the ABA Young Lawyers Division and the ABA AIDS Coordinating Committee, and recently completed a term of service as the Young Lawyers Division's Public Service Coordinator, where he led the development of Answering the Call.

[1]50 *Morbidity and Mortality Weekly Report* No. RR-19 (11/09/01), *available at* http://www.cdc.gov/mmwr/PDF/RR/RR5019.pdf

[2]Id. at 37.

[3] *Letter from the Los Angeles City Attorney's AIDS/HIV Discrimination Unit to the CDC Re: Public Comments – 10/17/00 Draft Revised Guidelines for HIV Counseling, Testing and Referral* (11/26/00), available by request from dschulm@atty.lacity.org.

[4]*Answering the Call* information and materials, available at http://www.abanet.org/yld/answerthecall/home.html

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Bankruptcy Reform At Year One

By Lloyd D. Cohen

With the first year anniversary of bankruptcy reform in sight, practitioners are beginning to peer through the twilight of statutory vagueness into the daylight of uncertain practice. An initial court decision construing the *Bankruptcy Abuse Prevention and Consumer Protection Act* of 2005, "BAPCPA," actually commented that, "BAPCPA is not a model of clarity." Another written decision asked, "Can any rational being make a cogent argument that this stuff makes any sense at all?" Some practitioners sum-up their feelings by referring to BAPCPA by the alternate colloquial acronym 'BARF,' the Bankruptcy Act Reform Fiasco. But regardless of ones personal feelings about bankruptcy reform, it is here to stay.

Bench and Bar have struggled toward a reasonable administration of this law. Many districts have issued general orders clarifying some of the new BAPCPA requirements, including: How creditors should implement the clerk's registration of preferred addresses; how debtors should transmit required pay and tax information; and in Chapter 13 cases, how the trustee should administer adequate protection payments. These orders, together with updated local rules, and other helpful bits of information, often can be found on the court's web site. Also, Chapter 13 Trustees often have model Chapter 13 Plans available. Note however, that the U.S. Trustee has its own guidelines which are continue to be subject to change without notice.

All this still leaves trustees, creditors, debtors (and their attorneys) with the same question as that posed by Ronald Regan during his first successful campaign for the presidency. That is, "Are you *better off* today then you where four years ago?" At the risk of speaking for everyone, I would guess that the resounding answer is "No." At least, no one is *happier*, except for the select groups of creditors, supposedly blessed by BAPCPA, who are still waiting to see if they will ultimately be more profitable. Everyone else is just trying to cope with change.

Creditors are pleased with the current down-turn in the number of bankruptcy filings. However, since other regulations have caused charge card minimum payments to double, and recent financial conditions have caused interest rates to rise, more experience is needed before the forecast of any new trend is possible. Secured creditors and landlords are pleased with their improved rights, but again it is too early to measure its effect on defaults or collections. Meanwhile, creditor attorneys keep busy making sure that their clients are afforded all of their new rights. However, the vagueness of this law continues to cause its enforcement to be a challenge.

At the same time, trustees must now do more with less. They have more regulations, more required questions to ask, and more information to report. They must accomplish these tasks within shorter time periods but (so far) for the same compensation. Consequently, trustees may be tough on filers who have not completely and appropriately answered all of the required questions and who have not timely produced all of the required documents.

BACPA gives debtors have a mixed bag. On one hand, the era of cheap & easy bankruptcy may be over but, on the other hand, bankruptcy is alive and well. Standing alone, each of the new bankruptcy filing requirement may be trifling, but take as a whole, they can be daunting to the poor, the ignorant, or the emergency filer. Indeed, many potential filers are experiencing “sticker shock” not only as to the new total cost of relief but also as to the new duties that must be fulfilled to obtain relief. My conclusion is that the current down-turn in bankruptcy filings is not the result of the new pre-bankruptcy credit counseling or other requirements, but instead is the result of this “sticker shock,” or change in expectations. I speculate that the long-term effects of this may be the opposite of what the supporters of BAPCPA intended. The abusive filer, who should be dissuaded from filing, and the upper-middle class filer who should be encouraged to enter into a payment plan, may instead just enter into more extensive pre-bankruptcy planning. While those who are most distressed and most deserving may be denied access. Only time will tell.

Meanwhile, debtor attorneys are busy implementing all of their new duties. First they became “Debt Relief Agencies.” This new title brought a new layer of specifically tailored restrictions and obligations. Second, they found that they now have to obtain more documents then they ever did before, and perform a “Means Test” to qualify each debtor. They must do this while exercising an increased level of “due diligence,” else risk possible exposure to personal liability. These burdens have driven some general practitioners from the field, but there are still plenty of debtor attorneys available.

So even though the rate bankruptcy filings are down, filing volume is again slowing growing. Chapter 13 now comprises a larger share of these filings then it did under the old law. However, we are still in the period of time when we are waiting for consumer expectations to adjust. We are still wondering if that adjustment will cause any long term change in debtor behavior. We are all still waiting to have more experience with this law so we can return to an era of certainty. Meanwhile, **here is my quick list of simple answers to consumers’ Frequently Asked Questions**(You may copy and use them, with the understanding that the answers are very simple and very general).

Q. ***Is it true that the new bankruptcy law might affect what type of bankruptcy I might choose to file?***

A. Yes. Your ability to choose may be limited by a “means test” you must now complete to determine the type of bankruptcy for which you are eligible. The “means test” form is now part of the consumer’s bankruptcy case filing and it compares your last six months actual household income to the median household income level reported by families of the same size in your area. If your household income is above the median, then your household expenses are examined as well. If more than 50 percent of your debts are business-related debts, then you do not have to file a means test.

Q. ***How might the means test affect my bankruptcy?***

A. If your household income is below the median, you can file either a Chapter 7 “straight liquidation” bankruptcy or a three-to-five-year Chapter 13 repayment plan bankruptcy. If, however, your income is above the median (assuming yours is a consumer debt bankruptcy), and your household expenses result in excess income for your household, then you will not have the option of filing a Chapter 7 bankruptcy. Instead, you will be limited to filing either a Chapter 11 or Chapter 12 or Chapter 13 repayment plan.

Q. ***What are the differences between the types of bankruptcy?***

A. In a Chapter 7 bankruptcy, an examiner (the “trustee”) may sellassets with non-exemptequity (such as a valuable car with no loan against it, cash in the bank, or tax refunds) to pay off some of your debts. The most of the remaining debts are discharged (legally forgiven), although some debts, such as student loans, child support and spousal support, cannot be discharged.

In a Chapter 13 bankruptcy, you keep your property while repaying a potion of your debts over time. Your repayment amount is based on what the court finds to be reasonable.

A Chapter 11 bankruptcy is usually reserved for big businesses or very wealthy people. Most consumers file under Chapter 7 or Chapter 13. There is also a Chapter 12 bankruptcy that can be used by family farmers and fishermen. Bankruptcies filed under Chapter 11 or 12 do not require the means testing and counseling that is required for individuals filing Chapter 7 or 13.

Q. ***Must I now go through counseling if I intend to file for bankruptcy?***

A. Yes! You are now required to have two counseling sessions, one before filing and one afterward, but you can complete them in person, over the phone, or across the Internet. However, the sessions must be with a credit counselor that has been approved for bankruptcy counseling by the Executive Office of the United States Trustee.

Q. ***What happens during counseling?***

A. Before filing for bankruptcy, you must review your bills and budget with a credit counselor who will discuss non-bankruptcy alternatives(This is called pre-bankruptcy counseling). The second counseling session (called debtor education) must occur after you have filed your case, but before the 45th day following your first scheduled hearing with the bankruptcy trustee (called a “Section 341” meeting). Debtor education involves a financial management course.

Q. ***What types of documents will I need when I file bankruptcy?***

A. In addition to your pre-bankruptcy counseling certificate, you will need a record of the last six months’ income used to calculate the “means test,” including actual pay stubs received in the last two months before filing, and your last two to four years’ tax returns. Additionally, you may be requested to produce the following documentation:

- deeds, mortgages, motor vehicle and memorandum titles, as well as bank and investment accounts;
- any divorce or child support records, and records of any lawsuits or judgments; and
- the last couple of months of bills and a credit report (to ensure that all debts have been listed).

Q. ***When should I consult an attorney about bankruptcy?***

A: You should consult with an attorney experienced in bankruptcy issues when you believe you will not be able to continue to pay your bills on time, have been sued on your debts, or are uncertain as to your rights concerning the debts you owe. Depending upon your particular situation, your attorney can help you decide if it would be to your advantage to file bankruptcy or to avoid bankruptcy.

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Dealing With OSHA - The Most Common Mistake Companies Make

Say an OSHA inspector shows up at your door, unannounced, and wants to conduct an inspection of your workplace. What do you do?

If your company is like most others, you let the inspector proceed. At the conclusion of the inspection, which could be days, weeks or months later, you find out if OSHA is going to issue any citations to your company. Then, if you are cited for one or more violations, you might for the first time in this process call your lawyer.

Compare that scenario to a visitor who is injured on your property and sues your company. You (or your insurance company) immediately hire a lawyer to defend the lawsuit. The lawyer is integrally involved in all aspects of discovery; depositions, document production, etcetera. By the time trial comes around, the lawyer has carefully prepared the case and knows all of the applicable facts about it.

Now think back to the OSHA inspection. That inspector was interviewing your employees (i.e. taking depositions), looking at your logs, records and written programs (i.e. reviewing your documents), and where was your lawyer? Not hired yet! Most companies let OSHA conduct and complete its discovery before even calling their lawyer. Big mistake! You would never do that with the personal injury lawsuit, so why do it with OSHA?

A lawyer who is knowledgeable about OSHA procedures and requirements can help a great deal with the conduct of the inspection, in many cases significantly affecting its outcome. I routinely tell my clients that while both are important, if they only are willing to have me involved with either the inspection or the contest phase defending the violation, I can usually help them more during the inspection.

OSHA inspections occur in several ways. In each case, the inspector is limited to inspecting the part of your operation that gave rise to the inspection*, but no more. For example, if an employee complaint or an accident in your loading area lead to the inspection, the inspector is not supposed to delve into other areas of your operation. With that said, they can cite you for violations in other areas if they happen to observe them or learn of them during their inspection of your loading area. Many inspectors, if allowed, will gradually expand the inspection to encompass other areas of your business. Containing the inspection to one particular area or operation and shielding others from view has obvious benefits to the employer.

Examples of ways that a given inspection can be contained or allowed to expand are too numerous to mention in this article. But the point is that it is OSHA's right to conduct the inspection it is there to conduct, not some broader one. The best way to keep it from expanding into a larger inspection, and a bigger deal, is by assigning someone to represent the company in the inspection who knows the OSHA procedures, requirements and case law. That person is your OSHA lawyer.

So, say you're now convinced that you should bring in an OSHA lawyer to represent your company during an inspection. How can you do that when the inspector has shown up at your door unannounced? Easy!

OSHA has two mechanisms for conducting a legal inspection, your voluntary consent or a valid search warrant. The OSHA inspector seldom shows up with a search warrant. Without a search warrant, the only way the inspection can proceed at that time is by you voluntarily agreeing to allow it. If you tell the warrantless inspector that you will allow the inspection, but only once your OSHA lawyer arrives to participate in it, the inspector has only two alternatives: 1) he or she can leave and either obtain a search warrant or forget about you; or, 2) agree to wait for your attorney. If the delay is limited to, say, an hour or two, they will usually wait for the lawyer. Getting the search warrant requires a considerable amount of bureaucratic red tape.

Another step that is useful in getting your company ready for a surprise OSHA inspection is an anticipatory meeting between your OSHA lawyer and your facility managers. At that meeting, the process suggested in this article can be explained to each manager who may be the one in charge at the time an inspector shows up, as well as considerably more details such as: how to handle the initial introduction; what to expect once the inspection proceeds; what equipment to keep ready (i.e. camera and film to take side-by-side pictures of whatever the inspector photographs); what to tell employees; etcetera. Such a briefing can usually be accomplished in one to two hours, and makes a big difference in how your company fares when that surprise visitor from OSHA shows up.

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Phony E-mail and Old-fashioned Scams

By Lloyd D. Cohen

The **pitch** used by the sideshow barkers to hook an audience used to fascinate me as much as the oddities themselves. The pitch, that would always hook me, was the one for *The Amazing Gorilla-Woman*. In that exhibit, I would see a model morph into a gorilla. Then, without fail, the transmuted gorilla would become so fierce that it immediately broke down the bars of its cage, causing the barker to exclaim, "The gorilla is loose, run for your lives." Thereupon, the tent would immediately empty with each patron leaving the cost of admission far behind. Nowadays you do not have to cruise the sideshows to find scams because hucksters will e-mail their pitches right to you.

A popular pitch currently circulating the Internet is known among fraud-busters as the **"419 scam."** Named after the section of Nigerian law used to bust the original perpetrators, the scheme has crossed borders and variations now abound. It may appear in your e-mail as something like this: Someone claiming to be an employee of a foreign bank gives a pretext for contacting you and launches into a long and sad story. The sender explains that an out-of-county depositor died leaving millions in a personal account with no heirs. However, the money can be claimed by anyone without suspicion as long as it is transferred out of his country. Further, he is in a position with the bank to expedite such requests. In return for your help he offers to split the millions with you. Simply disclose some personal information along with your bank account number and the millions will be transferred to you. He will meet you later to split the money.

In reality, this type of e-mail is randomly sent to a myriad of recipients every day. If you disclose your information, then instead of having money transferred into your account, all of your money will be taken out of it. A host of national and international fraud laws are broken by scammers like these. Recently the **U.S. Department of Justice** established the **Internet Fraud Initiative** to coordinate law enforcement of this problem.Consumers may log complains through the **Internet Fraud Complaint Center** by contacting *usdoj.gov/criminal/fraud/Internet.htm*. The **Federal Trade Commission** also lists the most frequently reported scams at *ftc.gov*.

Modern scammers have become very bold. They may now dispense with the long sad story and delivery of a personal assurance. They may just blatantly ask you to disclose your personal data. These hi-tech fraudsters attempt to convince consumers to reveal their private information through **official looking fake Web sites** that request up-dates or verifications of your information. This crime is called **phishing** and it comes with a one-two punch. First, your identity information is harvested. Then, the information is used to obtain money or credit.

All scams, whether old or internet are essentially crimes of persuasion wherein the perpetrator makes a play for your trust. Traditionally, your trust may have been negotiated through personal contact and an elaborate pitch. However, in our fast-passed modern times, the fraudsters may just pander to an image or relationship that you have come to trust. The **Better Business Bureau**, found at *bbb.org/alerts*, recommends that you treat all unsolicited e-mail requests for personal information with great suspicion. When in doubt, telephone the inquiring business and personally verify the legitimacy of any request.

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Profit More By Billing Less: Technology That Saves Time And Fattens The Bottom Line

By Marc Lauritsen

The Productivity Paradox

Imagine completing the paperwork for typical transactions three or four times faster. Improvements like that are common with document assembly software.

Imagine finishing due diligence projects twice as fast. Efficiency gains like that are possible with intelligent checklists.

Imagine clients handling some aspects of what you do, getting (and paying for) results they need with little of your time. That's now very doable with online knowledge tools.

Could you make good use of such improvements? What's the catch?

Law offices can skyrocket their productivity through new technologies, but the fiscal payoffs are not obvious. In an hourly-billing world, greater efficiency can mean lower billables. Why invest in time-saving tools when time is what you charge for?

Many lawyers face this productivity paradox. The faster they work, the less money they make for a given assignment. There is a built-in tension between efficiency-improving technology and strict hourly billing. But there is also tension between inefficiency and business prosperity.

Here are some ways creative lawyers have found to unleash the profit-enhancing power of advanced practice tools. The first section discusses those who continue to bill hourly. The second discusses those able to bill in different ways. A third section covers techniques that apply to both kinds of people.

How To Make Money By Saving Time, Even If You Bill By The Hour

Maybe you're not ready to walk away from the billable hour. Don't let that stop you from working smarter and improving your bottom line.

1. Reduce the hours you don't bill for anyway. First, think about all the money you lose because you write off time. Good systems can help eliminate some of the time you feel compelled to write off because some timekeeper recorded more hours than can be justified, or because the overall bill seemed too high or the client complained. "Hidden caps" on bills are common. Explicit caps are increasingly seen, causing pain when accidentally over-run, and nail-biting when strategically under-set.

2. Improve work conditions for people whose time you don't bill. Don't forget that efficiencies for staff whose time is never billed, like secretaries, can reduce operating costs. Document automation can radically improve word processing efficiency, while minimizing errors and frustration. Making do with fewer support staff -- who are happier and stay longer -- could do wonders for your overhead.

3. Get more business. Practice automation can strengthen client service, quality control, and competitive advantage, as well as reduce costs. Offering high quality service with faster turnaround is a proven way to attract more business. Technology investments can help draw attention. You can pitch these improvements to clients, put them in proposals, and highlight them on your website.

4. Keep business you might otherwise lose. Perhaps you have a book of business that is not especially profitable, but for strategic reasons would be costly to lose. Maybe your anchor clients are actively shopping for better prices and services elsewhere. You can't afford not to innovate. Corporate counsel increasingly demand controls on outside legal costs. Loyalty will not stop them from moving work elsewhere if your charges are too high. One partner at a large New York firm told me that using document assembly is "the only way to stay competitive."

5. Add a transaction fee to recover technology costs. Document automation pioneer Eric Little recommended that firms add on a per-transaction cost that roughly splits the billable time savings between firm and client. Systems can be viewed as hypothetical banks of time that can be drawn down across many transactions. You make deposits of time as you create and maintain them, and you make withdrawals -- with interest -- as you use them. Reductions in hours billed are more than made up for in transaction fees.

6. Raise your rates for work that leverages automated expertise. Systems that demonstrably enhance your professional effectiveness can help justify higher rates. Quality work done quickly is worth more than work of lesser quality or speed.

How To Make Even More Money Through Value Billing

You've probably noticed that some of the most valuable things you do for clients are not fairly measured by the time they take, and that an hourly approach penalizes you for becoming more efficient on commodity tasks. Value-based billing opens new windows of profit opportunity on both fronts.

1. Use new technologies in contexts where billing practices already reward greater productivity. **Some practice areas, like contingency fee litigation,** consumer bankruptcy, immigration, no-fault divorces, estate planning, and municipal finance already have a tradition of fixed or not-to-exceed fees. In these contexts, the basic economic analysis is simple: Given the volume of work you do (or could do), and the time/cost savings you could realize by deploying productivity-enhancing tools, is there an adequate return on investment for the costs of those tools?

2. Charge for the time it used to take you before automating. Many lawyers engage in some de facto value billing: They charge for the time some task ordinarily would have taken, or should have taken, even if they happened to have actually spent more time (or less time, because similar work was recently done for another client). Absent clear client disclosure, "hypothetical" time accounting like this raises ethical concerns. But with client consent, it can serve everyone's interests. Nancy Grekin, a Honolulu practitioner, notes: "Pigs get fed and hogs get slaughtered. If a lawyer charges too much the client will complain, and it doesn't take bar association ethical standards for the lawyer to figure that out. I see the billing for automated documentation as the amortization of the lawyer's time and expertise in creating that document and turning out something that is correct and is what the client wants and needs."

3. Set flat rates for service packages that are amenable to automation. If the competition keeps busy doing a certain kind of work at an average price of $X without any significant knowledge-leveraging technology, power tool-equipped providers should be able to do that work at a significant discount and still make a profit. One way is to specify fixed prices for well-defined service packages. If automating enables you do a job in one-half the time it ordinarily would take, charge a flat fee that is perhaps 10 to 15 percent lower than the average fee pre-automation and you can make a lot of money.

How To Make Money Either Way

1. Think long term. Consider the contributions to firm quality and productivity that go beyond the immediate bottom line, such as training new attorneys, capturing knowledge of staff who leave, reducing errors, and making practice less dreary. Quality-of-life improvements like these will more than pay for themselves over the long run.

2. Ask clients to underwrite some costs of your technology. Think of billing as the process through which clients are asked to contribute appropriately to the cost of services they receive. Given the opportunity, long-term clients might happily underwrite technologies that enable you to deliver services more cost-effectively. Not only will that help you serve them better with little out-of-pocket cost, but the results can often be put to profitable use elsewhere. One top firm arranged for a client to fund the development of the knowledge base underlying a system, which was independently valuable to the client, and then sold systems based on that work to other firms, law departments, and a publisher.

3. Consider hybrid scenarios. None of these approaches need be pursued in isolation, and some naturally go hand in hand. For instance, Lee Knight, an independent document assembly application developer based in San Diego, reports: "One of my clients (a group of estate planning attorneys and paralegals) realized that in order to take advantage of document assembly efficiencies they had to change their billing practice from an hourly rate system to a combination of (1) fixed per-document charges (varying according to the type of document) and (2) per-hour counseling charges for any work exceeding the baseline for preparation of those documents. It took some time to figure out the charges, but the new system is working well. The client's clients seem to like the new system because it gives them a more definitive idea of what their costs will be."

Doing Well By Doing Good

Advanced technologies can richly reward firms that figure out how to leverage them. Often an hourly-billing mind-set gets in the way of both profitability and client satisfaction. But you don't need to jettison current billing arrangements to do better.

Lawyers tend to under-invest in technologies that enhance their effectiveness. Not enough of them have figured out how to profit from practice technology, and until they do, our profession will fail to live up to an important aspect of its potential. Making money from working smart as well as working hard is a recipe not only for lawyer prosperity, but for the effectiveness of the legal system.

Clients crave quality, attentive service, predictability, and good value. In the long run, lawyers who use the latest tools and techniques responsibly will get the work -- and the results -- they deserve. Let's see ... drive costs down, bring revenues up. Sounds like a formula for profit -- whether you bill by the hour or not.

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Residential Landlord Tenant Under BARF[1]

BARF was the first major rewrite of the Bankruptcy Code since 1978. It makes major changes in all aspects of the practice of bankruptcy law, including landlord tenant relationships.

The first change involves the Stay of proceedings pursuant to §362. Section 362(b) now excepts from the automatic stay the continuation of any eviction, unlawful detainer action, or similar proceeding by a lessor against a debtor involving residential property in which the debtor resides.

What this means that the stay does not apply to the continuation (not commencement) of an unlawful detainer action immediately without an Order unless the debtor files with the petition a certification stating whether a) a judgment for possession had been entered before the petition **and** whether under non-bankruptcy law the debtor could cure the monetary default after the entry of the judgment and the debtor deposited with the clerk of the Bankruptcy Court the rent that would be due during the next 30 days and within 30 days the debtor has cured the monetary default.

The stay is also terminated by order, upon a hearing that must be held within10 days of the filing of the landlord's objection to any certification. It is also terminated immediately if the court so determines. It automatically terminates 30 days after the petition if the debtor files the first certification but not the second.

If there was a judgment for possession entered prior to filing, it must be indicated on the petition including the name and address of the landlord.

The stay does not apply if the landlord files a certification that the eviction is based upon endangering the property or because of the illegal use of controlled circumstances or that the debtor has allowed others to endanger the property or illegally use controlled substances on the property.

If a judgment for possession has been obtained before the bankruptcy case is filed for a property in which the debtor resides, the debtor must indicate on the bankruptcy petition that such a judgment has been obtained, and state the name and address of the lessor. If no certification is filed with the petition, or no further certification is filed within 30 days of the petition, the clerk must immediately serve on the debtor and the lessor a certified copy of the docket indicating the failure of the debtor to file the certifications and the applicability of the stay exception under § 362(b)(22).

Section 362(b)(22) imposes new administrative burdens on bankruptcy court clerks. These are burdens that the clerks are not yet prepared to handle. In addition to the notification requirements the clerk will now have to accept rental payment deposits by debtors. In the past, payment into the registry of the court required a specific order to put it in and another order to get it out. The interim rules are unclear whether an order is required. Section 362(l)(5)(D) also requires the clerk of the court to arrange for the prompt transmittal to the lessor of any rent deposited with the court. In theory it seems like a reasonable solution. Reality is, however different and it is anticipated that there will be any number of problems with the implementation. The federal judiciary has had massive budget cuts. The staffing to handle all of these and other new obligations is not there and there is no budget to provide for additional staffing. In the Western District of Washington, the court has adopted a local rule to attempt to solve the problem. Local Bankruptcy Rule 4001-1 provides:

(b) Rent Deposits Under Section 362(l). Any deposit of rent made by or on behalf of a debtor pursuant to 11 U.S.C. § 362(l)(1)(B) must be in the form of a cashier's check or a money order payable to the order of the lessor, and delivered to the clerk upon filing of the petition and certification made under Section 362(l)(1). The debtor must at the same time file a copy of the judgment of possession or eviction and proof of service of the certification under Section 362(l)(1) upon the lessor. Upon receipt of the cashier's check or money order, the clerk will promptly transmit the check/money order to the lessor by certified mail/return receipt requested, at the address of the lessor as stated in the certification filed by the debtor under Section 362(l)(1), unless the clerk is instructed in writing by the debtor or landlord to use a different address.

Exception for Eviction Based on Illegal Use of Controlled Substances or Endangerment to Property

New § 362(b)(23) creates an exception from the stay if the landlord files and serves on the debtor a certification under penalty of perjury that: (1) an eviction based on the illegal use of controlled substances or endangerment to the property or (2) the debtor has within 30 days before the certification either endangered the property or illegally used or allowed to be used controlled substances at the property. This provision does not apply until 15 days after the lessor files and serves a certification even though it is placed in § 362(b) as an exception to the stay.

The debtor is given, pursuant to 362(m), 15 days to file and serve on the lessor an objection to the truth or legal sufficiency of the lessor's certification. If the debtor is successful, the exception does not go into effect and the stay under § 362(a)(3) continues to apply until it would normally terminate. The hearing must be held within 10 days of the filing of the objection and the debtor must demonstrate that the situation which gave rise to the lessor's certification of or illegal drug use either did not exist or has been remedied in order to prevail. Given the numerous additional hearings that are contemplated by BARF, getting a hearing within 10 days may be impossible. There is no clear indication of what happens if the hearing does not happen or if the court continues it. Since § 362(m)(2)(C) does not state when such a cure must occur, presumably the debtor may remedy the alleged improper activity at any time prior to the hearing.

If no objection to the lessor's certification is filed, or if court rules against the debtor, the clerk must "immediately" serve on the parties a certified copy of the docket indicating either the failure to object or entry of the court's order. Since the exception is limited to the stay provided under § 362(a)(3), the lessor may not proceed with an eviction that seeks to recover on a pre-petition claim against the debtor, such as a claim for damages to the rental property, without first obtaining relief from the stay provided under § 362(a)(6). In addition, the stay provided under § 362(a)(3) should continue to apply to any attempt by the lessor to obtain possession of the rental property that is unrelated to the certification and not based on the endangerment of the property or the illegal use of controlled substances.

The statutory language in subsections (b)(23) and (m) provide virtually no guidance to the court in making findings about the truth or legal sufficiency of a lessor's certification that the debtor has "endangered" the property or used or "allowed to be used" a "controlled substance" on the property. These terms and phrases are not defined in the new subsections or anywhere else in the Code. In fact, the term "endanger" and the phrase "endangerment of property" are not even Residential Landlord and Tenant Act. As in most of BARF, there are contradictory and different interpretations. For example, by stating that the illegal drug use must be "on the property," it is not clear whether this includes only the immediate rental premises occupied by the debtor. It can be argued that it includes other apartments or common areas in a complex in which the debtor resides. The issue of what constitutes a sufficient cure by the debtor of the alleged property endangerment or illegal drug use also requires interpretation and analysis.

The lack of clarity in the statute, the brief 10-day period for conducting a hearing on the will impose other challenges for the court and the parties. Although a lessor's certification filed under § 362(b)(23) should be treated as a contested matter, it is not clear whether the procedures outlined in Bankruptcy Rule 9014 will apply. Since the lessor's certification may involve fiercely contested allegations concerning drug use and property endangerment, the lessor should be required to allege sufficient facts in the certification to give notice to the debtor effective notice of what the landlord is claiming. Presumably Bankruptcy Rule 9014(c) will be applicable to some extent so that the parties may conduct discovery. However, given the time deadlines, this may be impossible. It is not clear that the court has the authority to continue the hearing beyond the 10-day period.

The effect of these revisions is unknown. It would appear that there will not be sufficient time to file pleadings and the courts will be required to hear oral testimony, make findings on disputed facts and rule on legal issues that they would previously have permitted state courts to deal with. All that this means is that the stay is gone. It does not lead to the issuance of a Writ fo Restitution. That will require a further hearing in Superior Court where the Bankruptcy Court's findings may or may not be *res judicata.* Despite the possible advantage to the lessor of an expedited stay termination under subsections (b)(23) and (m), lessors may prefer to file a stay relief motion rather than submit a certification

The Chapter 13 Trap

When all of these provisions got enacted, Congress forgot about the co-debtor stay under § 1301 when the debtor is in Chapter 13. Expedited procedures may allow the landlord to terminate the stay as to the debtor, the expedited procedures need not apply in Chapter 13.

Logic would dictate that if relief from stay is granted pursuant to sub-section (m) that it will also apply to the co-debtor. However, if it is for a pre-petition debt and the obligation is purely monetary, the result is not so clear. Only time and the courts will decide.

Acceptance or rejection of the lease.

In a Chapter 7 this is not relevant. However, in a Chapter 13, the landlord can move the court for an Order Compelling the debtor to accept or reject the lease. If the lease is accepted, the debtor must cure all of the arrearage and any other default. If it is rejected, the debtor must vacate the property. Getting the debtor to accept the lease means that the landlord is entitled to an administrative priority for all post petition payments. That means the landlord gets paid equivalently with the trustee, the attorney for the debtor, or any other post petition obligation.[2]

[1]The Bankruptcy Abuse Reform Fiasco (more officially known as the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA))

[2]There is an exception for domestic support obligations.

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Scientific Client Selection

As the practice of law entered the 21st Century, there have been major changes in the manner in which lawyers perform their duties. What was once considered a “learned profession” first became a profession and has now become a business. Law Practice Management Consultants abound. They converse in terms of leveraging associates, earnings ratios, marketing, and maximizing productivity. Numerous articles and even books have been written about how to charge more, how to increase billable hours, and even how to go “beyond the billable hour.”

Tomes have been written about how to attract and retain clients, how to effectively market practice areas, cross sell services, and how to develop good client relationships. However, little, if anything has been written about how to determine whether you want the client you attracted and, even more importantly, how to make that decision when they first come through the door. Until now, no one has applied scientific principles to the initial determination of whether to accept the client in the first instance.

In our office we have developed a scientific system for making this decision. In short we take the factors outlined below and, after applying statistical methods and means averaging analysis, we rate each potential client on our Client Flake Index (CFI). We then apply that rating to our Monthly Flake Quota (MFQ) and Office Flake Allowance (OFA) to determine whether to accept representation of the potential client.

There are a number of factors that go into a determination of the CFI[1]. The first and most important of these is the LPR or Likelihood of Payment Ratio. Experience has shown that a client with a low LPR has a substantially higher CFI even when all of the factors are considered. Consequently, a quick determination of the LPR[2]cases requiring an instant determination will provide a good indication of whether to take on this client's problems.

The LPR is derived from a number of factors. What is the retainer amount? Is the client employed? What kind of payments can they make? What is the referring attorney’s experience with the client? Are there wealthy relatives? Are there assets (house, real estate, etc.) that can be liquidated to pay you? Will the client secure your fee? If so, on what property and in which position? If the retainer check bounces, the LPR is negative and you should consider whether or not the client falls into the TFC status discussed *infra*.

The LPR is determined as follows:

$$LPR = \frac{1}{RA + (CPMP - PWD) + VS} \times 10$$

where RA= Retainer Amount, CPMP = Current value of projected monthly payments, PWD = Potential Work Date (When will you have to do the work), VS = Value of Security, and PTF = Projected Total Fee.

Since the vast majority of our business is the result of referrals from other lawyers, the RACF or Referring Attorney Credibility Factor is important in our office. For instance, some attorneys send us all of their non-average bankruptcies. If the referring attorney is a regular referral source, it may indicate that the client is a good risk since most attorneys do not wish to be known as sending flaky clients. If you have never heard of the referring attorney it means nothing. However, if you think (s)he is a clod, a higher CFI is indicated. If you really don't like them, they may be getting even with you for something in the past. Tread carefully.

Our office handles a number of complex cases which have been mishandled prior to our involvement. The PCCF or Previous Counsel Competency Factor is therefore important. If previous counsel was competent, a higher CFI results. If previous counsel was incompetent, a lower CFI is indicated. If the attorney is an idiot and the client recognizes it, it does not indicate much of anything unless the client has been with the attorney for a long time. In this case, a higher CFI is indicated. A good general rule is that if you are the second counsel and previous counsel has a low PCCF score; do not elevate the CFI on this basis. Be cautious, however. If previous counsel was competent; or if you are the third attorney, don't take the case, regardless of other factors. The possible exception to this is if you are a specialist and the referring attorney is also prior counsel.

The Client Honesty Factor, or CHF, is the next item to consider. If the client is lying to you, it is not worth representing the client. Period. With the expansion of Rule 11, and the new obligations under § 707(b) of the Bankruptcy Code, it is important that you investigate all that your client tells you. If you must do this regularly, it takes time from other cases. If you must pay sanctions because your pleadings are not grounded in fact, your reputation with the court will suffer, you will probably lose the case, the client will be angry with you, you will not be paid, and you will have to pay the sanctions from your own pocket.

A related factor to consider in deciding to represent a potential client is the MPF or Malpractice Premium Factor. This is a function of client honesty, rationality and expectations[3]. The factor is most appropriately summarized in the following question, "Will this @#%$$# sue me if he/she/it does not get the relief desired and what will it do to my malpractice insurance premiums?"

If the potential client wants to do it as a "matter of principle" be extremely careful[4]. This is the client who will look for a malpractice action and probably will complain about your bill. They most probably will not pay your bill.

In our office the SIF or Secretarial Intuition Factor is an important element of a clients CFI quotient. My current secretary has more life experience than I, and an uncanny ability to spot flakes. Consequently, her opinion[5] is a major factor in the determination of the CFI.

The last factor to be discussed in depth in this article is the PRF or Potential Referrals Factor. I have, throughout my career, represented a number of clients with CFI statistics off the scale. However, these clients have sent me numerous substantial business clients who pay their bills regularly, listen to my advice, and do what they say they will do. Consequently, they rate a low CFI. These clients would not have come to me but for my representation of their friend, relative, etc.

This is a minor factor. After all, flakes seem to travel in packs[6] and it is unlikely that your flaky client will have non-flaky friends. At the outset, it is extremely difficult to determine what the possible referrals are. While the PRF may not be readily available when determining to take the client, it should certainly be considered when deciding whether to fire the client.

There are a number of additional factors which go into our determination of a client's CFI. Is the client pleasant; do you need to fumigate the office after he/she/it leaves; will they follow your instructions; will they do what they tell you they will do; can they; do you like the client; do they reek of cheap (or expensive) perfume, aftershave, or spirits, do they smoke?[7]

After establishing the CFI, we then apply that number to see if the potential client meets our MFQ or Monthly Flake Quota. We have arbitrarily set our MFQ at 500. In order to determine whether a client is over or under our MFQ we simply add the CFI for each new client taken during the month. This is expressed mathematically as:

$$\mathrm{SUM}\ (CFI1+CFI2+CFI3\ ...) < MFQ$$

where each superscript number is a client and MFQ is our Monthly Flake Quota.

We also maintain an Office Flake Allowance (OFA)[8]. This is the sum total of the CFIs of all active cases. In our office this is set at 10,000. In the event that our OFA exceeds this level we do not take new clients and do not start new matters until the OFA is reduced. The reason for this is that when our OFA reaches this level, the office cannot physically or mentally handle any new case.

When a client's CFI will result in a total score in excess above our allocated MFQ we refer the client to another attorney or tell him/her/it to come back next month. The same is true if our OFA is at or near capacity.

This process is designed to weed out Marginally Flaky Clients (MFC's). When applying the formula to real life it is important to remember that if clients didn't do stupid things, we would not be in business. MFCs appear reasonably intelligent and normal. They may even act normally. However, they are not. The Degree of Flakiness (DOF)[9] is an indication of how much trouble[10] you will have representing them and how much staff time they will take in the event that they retain you.

This process may be helpful in allowing you to avoid the Totally Flaky Client (TFC). The TFC is to be avoided at all costs[11]. The TFC will argue about your bill, obtain an adjustment and still not pay you. (S)he will not listen to your advice and will not tell you all of the truth. He will spend time researching his case on the internet and then argue strategy and procedure with you. She will consume vast amounts of time and cause untold amounts of aggravation. No amount of analysis will allow you to be certain you have a TFC. However, to paraphrase Justice Stewart, you'll know him/her/it[12] when you see him/her/it. And when you see one, RUN!

This entire process is intended to answer the one question that every attorney must ask when taking on a new client. I have always referred to it as the S.O.B. question. Six months from now would I rather be unpaid and defending a motion for sanctions for an

SOB who is angry with me or would I rather be unemployed and **S**itting **O**n the **B**each? [13]

[1]The relative values assigned to each factor will vary with the office and with the personality of the lawyer involved.

[2]In 90% of cases the LPR = CFI

[3]If you are taking the case pro bono, charge something. Even $5.00 per hour gets the client invested in the process and makes them realize that they are receiving value. It won't cover your overhead but it will cut down on useless phone calls and will inject some reality into their decision making.

[4]I usually tell such clients that principles are important and to litigate his case he should place $15,000 in my trust account so that the matter can be properly pursued at least $5,000 is not refundable. This usually injects some reality. On the other hand, if they pay it. . . .

[5]Since most clients deal with my secretary/paralegal directly, and, she is the primary contact point and client interface, her reaction to the client is extremely important. If they can work together, a good attorney client relationship is more likely.

[6]This is sometimes referred to in the literature as the Flake Grouping Effect or the Lemming Principle.

[7]In addition to establishing the values to be assigned to each factor, each office or attorney must decide what individual factors must be considered. It is anticipated that the factors in a personal injury client may be different from those in a securities client.

[8]This is sometimes referred to in the literature as the A/STL or the Attorney/Staff Tolerance Level. In other words, will continued dealing with the client give you the screaming meemies.

[9]The DOF is measured in our office on CFI. It is not to be confused with the DOJ which is in a different world altogether.

[10]In nearly all cases DOJ=TROUBLE where D is a department of or part of a governmental agency and J is equal to or greater than Justice. *See, inter alia*, Office of the U.S. Trustee. As in "I'm from the government and I'm here to help."(The scariest words in the English Language) *See, inter alia,* Federal Emergency Management Agency (FEMA) *In Re Hurricane Katrina* (2005)

[11]Unless he/she is married to your brother, sister, mother, father, etc. in which case you are already out of luck.

[12]Note: Politically correct designation

[13]The Beach" is allegorical. In the middle of winter in Chicago it might be better to be in a warm courtroom with adrenalin flowing than on one of Chicago's "famous" beaches. However, that courtroom is probably not as good as the slopes at Aspen.

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Think Before You "Click"

By Lloyd D. Cohen, Attorney at Law

The riddle for modern times goes like this: **When is your signature not your signature?**

When is something in-writing never written? The answer is simple but the impact is enormous.

Since the middle ages, people have memorialized their important legal choices with the ceremony of laying ink on paper and briefly waiting for it to dry. The ritual not only emphasized the importance of the action being undertaken, but also its finality. Many readers can recall the nervousness and hesitation associated with putting pen to paper when the realtor slides a purchase contract across the table; or the banker, a loan; or the lawyer, a will.

Now in modern times, the signing ceremony may be replaced by the mere "click" of a computer key. A legally binding contract may only exist as electronic fields and templates associated by a database program stored in the memory of a computer. A digital or electronic signature binding you to the contract may be symbolized by something other then your name and might not exist on any paper anywhere.

Most states have adopted a ***Uniform Electronic Transactions Act***. The Ohio UETA says that an electronic signature may be attached to or logically associated with an electronic record. The law provides that:

A. Information, records, and signatures shall not be denied legal effect, validity, or enforceability solely on the grounds that they are in electronic form.
B. Where a rule of law requires information to be "written" or "in writing," or provides for certain consequences if it is not, an electronic record satisfies that rule of law.
C. Where a rule of law requires a signature, or provides for certain consequences if a document is not signed, an electronic signature satisfies that rule of law.

Since WWII businesses in need of product have enjoyed the ease of being able to mail a "purchase order" to a supplier. Such orders, received in the normal stream of conference, cause the fairly automatic shipment of the requested product, which arrives with an "order invoice" attached, requesting payment of the amount due. This practice makes business more efficient by eliminating the need for buyer and seller to enter into a separate contract each time a purchase is desired. The **E-commerce** laws now permit businesses to make purchases simply through the use of **e-mail**.

In tandem, the federal ***Electronic Signatures in Global and National Commerce Act***

(ESIGN) decrees that in the United States the use of a digital signature is as legally valid as a traditional signature written in ink on paper. *The law also contains some consumer protections.* Information required by law to be in writing can be made available electronically to a consumer only if the individual affirmatively consents to receive the information electronically and if the business clearly and conspicuously discloses specified information to the consumer before obtaining the individual's consent. A consumer's consent to receive electronic records is valid only if the consumer confirms his or her consent electronically, in a manner that reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent.

Under these laws, your consent and your signature may be represented by something other then your signed name. Some software makers talk about your **digital signature**.

However, this may refer to a cryptographically encoded document that alerts the reader to any alteration, or the reference may actually be to an attachment of a graphical image that really looks like your own signature. However, your **e-signature** may have nothing at all to do with an image of your name. The law provides that your **e-signature** can consist of almost anything. Even a voice print, a retinal scan, or a passcode can be considered to be your signature. Your consent to a contract can be given as easily as just filling-in a "dot" in an on-screen box, or the mere "clicking" of the "y" on your keyboard.

According to an *Federal Trade Commission* study on this subject, a clue that you are dealing with an honest on-line party is that disclosures will be timely, clearly, and conspicuously made, with ample opportunity for down-loading and printing. A clue that you are dealing with unscrupulous operator will the presence of confusing or unprintable material. Either way, you need to think before you "click." Although a "keyboard click" is a much more casual type of communication then the physical action of taking a pen across a printed page, it can have the same legal significance.

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Circular 230-How It Changed Our Lives [Or At Least Our Practices]

By Edward M. Manigault and Steve R. Akers

As most readers should now be aware, the IRS substantially revised Circular 230 effective for written advice given after June 20, 2005. See Edward M. Manigault & Steve R. Akers, Nuts and Bolts of "Covered Opinions" Under Circular 230, Prob. & Prop. 34, Mar./Apr. 2006. As expected, the "covered opinion" requirements of Circular 230 have changed the practice of tax law. Although the authors (part of a group of Section members who prepared comments to Circular 230) expected the covered opinion rules of Circular 230 to have a material effect on tax practice, even they were surprised at the suddenness and the magnitude of the effect of Circular 230.

Here is an anecdotal example of how quickly, and how dramatically, the covered opinion rules changed the way practitioners deliver tax advice. A client wanted to transfer a particular depreciable asset to her children. The asset in question was valuable, but it had materially decreased in value from its purchase price. The advisors determined that if the client gave undivided interests in the asset to her children, the value of the gift would be based on the current fair market value, most likely with a fractional interest discount. If the children subsequently sold the asset, the children would calculate the loss using the fair market value on the date of the gift as the basis under Code § 1015(a). The advisors further determined that if the children retained the asset, they could continue to depreciate the asset using the mother's original purchase price less prior depreciation. Based on the differences between the mother's and children's income tax situations, the children would benefit over time from the gifts of the assets, even if they paid the gift tax as a net gift, and even if there were little or no future appreciation in value.

The advisors prepared a written communication for the mother, explaining the potential transaction, including the risks and potential benefits. The analysis seemed fairly straightforward, because the benefits were based on the difference between basis for determining a loss following a gift (the lower of carryover basis or current fair market value) and the basis used for depreciation (carryover). The advisors did not complete the analysis and memorandum until shortly after June 20, 2005. At that time, it was not clear whether the transaction was a "principal purpose transaction." There was no clearly applicable exception. Unless the client was willing to go through the trouble and expense of a full-blown covered opinion, the advisors did not feel that they could safely provide any written advice. Instead, they met and discussed the transaction in person.

Similarly, the authors know of a well-respected attorney who created a family limited partnership and an irrevocable grantor trust, made gifts to the grantor trust, and sold limited partnership interests to the grantor trust without a single written word from the attorney to the client other than the legal documents themselves.

The authors assumed that planners already have altered substantially their normal practices in light of Circular 230. They therefore thought it would be appropriate to investigate what other practitioners expected to happen with the Circular 230 changes, how their expectations compared to what they actually experienced when the Circular 230 changes became effective, and what actions they have taken or procedures they have implemented in response to the covered opinion rules of Circular 230. As part of that investigation, the authors prepared a survey, which was completed by 200 participants. The survey was not performed scientifically, and not all participants responded to each question. Percentages quoted are of those who responded to the particular question. This article discusses the results of that investigation and survey.

Circular 230--Familiarity, Expectations, and Reality

As a result of anecdotal discussions with other practitioners, the authors had come to believe that many advisers were simply uninformed about Circular 230. Many were not aware of the existence of Circular 230 before the discussion of the recent changes, even though Circular 230 traces its origins back through predecessors promulgated over 100 years ago. Some practitioners were not familiar with the provisions of Circular 230 unrelated to "covered opinions." Not surprisingly, 53% of the survey respondents said that they had still not read Circular 230 in its entirety, even though 91% had filed a Form 2848--Power of Attorney and Declaration of Representative, thus subjecting them to all of Circular 230, not just the covered opinion requirements. Interestingly, Circular 230 arguably may not cover the 9% of respondents who had not filed a Form 2848, including the covered opinion requirements, based on a literal reading of the definition of "practitioner" in sections 10.35(b)(1) and 10.2(e) and those who may practice under section 10.3(a) "by filing with the Internal Revenue Service a written declaration." What did surprise the authors in this context is that 14% of the participants said they had not read even the covered opinion requirements of section 10.35 of Circular 230. Given the importance of the covered opinion rules, every practitioner should read section 10.35, and because of its complexity and nuances, preferably several times.

As with many things in life, the expectations of the surveyed practitioners were not consistent with actual experience. Of the participants responding, 75% said they did not expect that the covered opinions rules would apply to their practices. In sharp contrast, 63% of the participants said that section 10.35 had in fact changed their practices! Perhaps their expectations were based on a lack of familiarity with section 10.35, as many of the responses indicated that participants provided advice that is apparently within the scope of a literal reading of the covered opinion rules. For example:

- 66% of participants indicated that they prepare projections of the potential financial effects of possible **estate planning** transactions assuming valuation discounts;
- 43% indicated that they had prepared, after June 20, 2005, financial projections assuming a valuation discount for an interest in a family limited partnership or LLC;
- 31% indicated that they had issued, since June 20, 2005, what would be a "reliance opinion" but for a disclaimer that the advice could not be used for penalty protection;
- 16% had issued, since June 20, 2005, written communications about what they consider to be a "principal purpose" transaction; and
- 7% had issued formal "covered opinions" after June 20, 2005.

Interestingly, 16% of participants believe they had issued written communications about "principal purpose" transactions, but only 7% had issued formal covered opinions. Circular 230, however, does not exempt a written communication about a "principal purpose transaction" from meeting the requirements of a covered opinion (other than the very limited exceptions in section 10.35(b)(2)(ii)). Therefore, some participants must not understand or are simply ignoring the requirement that written communications about "principal purpose transactions" meet the requirements of a covered opinion.

Another interesting result is that only 16% had issued written communications regarding what they consider to be a "principal purpose transaction." The authors do not know how many participants had delivered any written communications describing the use of family limited partnerships or limited liability companies in wealth transfer planning, although 43% had prepared written financial projections that assumed a discount on an interest in an FLP or LLC. Apparently, practitioners who prepare written summaries of transfer planning alternatives with FLPs or LLCs believe they are not "principal purpose transactions," even though the IRS has taken the position in a number of the reported FLP cases that the dominant reason for using the FLP was to take advantage of valuation discounts.

The differences between expectations and experience also might be based on the expectations of clients, as compared to the literal terms of Circular 230. Consistent with the authors' experiences, 94% of participants believe their clients want written communications primarily to educate them about the possible transactions, rather than for penalty protection.

When given a chance to comment on the covered opinion rules, and their experiences with them generally, participants expressed some strong feelings:

- "I am still having problems understanding Circular 230...."
- "The amendments to [Circular] 230 are an unwarranted and very destructive...."
- "Circular 230 is a gross overreaction to fraudulent practices by the big accounting firms."
- "Circular 230 is unconstitutional and it interferes with the attorney-client privilege. It is reminiscent of the stupid privacy statements the FTC tried to impose on us a few years ago. A waste of trees and time and over-broad. Stupid, stupid!!"

Covered Opinion Rules--What Are Practitioners Doing?

One does not have to be well-versed in the intricacies of Circular 230 generally, or section 10.35 specifically, to see that many practitioners have taken some steps in response to the covered opinion rules. The "Circular 230" e-mail legend is the most obvious (and according to many survey respondents, ridiculous) reaction. What is still not clear is the extent to which practitioners have implemented other procedures and practices in response to Circular 230. It is clear that there is no uniform response.

Circular 230 Disclaimers

A very high percentage of practitioners have adopted some variation of the Circular 230 disclaimer. The most common form of the disclaimer is usually similar to the following example:

IRS Circular 230 Disclosure: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

Although there seems to be general consensus about the language to be used in the disclaimer, practitioners disagree about what communications require the disclaimer, which authors must use the disclaimer, and who has the authority to remove the disclaimer.

Disclaimers on E-mails. A group of the largest law firms, most of which are either based in or have a significant presence in New York, developed the disclaimer language quoted above following a series of conference calls before June 20, 2005. Most of those participating in that ad hoc consortium agreed that the use of the disclaimer on all e-mails, even though not required, was practically expedient in that it relieved the practitioner of the burden of deciding whether to include the disclaimer on a case-by-case basis. Of those responding, 68% have apparently adopted this rationale and require **disclaimers** on all e-mails. This approach is not without its detractors. Some participants had some interesting things to say, both about the results of this practice and about those who follow it.

- "All communications now have that silly disclaimer on them."
- "Huge waste of space."
- "I have rejected the idea of putting [the Circular 230 disclaimer] on every written communication. When I see practitioners doing that, I think it looks stupid."
- "I think it reflects badly on practitioners who adopt the policy of putting the disclaimer on all communications."
- "Use some common sense for Pete's sake."
- "The bar's response of making it 'industry standard' to include the legend is also a gross overreaction to Circular 230. Hopefully saner heads will correct this nonsense."
- "On the rare occasion that a client asks about it, they're told, 'don't worry; it's just another silly IRS rule.'"

Despite these reasons for being more selective in using e-mail **disclaimers,** the fact is that most practitioners are using the **disclaimers** on all e-mail messages.

- "Circular 230 'legends' on almost all written advice."
- "Circular 230 Disclaimer added to all e-mails issued from this office."
- "I now include a version of the Circular 230 disclaimer in most letters and messages."
- "We use a 230 notice on all fax cover sheets, e-mails, and most client letters."

Disclaimers on Other Written Communications. Although most practitioners have chosen to use **disclaimers** on all e-mails, the opposite is true for other forms of written communications. Of participants responding, 60% had not adopted a policy requiring the use of **disclaimers** on written forms of communications other than e-mails. Many participants explained that they do not require the **disclaimers** when no advice is given, such as in transmittal letters. Others appear to determine whether a disclaimer ***35** is warranted based on the nature of the advice, excluding the disclaimer if the advice is "plain vanilla" or if "clear under existing law." Some participants conceded that they have still not adopted any policy.

Disclaimers--Who Includes and Who Can Remove? For those firms that use **disclaimers,** there seems to be a lack of uniformity on who within the firm uses it. For example, some participants stated that they require the disclaimer to be used by all personnel, not just attorneys. Others stated that only lawyers, or only lawyers and paralegals, must use the disclaimer. Still others distinguished based on the author's area of practice, such as tax, trusts and estates, or ERISA/employee benefits, with the same variations (all personnel, lawyers only, lawyers and paralegals, or secretaries of those groups).

The amount of discretion, if any, given to practitioners to remove or omit the disclaimer on written communications varies widely. Some participants gave each attorney the discretion not to use the disclaimer. At least one participant left the decision to use a disclaimer to a tax partner. The authors know of at least one firm that requires the use of the disclaimer on all written communications containing tax advice, unless the written advice is in the form of a full-blown covered opinion, or an absolute exception in section 10.35(b)(2)(ii)(A), (C), (D), or (E) applies. This particular policy does not permit an attorney to conclude that section 10.35 does not apply based on the level, or absence thereof, of intent to avoid or evade taxes.

Other Responses and Firm Policies

Many commentators warned that the covered opinion rules would merely lead to reduced written communications. The survey results support this premonition, as 52% of responders indicated that they had reduced the amount of written communications in response to section 10.35. An amazing 14% of responders had completely eliminated written communications in favor of verbal communications. Some of the comments on this issue are interesting:

- "Client calls and wants options in **estate planning** for GRATs, FLPs, etc. We cannot put them in writing unless we charge an exorbitant fee, so we discuss in person."
- "I'm much more hesitant to write now; in fact, I have not written an in-depth discussion of any planning since June 20, 2005."
- "It is more difficult to provide written guidance to clients so that they can understand the potential tax consequences of proposed transactions because of concerns that the transaction may be deemed a principal purpose transaction that would require an extensive covered opinion even if the disclaimer is included."
- "I give a lot more advice over the telephone. I have actively discouraged clients from requesting written advice." (Emphasis added.)
- "I have stopped responding to clients' tax questions by e-mail. I now call them on the telephone."

In contrast, some practitioners are writing more, not less. For example, two participants commented: "more gobbledygook in my correspondence!!" and "I now provide more detailed memorandum opinions for transactions no matter how settled the law is and no matter how basic the issue."

In addition to the "covered opinion" rules of section 10.35, the IRS revised Circular 230 to require practitioners to adopt certain internal policies and procedures to govern tax practice. Under section 10.36(a), each practitioner who either individually or as part of a group has principal authority and responsibility for overseeing a firm's practice of providing federal tax advice must take "reasonable steps to ensure the firm has adequate procedures in effect" for all members, associates, and employees for purposes of complying with the requirements for covered opinions under section 10.35. A failure to meet the requirements of section 10.36 could lead to fines, censure, suspension, or disbarment of the lawyer with oversight responsibility.

The survey asked participants if their firms had adopted any additional requirements (apart from any requirement for attaching legends to e-mails) consistent with section 10.36. One-half of the participants indicated that they had not adopted any such additional policies or procedures as required by section 10.36. Maybe this response reflects a basic issue with section 10.36-- it is not clear what steps a practitioner must take to comply with the rule. Although the survey did not ask for examples of the policies or other steps taken by firms to try to comply with section 10.36, the authors are aware that some firms have already adopted or amended existing internal compliance procedures. These compliance procedures can include "guiding principles" and opinion issuance policies. Some firms have formed internal "Circular 230 Committees." Others have either adopted or reaffirmed policies requiring two-partner review of formal opinions. It is expected that firms also will take steps to educate attorneys in the firm of the section 10.35 requirements. Of course, all such steps will probably be documented.

Conclusion

The authors believe that the majority of advisors were surprised by the effect of the covered opinion rules of Circular 230. It is not yet clear that the tax community has a widespread understanding of the covered opinion rules. Certainly there is no uniformity in responses to Circular 230. Only time will tell if a consensus grows or if "best practices" develop among practitioners.

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GP|Solo Law Trends & News
Estate Planning

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Summary Checklist For Family Limited Partnership Formation And Operations

By Byrle M. Abbin

A. Problems That are Created Upon Formation of Family Limited Partnerships

Delay in Funding: P/S Created Under Law Before Funding

- Delay in Registering Partnership with State
- Nearly 100% of Founder's Assets [including residence] Contributed
- Aggressive Marketer [Fortress Group] Promoted FLPs, Provided Complete Packages, Including Legal Documents for a Flat Fee
- Excessive Powers Over Operations, Distribution and Withdrawal are Retained
- Documentation of Transfer of Assets to FLP Delayed
- Simultaneous Transfers: FLP Formed and Gifts of FLP Units Made
- Founder of FLP has Power to Control GP/Replace GP
  - Kimbell Circuit Court Rejected Implicit Control Doctrine
  - Bongard applied a "Practical Control" Test
- FLP Formed When Founder was Very Old [95, 86, etc.] and/or Terminally III
- P/S Agreement Powers Vitiate General Partner's Fiduciary Duty
- There is a Lack of an Independent Trustee
- P/S Assets and Management are not Segregated from Those Retained by Founder
- FLP and/or Related Estate Planning Documents Indicate Founder's Financial Needs are Primary: Has First Call on All Income
- Written/Oral Statements of Family Members Indicate Implied Agreement That All Income is Available to Creator
- FLP is Funded by Generation 1Solely With Portfolio Assets
- No Non-tax Reasons Evident or Stated For Partnership's Formation
- No Business Activities are Conducted by the FLP (Portfolio Turnover, etc.)
- Control Retained as CEO, Board Member of Business Place into FLP

No Bona Fide Sale for Adequate and Full Consideration Took Place

- Second Tier Entity is not Required to Obtain Creditor Protection

B. FLP Operation--Actions Taken or Overlooked During Admininstration of Partnership

- Required State Filings not Accomplished or Significantly Delayed
- Separate Books and Records for P/S not Maintained
- Separate Bank Accounts Not Maintained: Co-mingling of Assets
- Lack of Recordation of Business Activities
- Disproportionate Distributions are Made to Founding Partner
  - Especially to Meet Living Needs and Medical Expenses
- FLP's Assets Managed by Outside Party, not the Partnership

- Partner Redeemed Donee Charity Soon After FLP Formed
- Indirect Control Provided to FLP Creator in P/S Agreement: so Control Not Given Up

Once FLP Formed, no Donative Transfers are Made [Implies Estate Planning was Sole Motive]

- P/S Administered Like a Trust, not a Business Entity
- Lack of Regular Partner Meetings
- Non Pro-rata Distributions to Partners [Based Upon/Related to Assets Transferred by Each Partner]
- P/S K1s Misreported Identity of Partners [Ignored Intervening Trust]
- Founder as Limited Partner Makes All/Most of Management Decisions
- Fiduciary Responsibility of General Partner is not Relevant if FLP

Does not function as an Operating Entity

C. "Big Picture Considerations: Often Involving Bad Perception

(Another way to consider some of the problems noted above, sometimes alluded to as not passing the "smell test" and noted up front by the courts)

- Low Wealth of Founder: Small Sized FLP Includes Personal Residence and/or Other Personal Property
- Mass Marketer [Fortress Group] Promotes for a Flat Fee
- Extreme Age and/or Sever III State of Founder
- Unwinding of FLP Soon After Creator's Death [Implies Estate Planning]
- P/S Formed by Agent [Under Power of Attorney] - Founder Uninvolved in the Process
- Hard Copy Indicates Discount/Transfer Tax Savings Sole Purpose of P/S
- Founders Illness Caused a 'Call' on all of P/S's Income
- Family's Statements, Testimony Acknowledged 'G1 FLP Founder had Call' on all P/S Income
- FLP's Assets Comprised Solely of Portfolio Securities
- No Other Family Member Contributed to the P/S
- Court Testimony of Family Member Exhibited Non-Informed About Details of Transaction and Evasive About Purpose of FLP

D. The "Good" Items to be Emphasized Upon Formation and During Partnership Administration

- Regular Partnership Business Meetings
- Recordation of Business and Non-tax Reasons for P/S
- All Activities in Formation and Administration Done Orderly, in Proper Legal and Tax Sequence
- Record Made of Contentious Family Relationships Between Parents and/or the Children as Reason and Need for Entity Wrapper
- All Involved Family Generation Members Have Their Own Advisers
- Lower Generations(s) Also Contribute Their Own Assets to P/S
- Independent Evaluation by Financial Advisers/Accountants of Founder's Needs for Retainage, Determination of Amount
- Contribution to P/S of Business Type Assets: Real Estate, Oil/Gas Working Interests

E. The Conflict in Court Determination of What Qualifies as a "Bona Fide Sale for

Adequate and Full Consideration"

1. Kimbell

- Arms length bargaining does not involve willing buyer/seller doctrine, but serious, businesslike intra-family negotiations
- A bona fide sale is based upon objective factors at inception of the partnership
    - Each P/S contributor receives a property interest
    - Conclusory attitude [like Turner] on family transaction cannot be bona fide is rejected
- De minimis contribution by other partners [G2, etc.] is recognized
- Discounting of FLP interest does not connote lack of consideration, since entity provides future intangibles of value: management continuity, asset protection, buffer against intra-family friction and conflicts
- Partnership is respected when 1) there is an asset contribution for a proportionate interest in the P/S, 2) such contribution is credited to a partner's capital account, and 3) upon dissolution/withdrawal, each partner is entitled to the value of her/his capital account

2. Turner

- Bona Fide Sale not based upon willing buyer/seller but family deals are held to a 'higher' standard
    - There is no Bona Fide Sale if there is not business purpose and transaction is devoid of non-tax reasons [applies to portfolio partnerships]
    - Court rejects Kimbell definition and application; prefers subjectivity
- Insufficient consideration is received for assets transferred to the FLP because of the entity discount
    - Yet, no front end gift resulted!!!
- Arms' length willing buyer/seller standard is not required in establishing price, yet it is 'highly probative'
- Value discount connotes a lack of adequate and full consideration to be a bona fide sale
    - Intangible benefits from the entity: asset management/continuity, asset protection, avoid family conflict from dissipating assets are irrelevant

3. Bongard

- There are two elements--1) a bona fide sale, and 2) adequate and full considerations required to meet the exception to application of Sec. 2036(a)(1)

"Bona fide sale" requires at least one significant non-tax reason

- FLP creator must be financially independent of P/S, not depend upon P/S distributions

4. Strangi "IV"

- To meet the exception to application of Sec. 2036(a)(1), both "prongs" of the test must be met: 1) a bona fide sale, and 2) adequate and full consideration
- Adequate and full consideration is provided if there is proper partnership accounting for partners' capital contribution, distributions are charge proportionately to capital accounts,
- diminution of value by receipt of partnership interest in formation of FLP is

irrelevant

- A bona fide sale requires that there be a significant non-tax reason for the partnership entity
- The Tax Court's finding regarding the probity of non-tax reason(s) provided by the taxpayer controls, unless such conclusions are clearly erroneous. Even though the appeals court may have determined otherwise, generally it will not second guess the finding of fact by the Tax Court.

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Family Law

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Family Lawyer Concerns About Preparing Qualified Domestic Relations Orders

I just recently returned from speaking at a continuing legal education seminar on family law issues. My presentation focused on Qualified Domestic Relations Orders (QDROs). A “QDRO” is a court order required in order to divide certain retirement assets in a divorce proceeding pursuant to applicable federal law (namely, the Internal Revenue Code of 1986 (Code), as amended, and the Employee Retirement Income Security Act of 1974 (ERISA), as amended). As has happened on numerous occasions in the past, after either making a presentation to family lawyers or speaking with family lawyers while serving in my capacity as former in-house counsel for two large national pension funds in Washington, D.C., I received numerous comments similar to the following: “Preparing the QDRO is the part of the divorce proceeding we family lawyers dislike the most because we are concerned about the possible malpractice involved in handling this complex area of federal law.”

In light of the above, I carefully examined why divorce attorneys seem to have a disdain for QDRO-related issues. I concluded that the following may be possible causes for their consternation. In addition to understanding and handling all aspects—procedural and substantive—of the applicable state domestic relations law, an attorney handling a divorce proceeding on behalf of a client is also responsible for understanding the governing provisions of the Code and ERISA applicable to QDROs—laws with which most family lawyers are not intimately familiar. Moreover, domestic relations attorneys must obtain and understand all documents and instruments governing the particular employee benefit plan at issue. And, since each employee benefit plan contains different terms, understanding the nuances of each plan is a difficult task. Adding to the confusion is the fact that an order that was deemed perfectly acceptable by one plan administrator may be rejected by another plan administrator.

Another aspect of this area of the law with which domestic relations attorneys seem to initially struggle is the fact that it is the plan administrator, not the judge of the court having jurisdiction over the state domestic relations proceeding, who ultimately determines whether a domestic relations order is “qualified” (i.e., enforceable). This grant of authority to the plan administrator, rather than the judge, seems strange because attorneys go through law school reading cases establishing the binding authority of the court. However, most family court judges, like domestic relations attorneys, are not extensively familiar with ERISA, the Code or the particular employee benefit plan at issue. Therefore, Congress and the governmental agencies having jurisdiction over QDRO matters determined that the plan administrator, rather than the court, should have ultimate authority to determine whether a domestic relations order is, in fact, “qualified.”

In light of the above, if a domestic relations attorney simply prepares an order and submits the same to the court for entry without first obtaining approval from the plan administrator, even if such order has been entered by the court, the plan administrator can reject the order, provided the plan administrator has a reasonable basis for doing so. The family lawyer then must re-draft the order and submit such “amended” order to the plan administrator for approval and then, once approval has been obtained, re-submit the amended order to the court for entry.

Further complicating the drafting phase is the fact that each plan may have different administrative procedures (e.g., distribution rules, application procedures, payment forms, etc.) governing the operation of the plan. Although the plan's procedural requirements may not make logical sense to a person not closely involved with the plan's operations, most likely the plan administrator has a very good reason for requesting that certain provisions of the QDRO be drafted in a particular manner.

Notwithstanding the above, as the domestic relations attorney representing your client's interests, you must remember that there is more than one way to draft a QDRO. Moreover, you are not obligated to follow verbatim the model QDRO provided by the plan administrator. If you do utilize the model QDRO provided by the plan administrator, you must carefully review the terms of the plan and understand all of the ramifications of using such sample QDRO language; otherwise, you may end up with an unintended result, which may disadvantage your client. Remember also that even if a QDRO is deemed acceptable by the plan administrator, if such order does not carry out the intent of the parties, as set forth in the divorce decree and/or marital property settlement agreement, as the attorney representing one of the parties, you may be subject to liability and/or a claim for malpractice.

Since retirement assets may be one of the most significant assets in the marital estate, and since a QDRO is a legal court order, it should be prepared by a licensed attorney having expertise in QDRO matters. Note that not all self-labeled "QDRO experts" are licensed attorneys. Even though you are the domestic relations attorney handling the divorce proceeding and, as such, have the ultimate responsibility for making sure that an acceptable QDRO is entered by the court, if you do not feel comfortable preparing the QDRO, engage an experienced QDRO attorney so you do not have to worry about whether you have complied with all of the nuances of this complicated federal law.

Jo Ann Petroziello Collins recently opened the Law Office of Jo Ann P. Collins in Harrisburg, Pennsylvania, a law firm dedicated to assisting family lawyers in all jurisdictions with the division of retirement assets in divorce proceedings and handling all aspects of Qualified Domestic Relations Orders. Prior to re-locating to Harrisburg, Ms. Collins worked in Washington, D.C. for over 13 years, practicing exclusively in employee benefits law. She earned her Masters of Law degree in taxation and her Certificate in Employee Benefits Law from The Georgetown University Law Center and her Juris Doctorate degree from Ohio Northern University Pettit College of Law.

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Litigation

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Are you prepared for the unthinkable?

By Beverly Michaelis

As lawyers, we are trained to look out for the interests of others. We counsel our clients on the importance of having an up-to-date estate plan. We prepare them for the possibility of illness or disability and talk about who will make health care and financial decisions on their behalf. We advise clients to inventory their assets and keep accurate records. We do all of these things very well. Seldom, however, do we follow our own advice.

THINK ABOUT THE UNTHINKABLE

Imagine that while you are driving home this evening, a careless driver runs a red light and hits your car. You are badly injured and lose consciousness at the scene of the accident. At the hospital, your family is told you need emergency surgery and may not live. What is your family feeling at this moment? Can they, or should they, be expected to worry about the motion you are scheduled to argue tomorrow? What about the distraught client you have an appointment with the next afternoon? Or the bills you need to pay, or the trust account you haven't reconciled? Could your loved ones make sense out of your office: What should be done with your mail? Which files are open and which are closed? Where do you keep your accounting records? What are the passwords for your e-mail and voice mail? Do you have a safe deposit box? Where is the key? Does anybody need to be notified that you are incapacitated?

This scenario is just the tip of the iceberg. We take for granted that we will live long lives, free of serious illness or debilitating injury. We believe it won't happen to us. We think to ourselves: "I don't have to worry." Or, "If something happens, someone else will take care of everything." Unfortunately, the dilemma described above is not far-fetched. In recent years, the Professional Liability Fund has helped colleagues or loved ones close the law offices of attorneys who committed suicide, were murdered or died unexpectedly. Lawyers who have a health crisis, drug or alcohol dependency, depression, severe stress reaction, or accidental injuries all need to make arrangements to cover their practices. We all do. It can happen any time to anyone.

PLAN AHEAD TO PROTECT YOUR CLIENTS

How can you spare your loved ones the stress and uncertainty of closing a practice that is not in order? How can you protect the clients who are depending on you? How can you protect yourself and ensure that when you recover you will come back to a viable practice? The answer is to plan now and arrange to have someone close or watch over your practice. The process starts by finding someone, preferably a fellow attorney, who is willing to close or manage your practice if necessary. If you don't know a colleague who can do this for you, contact the Oregon State Bar Lawyer-to-Lawyer Referral Service at (503) 684-3763 or (800) 452-7636.

The arrangement you enter into with this attorney (the "assisting attorney") includes a variety of features. It should include: a signed consent authorizing the assisting attorney to contact your clients for instructions on transferring their files; authorization to obtain extensions of time in litigation matters when needed; and authorization to provide all relevant people with notice of the closure of your law practice. This agreement can also include arrangements for payment by you or your estate to the assisting attorney for services rendered.

The PLF offers a handbook entitled Planning Ahead: Guide to Protecting Your Clients' Interests in the Event of Your Disability or Death (1999). The guide is free and contains solid, practical advice any lawyer can use, including:

- A checklist for creating a plan.
- Sample agreements to allow another lawyer to close or temporarily manage your practice.
- Form letters to use in communicating with clients when a lawyer is unable to continue practicing.
- A comprehensive list of contacts, assets and other essential information loved ones or others would need to close a practice.

PLAN AHEAD TO PROTECT YOUR LAW PRACTICE

If your practice must be closed due to death or sudden illness, there will be many business repercussions, which may include: canceling your office lease; selling or moving your office equipment and furnishings; meeting final payroll obligations; paying bills; issuing final statements to clients; collecting fees and the like. There may be an entity or partnership to dissolve. And what about the funds on deposit in your trust and office accounts? How will clients -- who must now hire a new lawyer -- get their money back?

Tending to these financial matters will be your family's responsibility. Your planning -- or lack thereof -- will determine how easy or difficult it will be for them to take the proper steps.

Reconsider the car accident scenario. What if you are the only signer on your trust account? Will your family members be able to persuade the bank to release trust funds? The odds are good if you previously signed a durable power of attorney. Otherwise, a conservatorship may be required. If you die without a second signer on the account, the bank probably will refuse to disburse funds to anyone other than a court-appointed personal representative. As a result, a probate or small estate proceeding may be required when none was intended.

Preparing a durable power of attorney or adding a second signer to your accounts are possible ways to avoid these scenarios. The pros and cons of these approaches are thoroughly discussed in the PLF handbook referenced above. You can also ensure that the business aspects of closing your law practice are handled properly by giving your assisting attorney authority to wind down your financial affairs, provide your clients with a final accounting, ***31** collect fees on your behalf and liquidate or sell your practice.

PLAN AHEAD TO MAKE YOUR PERSONAL WISHES KNOWN

In addition to steps you may take to protect your clients and your practice, you should also protect yourself and your estate. Prepare an advance directive. Keep your will and any related estate planning documents current. If you are incapacitated because of an accident or a sudden medical emergency, your loved ones will know your wishes and will have the proper authority to act. Consider what might happen if you fail to take these steps. It is not uncommon for family members to disagree vehemently about medical decisions or how to handle a lawyer's financial affairs when the lawyer dies intestate. At the PLF, we have witnessed several such disputes, all of which could have been avoided had the lawyer planned ahead.

ORGANIZATION IS KEY: Office Systems, Client Files and Avoiding the Albatross

Arranging for an assisting attorney to close or temporarily manage your law practice fulfills your ethical responsibilities and ensures that your clients' interests are protected in the event of your disability or death. (Or Formal Ethics Op 1991-129, ABA Formal Op 92-369.) You can take a number of steps now to make any transition go smoothly. The key is to keep your office organized.

Office Systems

- Make sure your office procedures manual explains how to produce a list of client names and addresses for open files.
- Move closed files to storage promptly to avoid confusion.
- Record all deadlines and follow-up dates on your calendaring system.
- Keep client files documented well.
- Maintain current, accurate accounting records.
- Be punctual about posting time and expenses and also about billing clients.
- Reconcile your bank accounts, especially your trust account.

If your office is in good order, it will be less costly for the assisting attorney to close your practice. Your law office will then be a valuable asset that can be sold and the proceeds remitted to you or your estate.

Client Files. Proper maintenance and handling of client files is obviously an integral part of keeping your practice organized. The PLF recommends that you keep client files for a minimum of 10 years to ensure that the files will he available to defend you or your estate against legal malpractice claims. If you die or are incapacitated by sudden illness or accident, the documentation in your files will be the only line of defense against a claim. Talk to your family today about the importance of keeping these vital records. At the same time, don't overburden loved ones by keeping more than you need. Generally, client files more than 10 years old can be destroyed. Don't leave this task to your family. Create and implement a file retention and destruction policy now.

For a complete discussion of this subject, consult the PLF publication, A Guide to Setting Up and Running Your Law Office: Avoiding Malpractice Through Efficient Office Systems (2003) or the PLF practice aid entitled File Retention and Destruction. Both may be found on the PLF website at www.osbplf.org. Click on Loss Prevention and follow the links to Books and Publications and to Practice Aids and Forms, respectively.

AVOIDING THE ALBATROSS: Deeds, Contracts, Wills and Other Client Originals

Original client documents such as deeds, contracts and wills pose a special problem for family members when a lawyer's practice must be closed. Original client documents are the property of the client and should be returned to the client or properly stored. Original wills are specifically protected by ORS 112.815, which requires that 40 years elapse before a will can be destroyed. To avoid burdening your family with the responsibility of returning, storing or protecting these items, do not retain original client documents in your files. Return original documents to the client at the conclusion of your representation. The PLF offers a File Closing Checklist that will remind you to perform this important step each time a file is closed. The checklist can be obtained on the PLF website at www.osbplf.org. Click on Loss Prevention, follow the link to Practice Aids and Forms, and look for the category "File Management." For information on how to return original wills to clients, contact the PLF practice management advisors at (503) 693-6911 or (800) 452- 1639.

TAKE THE FIRST STEP TODAY

Start now. This is something you can do now to plan for your future, protect your assets and spare your loved ones additional heartache. It takes only a small amount of time and costs virtually nothing. Don't put it off -- start the process today.

Download a copy of Planning Ahead: A Guide to Protecting Your Clients' Interests in the Event of your Disability or Death (1999) from www.osbplf.org. Click on Loss Prevention and follow the link to Books and Publications. If you do not have Internet access, contact the PLF at ***34** (503) 639-6911 or (800) 452-1639 and request a hard copy.

The author is a lawyer and practice management adviser with the Professional Liability Fund. If you would like assistance improving your office systems or planning for the closure of your office, contact one of the PLF's practice management advisors at 503-639-6911 or (800) 452-1639. The practice management advisers are available to assist lawyers throughout the state in setting up efficient, cost-effective office systems. Practice management assistance is free and confidential.

The Oregon Formal Ethics Opinions will be renumbered and reissued in late 2005 in accordance with adoption of the Oregon Rules of Professional Conduct. Monitor the Oregon State Bar Web site, www.osbar.org, for developments.

While probating your estate may be effective to cut off some client claims (such as fee disputes), it will not cut off the client's right to assert a legal malpractice claim within the statutory time limit.

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Checklists for Discovery and Strategic Planning

Weaknesses in Drug Analysis

Use the materials obtained during discovery and answer the following list of questions regarding the validity of lab results to develop a strategy for the defense case or troubleshoot for the prosecution. Keep these questions in mind when investigating:

1. Were the laboratory's testing procedures scientifically valid?

2. Were the methods as performed compliant with approved and validated procedures?

3. Can the laboratory's activities, observations, and results be reconstructed solely on the basis of the available records?

4. Did the laboratory comply with applicable elements of its own internal rules and regulations?

5. Did the laboratory comply with generally-accepted standards of a quality assurance program?

6. Were all measurement systems and instruments in accord with scientific controls at the time of the analyses?

7. Are the reported uncertainties consistent with methodology, validation, and quality control results?

8. Are measurements traceable through appropriate use of calibration, standards, and reference materials?

9. Was the forensic scientist/technician properly trained in the appropriate procedures?

10. Were all steps taken to avoid cross-contamination or degradation of the sample during analysis?

11. Was the laboratory sufficiently well-designed and operated to avoid increased risk of contamination?

12. Did the laboratory have any controls to determine if a sample was contaminated?

13. Does the laboratory have a good or bad reputation in the type of analysis at issue in the case?

14. Can evidence of a bad reputation be obtained?

Checklist of Evidence to Obtain During Discovery

1. A step-by-step list of all persons who had contact with the sample at any stage of the collection, analysis, handling, packaging, storage, transport, documentation process, including their

    a. education,

    b. experience,

    c. membership in professional societies, and

    d. role played in collecting, analyzing, storing, transporting, or documenting the sample.

    The above information should be produced in the form of a résumé, curriculum vitae, and/or personnel file or files for all persons involved in the handling, receipt, storage, packaging, transport, preparation, analysis, documentation of results of the test.

2. Personnel files of police personnel involved in the collection, handling, storage, transport of the original sample.

3. Copies of all complaints or lawsuits filed against anyone, including law enforcement officers and lab personnel involved in

a. collection of the sample,

b. handling of the sample, in any way, and/or

c. forensic laboratory used in the processing of the drug analysis.

4. Copies of training manuals used to govern procedures or policies in the laboratory.

5. Reports, proficiency tests or results thereof, relating to the laboratory's ability to conduct analyses of controlled substances.

6. Identification and documentation of any changes made in the last three years in response to proficiency tests, audits, or other methods of assessment.

7. Documentation of accreditation for the laboratory.

8. Information about the laboratory procedures and standards, including

    a. copies of "quality manuals,"

    b. "standard operating procedures,"

    c. "quality procedures,"

    d. internal audit schedules and reports, and

e. inventory of laboratory equipment.

9. Copies of validation studies as to the analytical methods used to test the sample.

10. Documentation of assumptions and basis for statistical analysis of results.

11. Copies of any previous testimony in narcotics prosecutions provided by the forensic chemist, technician, or policeman involved in the case.

12. Chain of custody for collection of sample through testing and storage, including

a. all written records, notes, or other documentation prepared by all persons who had any contact with the sample, including but not limited to police, forensic chemists, technicians, examiners relating to

i. sample collection,

ii. identification,

iii. transport,

iv. receipt of sample by forensic laboratory,

v. storage,

vi. processing, and

vii. testing.

13. All documentation of technical procedures used to analyze the nature of the controlled substance and identify it, including but not limited to:

14. All tests conducted on the sample, including but not limited to tests used to determine the presence and concentration and form of drugs or chemicals used to prepare or process the sample.

15. Describe all procedures used in testing the sample, including copies of all laboratory protocols consulted.

16. Describe all scientific equipment used to test the sample, including

a. state of repair,

b. when last checked for accuracy, and

c. how the examiner determined it was functioning prior to testing the sample.

17. All documentation produced in relation to the testing process, including

a. computer print-outs,

b. graphs, and

c. other data that documented the testing process.

18. Description of documentation that might have been discarded, and the reasons for it having been discarded.

19. All criteria used to review and interpret the test results, including but not limited to documents, reports, treatises, texts, peer reviews, used to interpret the test results.

20. All field test kits used to analyze the sample, or any field documentation of the collector's identification of the sample.

21. All documentation of the preparation and verification of the test reagents (including tests used to validate that the methodology was proper for identification purposes).

22. Examples of data produced or obtained by the test analysis.

23. Quality assurance and standardized guidance relating to the test analysis.

24. Quality assurance standards for the laboratory as it relates to analysis of controlled substances generally.

25. Names and descriptions of all external quality assurance programs that relate to the determination of the laboratory's ability to operate during the time period in question.

26. All internal quality assurance policies and procedures used to ensure and support the reliability of drug testing and the result reported for an individual sample.

27. All studies conducted by the laboratory relating to drug testing and the occurrence or frequency of "false positives."

The above list is not exhaustive, nor is every type of documentation discoverable in every case, depending on the rules of the jurisdiction, the proclivities of the judge, and the cooperativeness of the prosecution. However, the checklist serves as a reminder of the scope of documentation that provides insight into possible weaknesses in the government's scientific case.

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How To Get The Most Out Of Your Health Care Expert Witness

By Sue Antoni

In the complex world of health care litigation, identifying and engaging the most appropriate expert witness can often be a taxing process, but maximizing the value of that expert once found can be equally challenging. Your expert can be helpful beyond just providing formal opinions and testimony. In fact, the expert can provide you with greater insight regarding the data available, its practical implications and the complexities of the issues at hand, which can significantly and positively impact a case. The litigator's efforts may be considerably enhanced and the clients' interests advanced as a result.

Although the skill level, years of experience and credentials of your experts may be unmistakably well-suited for the dispute, giving them the tools to adequately contribute to your victory is a collaborative effort. Where appropriate, taking advantage of the technical knowledge of the experts can aid you by allowing them to have an active role in structuring your case by fully identifying what really happened. As discussed in greater detail below, the complexity of day-to-day operations in the health care industry makes it such that there often can be a significant difference between strict legal appearances and understanding what really took place. Understanding this can make all the difference.

Indeed, different cases require different approaches from the outset, and where an expert might have the greatest impact in one case, he or she might not offer much more than the ability for the lawyer to say, "Because an expert said so," in another. So then, when can an expert provide that additional advantage and what does it take to get there? Certainly, since the type of dispute and nature of the complaint determine the kind of expert sought and the work that will be involved, examples can be given of the types of cases where these unique advantages would be most applicable. Some of these are shared below.

Billing and/or Compliance Disputes

Typically, cases involving billing and compliance issues ultimately are a matter of over- or under-reimbursed providers. These disputes often require experts who have knowledge in areas of coding, billing systems, industry standards for practice management, and government and commercial billing regulations. This type of expert is often certified as a compliance professional and/or coder and will have enough years of experience to understand the changes that have taken place in the industry to give context to the rules that applied at the relevant time period.

This kind of litigation often includes expert analysis of claims. Based on the frequency of changing regulations and technical detail surrounding coding and claims processing, early involvement for the expert is key. The variables each claim represents, such as procedure codes, diagnoses codes, the type of coverage, the condition of the patient, the date of service and a review of the regulations in effect during the time the services were provided, require a sufficient amount of time for useful analysis. Each detail can potentially change the outcome of the expected reimbursement and, thus, the outcome of a major component in the case.

In addition to having the appropriate amount of time to review claims data to achieve an initial set of objectives, early involvement by the expert may result in findings that strengthen the ability to explore new information that will be beneficial to your argument. Additional damages may be sought or a stronger defensive position may be established if patterns of billing or reimbursement exist that were not known prior to the expert's review.

For example, if your expert is being asked to opine on the accuracy of CPT, or current procedural terminology, coding, but in the process discovers other issues such as inappropriate reporting of secondary insurance coverage as primary coverage, issues related to diagnoses coding, failure to refund credit balances or inappropriate balance billing to patients for services that were not allowed, these newly found items may have a significant impact on the case.

Beyond the technical coding and compliance knowledge, an expert may have knowledge regarding the use of specific, commercial health care billing software programs and different versions of these systems that have been used in years past. Accessing this knowledge may shed light on the capabilities or shortcomings of a billing system that has controlled all claims processing and data management during the years in question. The system-related claims processing that occurs in 2006 might not have been possible in 2004 under the then-existing version of the billing software. If learned early enough, this information will add a new element to the case that was not previously considered.

Payer/Provider Contract Disputes

Experts retained for these cases should have skills and experience in a variety of settings with managed care contracting, capitation, rate development and managed care contract administration from both the payer's and provider's perspective. Although contract interpretation is anything but foreign to most attorneys, a qualified expert with the requisite skills in managed care and other payer/provider agreements has negotiated, amended, implemented and experienced the corporate consequences of contracts they have managed. This "practical" experience can be substantially different than legal experience in the review of such contracts and in understanding the implications of their provisions as they actually occur day to day.

The most important tools to provide this expert with are all written material pertaining to the contracts in question, including older/amended versions of the contract, footnotes, attachments, and any correspondence or other written material that would alter the agreement(s) in any way (i.e., letters of intent, relevant notices to patients, claims information, remittance advice, etc.). Where some information may seem immaterial, it is too often the case that a simple footnote to an attachment can have the greatest impact.

As an example, consider a hospital that has a contract that includes carve-outs for cardiac-related care, but the contractual language is ambiguous regarding certain non-invasive tests. The expert's opinion on industry standards regarding the contractual terms based on his or her review of contract documents can be coupled with his or her review of the payer's remittance advice where there may be information embedded in payments that have historically been received and that would clarify the initial intent of the contract (or at least how it was implemented). Allowing participation of the expert in the discovery process such that he or she can clearly define all information that is needed to maximize use of his or her technical skills can frequently prove advantageous for these cases.

Valuation/Fair-Market-Value Lawsuits

The world of acquisitions and joint ventures opens the door to a variety of disputes involving the appropriateness and accuracy of valuation methods. Although many individuals in the industry claim to have expertise, they may actually only be just that: an "industry expert." There may be a significant difference between an expert who has finance expertise with some valuation experience, and one who has completed valuations for numerous and varied health care entities, for-profit and not-for-profit, for a range of engagements (e.g., mergers, acquisitions, divestitures, compensation agreements, etc.) and applying all the pertinent technical valuation methodologies. With the latter being the preference, there is a short list of these experts in our industry, and most know each other.

A valuation expert may be asked to focus on a specific set of data; however, there also may be a window of opportunity to access the knowledge he or she has of an opposing expert's reputation, strengths, weaknesses and tendencies for valuation methodology. Exploring this with your expert may unveil inconsistencies and errors from the opposition's expert that shed a brand-new light on your case.

Criminal Litigation

In criminal matters, the level of independent review from the expert will likely be less than what would be wanted in a civil matter. An expert who has had experience in criminal litigation will often be more familiar with the expectations of the attorney. In contrast, an expert who has only worked on civil matters in cases where they have been given carte blanche to introduce new issues might not fully appreciate the need to avoid deviating from the attorney's specific instructions. This certainly is not to imply that evidence should be concealed. Rather, it is to emphasize that many people who qualify as experts are more than willing (and all too often actually excited) to share every possible lapse in compliance that they can unveil to highlight the breadth of their knowledge.

An additional advantage to using an experienced expert is the exposure to the legal process for criminal matters, which immediately gives the expert context to the nature of your request for their services. For example, in cases involving fraud and abuse, the experienced expert will likely understand the relationship between the total dollars paid based on fraudulent claims and the sentencing that may follow if the defendant is found guilty.

A clear definition given by the attorney at the beginning of the case regarding the expert's scope to ensure that the expert stays within the confines of the review and opinion being sought will help ensure that they stay on track, do not exceed expected costs and prevent additional exposure.

Conclusion

While there may be a reluctance to engage an expert sooner due to cost considerations, experience shows that health care litigators benefit from the timely and effective use of outside experts, regardless of whether the context is a deposition, mediation, government investigation or an actual trial.

While health care litigators must stay current with legal and regulatory statutes that seem to shift on a monthly basis, the impact of these frequent changes are experienced through actual change management and implementation by others (i.e., the "experts"). The result can in some cases be a significant knowledge gap between a technical understanding of the law and a pragmatic understanding of how those regulatory changes impact the daily operations of health care organizations. Within this gap lies potentially useful information and guidance your expert may have that should be explored as often and as early as possible.

Sue Antoni is senior vice president of Sinaiko Healthcare Consulting, one of the nation's leading health care management consulting firms. Antoni, who is a frequent expert witness in health care litigation, can be reached at sue@sinaikohc.com.

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Representing Individuals in Mandatory ADR Proceedings

By Joan M. Swartz

Mandatory arbitration/mediation clauses are becoming more and more prevalent in contracts today. The clauses range from just limiting the forum, to limiting damages and procedures available to consumers and employees are becoming common place. These clauses are becoming standard provisions included by some of America's largest corporations. Chances are your cell phone contract has such a clause: your home service contracts, (such as termite protection, lawn care, and more), have such clauses: your credit card contracts likely have similar provisions; many employers require employees to sign such agreements prior to extending an offer of employment. The proliferation of mandatory arbitration/mediation clauses in contracts is the result of the courts general preference for alternative dispute resolution and their willingness to enforce ADR provisions. Second, the companies are seeking to avoid judges and juries and their unpredictable nature. Third, and not to be discounted, companies are seeking to contain and control litigation costs.

The growth of these provisions, both in the consumer and the employment world, has led to an increasing likelihood you may represent a client in this forum, either as a consumer or in business.

This article sets forth some of the issues raised by employer/employee and consumer/vendor disputes and ADR mechanisms available to assist the practitioner in representing the employee or consumer effectively in this venue.

The first step is to review the provisions and the contract itself to determine whether there are grounds in your state to challenge the mandatory arbitration term. Many limit types of claims, type of damages (generally to compensatory damages), venue for disputes and whether the decision can be appealed. They are one-sided contracts by design. The first consideration is whether to challenge the mandatory ADR provision in court. Depending upon your home state and the financial resources available to you and your client, a challenge to the mandatory ADR clause may be unpractical.

How you prepare and approach the ADR session will greatly depend upon the contractual requirements and your right to file a claim in a court of law. It is common that these provisions limit the aggrieved party to mandatory arbitration, with no right to appeal. In that case, you should:

> Understand the Procedure—Many of the ADR providers have specific procedural rules which apply. One of the difficulties is that certain ADR providers have fairly detailed rules and procedures. It is your task to review the rules and understand them, The task can be daunting because you are essentially learning another set of rules of civil procedure which will control in your dispute. When in doubt, ask questions of the case

manager. Be vigilant that the rules are fairly applied to the dispute. Also, as a rule of thumb, the rules of civil procedure in the applicable forum will control when the ADR providers' rules are silent on any issue that arises.

Understand the Arbitrator Selection Process –learn the selection process used by the ADR provider. Some allow the parties to mutually select a neutral. Some select the arbitrator for you, particularly in consumer disputes which often times involve lower amounts in controversy.

Prepare for arbitration like you are preparing for TRIAL. Consider this is your client's only shot at an award, many times there is no right to appeal the decision, so prepare just like you would prepare the case for trial.

Conduct Discovery—if you are not sure whether the rules which control your arbitration allows for discovery, then insist that your arbitrator allow you to conduct reasonable discovery. Request the right to do written discovery as well depositions. When in doubt, the rules of civil procedure control. Ask for a scheduling conference and develop a reasonable schedule so you can accomplish all that is necessary in a reasonable amount of time, giving each side an opportunity to develop their case.

Take Depositions of key witnesses and be prepared to cross examine the opposition's witnesses.

Consider whether you should use an expert, and if the other side is presenting an expert, take his/her deposition.

Prepare your presentation as if you are presenting your case to a jury—use visual aids for the arbitrator. A picture is worth a thousand words.

There are some advantages to mandatory arbitration. You can stipulate to present experts by reports, saving time and money. Your presentation can be less formal, also saving time and expense. Many times discovery is less formal and can be done on a more informal basis. Much of a traditional motion practice can be eliminated. An added benefit is that clients seem to be more at ease in the less formal setting.

Some clauses are requiring mandatory mediation before any claim can be filed. In this instance, there are different considerations:

Understand the Procedure—make sure the rules are applied in a fair and unbiased manner and you understand the next step in the event that the ADR fails. The key is knowing the limits of the procedure and not extending beyond what is reasonable to achieve a result, if possible.

Understand the Mediator Selection Process –it is usually by consent of parties, but ask and understand the procedures in the event the parties are provided a list of mediators from which to select. It is recommended you do some research regarding any proposed mediators to learn their backgrounds, looking for possible clues regarding their disposition.

Prepare for Mediation—conduct whatever discovery is necessary so all the parties understand the dispute and have enough information and evidence to properly evaluate the case. You may choose to use this forum to learn more about the other side's case. In such case, use the tools available wisely. If you can, do discovery. Rules are often times more relaxed so you can get more accomplished. Learn all you can in this process, it can save you money and time, even if you are exhausting your remedy so you can proceed to court.

Prepare your Client—it is recommended you use this opportunity to fully evaluate your case and convey that information to your client. Expectations must be reasonable if you intend to settle the case. If you and your client decide that you are simply exhausting your remedy to comply with a mandatory mediation requirement so you may proceed to Court, prepare your client accordingly to avoid any potential admissions. Also, consider using the informal process to gather necessary discovery in a cost effective manner.

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The Basics Of Employment Contracts

By Christine Godsil Cooper

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Employers usually don't intend statements in employment handbooks to create enforceable promises. But that doesn't stop courts from finding contractual relationships in the employment context. Disclaimers often do the job, but they have limits.

EMPLOYMENT CONTRACTS raise exceptional concerns, but the basics remain just that: basic. Any contract question can be analyzed by reference to the following six inquiries:

- Was a contract formed?
- If a contract was formed, what are its terms?
- Did a duty of performance arise?
- Are there any defenses to enforcement?
- Was the contract breached?
- If the contract was breached, what is the appropriate remedy?

In this article, we will examine each of these points, and give special attention to disclaimers in employee handbooks and the effect of sexual harassment policies in creating a contractual relation between the employer and employee.

WAS A CONTRACT FORMED? In the employment context, the formation issue tends to focus on written, distributed employee handbooks or other policy statements. When there is an individual, written, separately bargained contract, the formation issue is easy. But what of handbooks and other policy statements? What of policies and practices? When are they considered contracts? (More on that later, but of course it varies by state.) What of oral assurances or other oral promises? That kind of contractual issue emphasizes problems of proof and also raises statute of frauds issues.

Contract Doctrine and the Employment Handbook

Beginning in 1980, American courts began to look at the employment relationship through the lens of contract law. The traditional view was that an employment relationship without a definite duration was at-will, with both the employer and the employee having the right to abrogate the relationship at any time, for any reason, without notice. While the relationship was inherently contractual--services in exchange for pay--the relationship could be freely terminated. What began to change was courts' willingness to find promises made by the employer.

Identifying the Employer's Promise

Since a contract is a legally enforceable promise, the first task is to identify the employer's promise. The promise, to be enforceable, must be a real promise, a commitment. The Restatement (Second) of Contracts (1981) defines promise:

"(1) A promise is a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made."

The types of employment promises commonly found in handbooks that are such commitments include promises to terminate only for cause, or only following progressive discipline, or after after specified pre-termination rights. Likewise, an employer's promise to layoff and recall in a certain order would constitute a commitment. Examples of what are not commitments are opinions, predictions, statements of good will, and the like.

Finding an Enforceable Promise

The promise, standing alone, will not mandate its own enforcement. Gratuitous promises or naked promises are not enforced. Promises are enforced only if there is something else. The time-honored means of enforcing promises are:

- Consideration (the bargained-for exchange, the mutual inducement, the price of the promise);
- Promissory estoppel (reasonable reliance on a promise where the reliance was foreseeable to the promisor, and an injustice would result if the promise were not enforced);
- Promise to pay for an antecedent material benefit where moral obligation substitutes for consideration; and
- Formality, such as a writing.

Moral obligation and formality have virtually no role in enforcing promises in the employment context. The hallmarks of enforceable employment promises are consideration and promissory estoppel, although only rarely do courts enforce promises through the device of promissory estoppel. Nonetheless, the spirit animating promissory estoppel is detrimental reliance, and courts commonly look to an employee's reliance when determining whether or not a promise should be enforced. See, e.g., Black v. Baker Oil Tools, Inc., 107 F.3d 1457, 1461 (10th Cir. 1997) (applying Oklahoma law) (no contract based on written policy of non-discrimination because employee did not provide consideration for the promise of non-discrimination, nor did the employee continue in position and not quit "at least in part on his reliance on the employer's promise").

"Promises" in Employer Handbooks

Courts began to find enforceable promises in employer handbooks and other policy statements, in past practices, and in oral assurances. Each of these kinds of promises tended to be lumped under the inartful rubric of "implied contract." When employers make promises in handbooks or policy statements, or when they make oral assurances, the employers are making express promises, not implied promises. When the totality of the ***48** circumstances of past practices, longevity of service, and reasonable expectations are used to form a promise of job security, such a promise can properly said to be implied and not express. Nonetheless, we seem to be stuck with the rubric of implied contract any time there is an obligation based on an employment contract that has not been individually bargained and reduced to writing.

How Do Handbook Promises Become Employment Contracts?

There are at least two theories of contract formation when an employer has promised job security in an employer handbook or other policy statement:

- The first is the unilateral contract theory, first proposed by a state supreme court in 1983 in Pine River State Bank v. Mettille, 333 N.W.2d 622, 115 L.R.R.M. 4493 (Minn. 1983), a seminal opinion not only for Minnesota but for the entire country. See, e.g., Ex parte Graham, 702 So. 2d 1215 (Ala. 1997) (unilateral contract analysis made personnel policies manual an enforceable contract, where there was an offer which provided specific disciplinary actions and the manual contained no disclaimers);
- The second is the "instinct with obligation" theory set forth by the Michigan Supreme Court in In re Certified Question (Bankey v. Storer Broadcasting Co.), 443 N.W. 2d 112 (Mich. 1989). The idea is that the employer gains benefits from issuing the handbook in the form of a more loyal and productive workforce, thereby justifying legal enforcement of the handbook promises. I include in this second theory the cases which find a contract, but by using a variety of factors--not often clearly delineated. See, e.g., Black v. Baker Oil Tools, Inc., supra (Oklahoma law finds "an implied contract right to job security by balancing several relevant factors, including: '(a) evidence of some separate consideration beyond the employee's services to support the implied term, (b) longevity of employment, (c) employer handbooks and policy manuals, (d) detrimental reliance on oral assurances, pre-employment interviews, company policy and past practices and (e) promotions and commendations.'")

How the Unilateral Contract Analysis Works

Many courts use the unilateral contract analysis. A common formulation of this analysis is set forth by the Illinois Supreme Court in Duldulao v. St. Mary of Nazareth Hospital, 505 N.E.2d 314 (1987):

- First, the language of the policy statement must contain a promise clear enough that an employee would reasonably believe that an offer has been made;
- Second, the statement must be disseminated to the employee in such a way that the employee is aware of its contents and reasonably believes it to be an offer;
- Third, the employee must accept the offer by commencing or continuing to work after learning of the policy statement. It is the commencement or continuation of work by the employee that constitutes both the acceptance of the employer's offer and the consideration to make the employer's promise legally binding.

The Emergence of Disclaimers

It took little time for attentive lawyers to advise their corporate clients to revise their handbooks. A disclaimer would undermine the employee's reasonable belief that a binding commitment had been made. Indeed, many of the courts that enforced promises contained in handbooks were explicit that a disclaimer by the employer would have avoided the litigation:

"All that need be done is the inclusion in a very prominent position of an appropriate statement that there is no promise of any kind by the employer contained in the manual; that regardless of what the manual says or provides, the employer promises nothing and remains free to change wages and all other working conditions without having to consult anyone and without anyone's agreement; that the employer continues to have the absolute power to fire anyone with or without good cause."

Woolley v. Hoffmann-La Roche, Inc., 491 A.2d 1257, 1271 (N.J. 1985), modified, 499 A.2d 515 (N.J. 1985). There were the predictable rounds of litigation determining just how clear and conspicuous a disclaimer had to be-- and how consistent it had to be with the remainder of the document--to be effective. When the dust had settled, more or less recently, employers were pretty confident that they could draft effective disclaimers. As discussed later in this article, this confidence was soon to be undermined.

2. IF A CONTRACT WAS FORMED, WHAT ARE ITS TERMS? • What constitutes the contract? Certain documents, words, or actions (even inactions!) may manifest the assent to contract. Which ones? In the employment setting, the focus is on the precise promise: Was it a promise that the employer would terminate only for cause? If so, what are the standards for cause? And what is the role of the jury in determining whether the termination was for cause--is the jury to second-guess the employer, ***50** or merely review the employer's decision for indicia of good faith based upon objective evidence obtained through an appropriate investigation? Early 1998 witnessed a decision profoundly important under California law--but, it says, a mere borrowing of established law from sister jurisdictions.

What Does "Just Cause" Promise in the Implied Contract Context?

In Cotran v. Rollins Hudig Hall International, Inc., 948 P.2d 412 (Cal. 1998), the California Supreme Court adopted what it called the "Scott-Pugh standard" for jury determinations in a particular species of wrongful discharge litigation, the implied agreement not to be dismissed except for "good cause." This decision remanded for retrial a case in which a jury had awarded $1.78 million to an executive terminated for sexual harassment. The jury did not believe the sexual harassment had occurred. The California Supreme Court said that was not enough for a finding of breach of contract. When a discharged employee denies committing the acts that provoked the decision to terminate employment, the jury's role is to decide whether the employer acted with "'a fair and honest cause or reason, regulated by good faith.'" Id. at 95-96, 99.

Two concerns informed this decision. First, the court believed that canons of contract construction dictate the outcome. Second, and perhaps more important, were practical considerations involving the workplace. While recognizing that the employer's belief "is not a substitute for good cause," the nature of the implied contract--the promises made--demands a focus on the employer's reasonable belief. The formal contract analysis utilized by the decisions relied on by the Cotran court is this: the implied contract not to terminate except for good cause is a promise not to terminate for good cause as objectively determined by the employer acting in good faith. That is the employer's promise.

How Does Implied "Just Cause" Differ from Express "Just Cause?"

Seen in this light, the Cotran decision, and the decisions upon which it relies, distinguish the promises made in the collective bargaining setting from the decisions made in the implied contract not to terminate except for good cause. The different institutional arena gives rise to different promises. "Good cause" in the union contract means good cause as measured by the seven well-known tests, ultimately reviewable by an arbitrator selected by both parties. Likewise, where the contract of employment is an express,written contract for a definite duration that states that the employee may be terminated for misconduct, the parties are agreeing to something different than in Cotran. They are agreeing that the employee cannot be terminated unless the employee is "actually guilty." Scherer v. Rockwell Int'l Corp., 975 F.2d 356, 59 FEP 1301 (7th Cir. 1992) (summary judgment to employer upheld because employee did not raise genuine issue of material fact regarding his innocence; he was unwilling or unable to deny the allegations upon direct inquiry). Interpretation of the contract, including "good cause" or "misconduct" will depend upon the means of contract formation. How the contract was formed helps tell what the terms promise. The public policy of the state helps, too.

3. DID A DUTY OF PERFORMANCE ARISE? There can be no breach of contract until one party is supposed to perform but refuses. (We are leaving aside the question of breach by anticipatory repudiation, which if material, operates as an ordinary breach and allows the non-breaching party to cancel and sue immediately). In other words, all conditions to one party's performance must "occur" before that party has a duty to perform. Any express conditions to party A's duty to perform must precisely occur or be excused before A has a duty to perform. Any constructive conditions to A's duty to perform must occur through substantial performance before A has a duty to perform.

4. ARE THERE ANY DEFENSES TO ENFORCEMENT? Not all contracts will be enforced. Some people have contractual incapacity, such as infants (usually those under 18) and mental incompetents. Some contracts will not be enforced unless they are evidenced by a sufficient writing, such as contracts for the sale of goods for $500 or more, and contracts that could not possibly have been performed within one year of their making (the one-year rule). Some contracts will not be enforced because they are against public policy, or are unconscionable. Contracts that were procured by fraud or duress can be avoided by the injured party. Sometimes contract performance can be excused because of impossibility or impracticability caused by unanticipated circumstances, the risk of which was not borne by the party seeking excuse.

In the employment context, the most usual defense to enforcement is the statute of frauds.

5. WAS THE CONTRACT BREACHED? If all conditions have occurred (either express conditions have occurred precisely or constructive conditions have been substantially performed), then the promisor's duty becomes absolute. If the promisor doesn't do what the promisor promised, and when it was promised, then there is a breach.

In the employment context, the claim of breach usually arises from an employee's termination, alleged to be in violation of contract, but it could arise from the breach of any promise.

6. IF THE CONTRACT WAS BREACHED, WHAT IS THE APPROPRIATE REMEDY? The typical remedy for breach of contract is expectancy, also known as benefit of the bargain: the injured party gets the end product (net) of what she would have obtained had the promise been performed. Note that the injured party doesn't come out ahead. She gets no windfall, only what she would have obtained (net) had performance occurred. Nor does the injured party normally get emotional distress damages or punitive damages for breach of contract. There's an exception for emotional damages when the nature of the contract contemplates that the injured party will suffer

emotional distress in the event of a breach, such as where the contract is for handling the corpse of a loved one, or at the other end of the scale, a contract for entertainment at a wedding reception. Courts do not allow emotional distress damages for breach of an employment contract. That's why plaintiff's lawyers want to find a tort.

Reliance and Restitution

When expectancy is inappropriate for some reason, usually some public policy reason, there are two other measures of relief:

. Reliance (what did the injured party lose by relying on the unperformed promise?); and

. Restitution (the breaching party must restore to the injured party any net benefit the injured party conferred on the breaching party).

Sometimes the breaching party is required to specifically perform the promise (an "extraordinary" equitable remedy). But courts do not require specific performance of personal service contracts, for this raises 13th Amendment concerns, as well as problems of court supervision. Sometimes the employee seeks reinstatement as a remedy for breach of an employment contract. Some courts will not allow this, either.

The type of breach is important for determining whether or not the non-breaching party may suspend all further contractual performance. Breaches may be material, in which case the non-breaching party is off the hook and need not perform. Or breaches may be immaterial (the breaching party did breach, but also substantially performed), in which case the non-breaching party must continue performance but may claim a monetary remedy to compensate for the breach.

JUST SAY NO? WHEN WON'T DISCLAIMERS WORK? • The point of an effective disclaimer is to notify employees that the handbook statements do not constitute binding promises or enforceable commitments. An effective disclaimer undermines contract formation. An effective disclaimer clearly proclaims: "We make no promises. This is not a contract. You may quit or be terminated at any time with or without notice. Nobody has the authority to modify this disclaimer." A clear disclaimer is one that a reasonable employee will understand, and the understanding will be that the employer has not made a commitment to employee job security.

Ineffective Disclaimers

An ineffective disclaimer does not defeat contract formation. An ineffective disclaimer leaves employees with contract rights to job security, as set forth in the handbooks or other policy statements. Ambiguities in the document will be construed against the drafter--the employer. Inconsistencies between the disclaimer and other language of promise in the handbook may create a jury question of whether a reasonable employee would understand that a promise has been made. For these reasons, employers who wish to issue handbooks that do not give rise to contractual obligations are urged to use language in the handbook that is not language of promise--that is language of discretion or guideline, but not language that is mandatory. These employers are further urged to use clear and conspicuous disclaimers that are attached to every policy to which they apply. A record of the employee's understanding of the disclaimer is advised.

Caution: Even Clear Disclaimers May Not Be Given Effect

Mercurio v. Therm-O-Disc, Inc., 634 N.E.2d 633 (Ohio Ct. App. 1993) demonstrates that disclaimers are no panacea. In Mercurio, an Ohio employer issued a handbook with a disclaimer. Later, the employer issued a separate document containing a progressive discipline policy. The progressive discipline policy did not contain a separate disclaimer. An employee who was terminated claimed that she had not received the benefits of the progressive discipline policy. The employer argued that the disclaimer defeated the former employee's breach of contract claim. The court held that the disclaimer in the handbook applied, by its terms, only to statements in the handbook. It did not reach the separate progressive discipline policy. The plaintiff's favorable jury verdict was affirmed. See also Black v. Baker Oil Tools, Inc., supra (no separate disclaimer in EEO policy promising non-discrimination on the basis of disability gave rise to promise). The lesson is that you can't have too many disclaimers.

What Happens if the Handbook Has Attained Contractual Status?

It may be impossible to disclaim an employment handbook that has attained contractual status without offering employees fresh consideration--and it may not be worth it!

Courts have been struggling with employers' attempts to withdraw job security that has already been provided through a contractual personnel policy. If the employer unilaterally modifies such a contract by, in effect, revoking contractual obligation, will such a unilateral modification be given effect if the employees get no new consideration in exchange for their relinquishment of contract rights?

In other words, once a handbook has achieved contractual status--usually by surprise owing to a court decision finding undisclaimed promises in handbooks or other policy statements to be contracts--can the employer try to take back its handbook promises by means of a subsequently issued handbook that contains a clear and conspicuous disclaimer? The disclaimer would say, in effect, "What used to be a contract isn't one anymore. We are disclaiming all contractual liability and we can fire you anytime by mere whim." Ever since the '80s, this is exactly what employers have been doing, although in more measured language.

Subsequent Disclaimer May Be Impossible

Several recent cases say that subsequent disclaimers won't work:

- Doyle v. Holy Cross Hospital, 199 Ill. LEXIS 15; 137 Lab. Cas. (CCH) ¶ 58,564 (Ill. 1999);
- Torosyan v. Boehringer Ingelheim Pharmaceuticals, Inc., 662 A.2d 89 (Conn. 1995);
- Brodie v. General Chemical Corp., 934 P.2d 1263 (Wyo. 1997); and
- McIlravy v. Kerr-McGee Corp., 119 F. 3d 876 (10th Cir. 1997).

Although the Michigan Supreme Court answered to the contrary ***55** in In re Certified Question (Bankey v. Storer Broadcasting Co.), supra, this issue has demanded renewed attention. Courts throughout the country are either split or uncertain about this issue. See, e.g., Demasse v. ITT Corp., 111 F.3d 730 (9th Cir. 1997) (certifying the question to the Arizona Supreme Court); Tothv. Square D Co., 712 F. Supp. 1231, (D.S.C. 1989) (applying South Carolina law) (contract modification requires mutual assent, so employer cannot unilaterally eliminate from a contractual handbook a provision regarding layoffs).

Why It Works This Way: Rules About Contract Modification

There are two basic approaches to contract modification: the pre-existing duty rule and the Restatement approach.

The Pre-Existing Duty Rule

The pre-existing duty rule says that doing what you are already obligated to do is not consideration. Therefore, if only one party to a contract obtains changed obligations through a contract modification, there is no consideration from the other party to support that change. There must be changes on both sides for there to be consideration from both sides. This view animates the cases holding that a subsequently issued disclaimer is ineffective if the employees do not get consideration for their relinquishment of contract rights.

The Restatement View

The Restatement view of contract modification is more tolerant of one-sided changes. This view is set forth in the section 89 of the Restatement(Second) of Contracts:

"A promise modifying a duty under a contract not fully performed on either side is binding

> (a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made; or
>
> (b) to the extent provided by statute; or
>
> (c) to the extent that justice requires enforcement in view of material change of position in reliance on the promise."

Courts that countenance subsequently issued disclaimers are guided by issues of fairness, at least to the employer. These courts are concerned with saddling employers with contractual obligations of infinite duration, or of saddling employers with different obligations to different employees.

Limited Disclaimers

Some courts limit the meaning of the disclaimer. The disclaimer means that there is no guaranteed duration to the employment relation. The employees remain at-will except for certain promises made in the handbook. For example, in Southwest Mississippi Regional Medical Center v. Lawrence, 684 So.2d 1257, (Miss. 1996), the Mississippi Supreme Court held that a hospital's disclaimer did not vitiate the handbook promise to compensate employees for on-the-job injuries. The hospital was not covered under the state workers' compensation plan, but was rather self-insured. The handbook contained at least two disclaimers which forcefully stated, "Nothing in this booklet should be considered a guarantee of continued benefits or employment by Southwest Mississippi Regional Medical Center." The employee successfully sued when Southwest would not compensate her for her on-the-job injuries. The promise of benefits was an enforceable promise, notwithstanding the disclaimer against continued benefits.

Hindsight is a wonderful thing. Employers would not face this problem if they had given clearly and conspicuously disclaimed handbooks to employees when--not after--

they were hired. The clear and conspicuous disclaimers should have been combined with non-promissory language in the handbook. That is, statements regarding job security should contain discretionary and permissive language, not mandatory language of promise. This tactic should prevent a handbook from being viewed as a legally enforceable contract.

How To Undo the Handbook-as-Contract

So what is an employer who wishes to undo a handbook-as-contract to do? Here are some suggestions:

- The first thing to do is to make sure that the old handbook you are concerned about really is a contract under the appropriate state's employment contract rules. If the handbook is not a contract, there is no problem. A subsequently issued modification with a clear and conspicuous disclaimer should simply be icing on the no-contract cake. You are probably safe in your subsequent disclaimers, for you have not unilaterally attempted to revoke a contract;
- If the old handbook you are concerned about probably is a contract under your state's employment contract rules, you have a serious problem. Any employee who was employed under that prior handbook presumably still has those contract rights. You can remove those rights only by giving the employees something in exchange for their relinquishment of these rights, such as a bonus or raise. You should consider giving a revised, disclaimed, non-contractual handbook when you give your next raises, because you must "purchase" the relinquishment of rights by the employees. That's what consideration is: the price of the promise. You could explicitly give the raise or bonus or other consideration in exchange for the employees' relinquishment of their rights under any prior handbooks. If this is your strategy, you should document this exchange;
- The easy answer is to provide fresh consideration to the employee who is giving up contract rights. The fresh consideration could be a bonus or a raise or other money. But it may not be worth it. Some employees may refuse the fresh consideration. Others may ask for more. Some may pay more attention to the handbook than they otherwise would have. These employees will believe they have contract rights that they had previously overlooked;
- You will have to make a difficult decision if employees refuse the bonus, etc., and cling to their rights. If you are going to terminate them (and that might be a very bad idea from the point of view of employee morale and fundamental fairness), be sure to follow the handbook rules and procedures, because the employees have rights to these rules and procedures. If you follow the rules and procedures for termination, you probably have the right to terminate employees who refuse to accept the new handbook;
- If only a few of your employees were employed under an undisclaimed handbook that has been subsequently and effectively disclaimed to new employees, you may wish to keep your head in the sand. It may be cheaper to let a few employees keep their old contract rights than to raise the issue of revoking rights that might not be asserted in any event. The employee may no longer have the old (contractual) handbook. The employee's lawyer may not think of this line of inquiry.

The lesson for employees and their attorneys is to examine all handbooks and policy statements that the employee received during her entire tenure with the employer or its successors. Those prior handbooks may be contracts, and they may not have been successfully disclaimed by a subsequently issued disclaimer.

THE CONTRACTUAL EFFECT OF SEXUAL HARASSMENT POLICIES A sexual harassment policy, undisclaimed and containing mandatory language, may constitute a contract that will be difficult to disclaim.

How Can a Sexual Harassment Policy Have Contractual Status?

Few cases hold sexual harassment or other EEO policies to be contracts. The usual reason that an EEO policy is not considered a contract is that it contains guidelines rather than rules, language of aspiration rather than promise. That may not be the result with regard to sexual harassment policies. These policies often contain:

Mandatory language;

- A clear promise of a prompt investigation in response to a complaint of harassment;
- A clear promise of non-retaliation for reporting suspected harassment; and
- A clear requirement that employees report sexual harassment under the procedures set forth in the policy. Plaintiffs' attorneys are now arguing with greater success that such policies constitute contracts.

Corluka v. Bridgford Foods: Unilateral Contract Analysis

In Corluka v. Bridgford Foods of Ill., 671 N.E.2d 814 (Ill. App. Ct. 1996), leave to appeal denied, 689 N.E. 2d 1138 (Ill. 1998), the employer distributed an undisclaimed sexual harassment policy. The policy promised non-retaliation, a thorough investigation, and prompt corrective action. The court held that this policy constituted a contract under the Illinois rules of contract formation, which was the unilateral contract analysis. The court also noted that the employee who reported sexual harassment was fulfilling his obligation under the sexual harassment policy. That, too, sounds like consideration. The court further held that the contract claim was not pre-empted by the exclusivity provisions of the state anti-discrimination statute, the Illinois Human Rights Act: "nothing in the Act or caselaw . . . suggest it was meant to preempt contract law."

The case was remanded for a trial in which the trier of fact must determine whether the employer breached the contract by discharging Corluka in retaliation for reporting sexual harassment.

Black v. Baker Oil Tools, Inc.: EEO Policy a Promise, but not a Contract

In Black v. Baker Oil Tools, Inc., supra, 107 F.3d at 1462, the Tenth Circuit Court of Appeals, applying Oklahoma law, found that the following EEO statement in a manual contained a commitment, a promise:

***59** "We believe the promise that '[a]ll relations and decisions pertaining to employment . . . [and] terminations . . . will be executed without regard to . . . physical . . . handicap . . . ' is more than a mere 'vague assurance' or 'puffery,' but rather is a 'substantive restriction' on [the employer's] ability to terminate its employees."

Disclaimer Did NotApply to EEO Policy

The employer argued that the policy could not be a contract because there was a clear disclaimer of contractual liability in the employee handbook as well as in the policy manual. But the EEO policy was in neither the employee handbook nor in the policy manual. The disclaimer applied to "this handbook" and to "this manual." The disclaimer did not apply to nor appear in the supervisory manual, which contained the EEO statement. The disclaimer was consequently ineffective. Id. at 1463.

Consideration Lacking

Although the EEO policy contained a clear and definite promise, and was undisclaimed, it did not constitute an enforceable contract because, according to the Tenth Circuit, the employee had given no consideration for the promise. Id. at 1463-1464. The plaintiffs' bar, in jurisdictions that use a unilateral contract analysis, can look to this Oklahoma case to strengthen the argument that an EEO policy is an undisclaimed promise that should be enforced under the law of unilateral contract analysis. The reason for this is that the unilateral contract analysis assumes that continued employment by the at-will employee constitutes consideration to make the employer's promise binding.

Bookman v. Shakespeare Co. EEO Policy a Promise, but At-Will Status not Otherwise Changed

In Bookman v. Shakespeare Co., 442 S.E.2d 183, (S.C. Ct. App. 1994), a South Carolina court of appeals held that the defendant's sexual harassment policy created a binding promise, but did not otherwise change the at-will relationship. The employer's promise was not to terminate an employee in retaliation for filing a harassment claim. The employer retained the right to terminate for any other reason.

What Can the Employer Do About Potential Breach of Contract Claims Based on Sexual Harassment Policies?

If a sexual harassment policy constitutes a contract because it is undisclaimed, employers must anticipate breach of contract claims ***60** for sexual harassment. The claim could be for failure to promptly investigate, or failure to take prompt corrective action. The claim could be, as in Corluka, for breaching the promise of non-retaliation. Although few employees would gain much by adding a breach of contract count to a statutory claim for sexual harassment, the employee who has not made a timely filing with local, state, or federal anti-discrimination agencies, or who has not otherwise complied with the administrative prerequisites of discrimination statutes, may nonetheless have a valid claim against the employer for breach of contract.

Contract Disclaimers of Sexual Harassment Policies Can Be Tricky

Disclaimer of sexual harassment policies is tricky. As a threshold, if the employer has already issued the policy and it will be viewed as a contract, then a subsequent disclaimer may require fresh consideration. Any attempt to explicitly ask your employees to take money in exchange for a disclaimer of a sexual harassment policy may create employee morale problems, if not material for David Letterman. ("Here's $10 if you don't mind if we fire you for reporting sexual harassment.")

There is another reason that it is tricky to disclaim sexual harassment policies: The disclaimer might have the effect of chilling employee willingness to report harassment. The employer wants an effective policy to prevent and remedy harassment. (After Burlinton Industries, Inc. v. Ellerth, 118 S.Ct. 2257 (1998) and Faragher v. City of Boca Raton, 118 S.Ct. 2275, it must have one if it expects to make an affirmative defense to a claim of harassment by a supervisor.) An important feature of such policies is a user-friendly reporting procedure designed to encourage meritorious claims of harassment. The employer will wish to rely on these policies to show that it had a serious, well-understood policy to address harassment. So any disclaimer should not in any way chill employees in reporting sexual harassment.

How To Craft an Appropriate Disclaimer

One way to manage a disclaimer of contractual liability while at the same time provide assurances against reprisals would be to make clear that federal law (and where appropriate, local and state law) prohibits retaliation for exercising rights protected by the discrimination statutes. It may be effective for the sexual harassment policy to state that it is part of the employment handbook, and is subject to the terms therein. And the terms therein would include the appropriate disclaimer. It may be a good idea to refer to the page in the handbook that contains the disclaimer.

CONCLUSION The presumption that employers and employees enter into the employment relationship on an at-will basis remains very much alive. However, courts have displayed a willingness to interpret the provisions of employment handbooks as making enforceable promises. Disclaimers can prevent this from happening, but the disclaimers must be clear and unambiguous. For the attorney advising the employer, the key is to keep the fundamentals of contract law in mind at all times.

Practice Checklist For
The Basics Of Employment Contracts

Employers who hire and retain employees on an at-will basis are often surprised when courts find that a contractual relationship exists. The key to assessing whether the relationship is something more than at-will is to evaluate the fundamentals of contract law.

- Was a contract formed? This turns in the first instance on finding some promise made by the employer.
  - The unilateral contract analysis. (The language of the policy statement contains a promise clear enough that an employee would reasonably believe that an offer has been made, the offer is disseminated in a way that makes the employee aware of its contents, and the employee accepts it by commencing or continuing to work);
  - The "instinct with obligation" theory, which posits that the employer gains benefits from issuing the handbook in the form of a more loyal and productive workforce, thereby justifying legal enforcement of the handbook promises.
  - If a contract was formed, what are its terms? In the employment context, the important question is whether there was a promise only to terminate for just cause or a promise to provide pre-termination rights, or other job security.

Was there a duty to perform? Any express conditions to party A's duty to perform must precisely occur or be excused before A has a duty to perform. Any constructive conditions to A's duty to perform must occur through substantial performance before A has a duty to perform.

- Are there defenses to enforcement? In the employment context, the most usual defense to enforcement is the statute of frauds.
- Was the contract breached? In the employment context, the claim of breach usually arises from an employee's termination, alleged to be in violation of contract, but it could arise from the breach of any promise.
- If the contract was breached, what is the appropriate remedy? The typical remedy for breach of contract is expectancy, also known as benefit of the bargain. When expectancy is inappropriate for some reason, usually some public policy reason, there are two other measures of relief:
  - Reliance (what did the injured party lose by relying on the unperformed promise?); and
  - Restitution (the breaching party must restore to the injured party any net benefit

the injured party conferred on the breaching party).

- Most employers rely on disclaimers to prevent promises in employment handbooks from becoming enforceable contracts:
  - Employers who wish to issue handbooks that do not give rise to contractual obligations should use language in the handbook that is not language of promise--that is language of discretion or guideline, but not language that is mandatory. These employers are further urged to use clear and conspicuous disclaimers that are attached to every policy to which they apply. A record of the employee's understanding of the disclaimer is advised;
  - If the employment handbook has already attained contractual status, will a subsequent disclaimer do any good? Probably not. Subsequent disclaimers are usually analyzed based on contract modification rules, and these are usually restrictive.
- Sexual harassment policies have been interpreted to have contractual effect. Since such polices are a must, employers need to decide whether to accept potential contractual liability or instead suffer the risks of disclaimer.

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20 Things to Look For in a Real Property Survey
An ALTA Survey Checklist

1. Survey is dated.
2. Surveyor's signature and seal are present.
3. A north arrow is present and accurate (verify using a city map).
4. Description on the survey matches that on the search (surveyors must survey the description of record.
5. Acreage content is stated on the face of the survey, if this is a factor used in determining the price of the property or in permitting the property for anticipated purposes.
6. Address on the survey matches that given by the lender (recorded subdivision plat is the authority for the street name).
7. Surveyor's inspection report and certificate are attached.
8. Survey is classified, if state has minimum standards requirements.
9. Flood-zone certification is included. Is flood insurance required? (Zone A-usually required; Zone B-depends on lender; Zone C or X-not required.)
10. Easements and other matters that are listed on the title search appear on the survey. If easements are not located on the survey, contact the surveyor for an explanation. Are there easements or other matters not shown on the title search? These may represent potential litigation or may interfere with a plan for development.
11. Are there any undedicated roads? An undedicated road may evidence a claim of access across the subject property.
12. Are there gaps between parcels believed to be contiguous? These may prevent the purchaser from developing the property as desired.
13. Are there fences on the property? Fences may be evidence of adverse claims or boundary-line problems. They may also indicate agreements contrary to title information. It may be necessary to secure a boundary-line agreement with an adjoining landowner.
14. Are there overlapping easements or improvements that overlap easements?
15. Does the subject property have access to a public street or have access by virtue of a recorded easement that is shown on the survey?
16. Building set-backs are in compliance with the protective covenants. If there is a breach of protective covenants, a waiver may be necessary.
17. Are there encroachments of improvements onto the surveyed property? These encroachments may have ripened into claims to a portion of the property. If this is the case, an encroachment agreement may be desired.
18. Does the property have improvements that encroach onto adjoining property? This is also a cause of potential litigation. An encroachment agreement may be needed.
19. Review all "notes" on the survey. Are there indications of any unusual or unauthorized use of the property or unexpected conditions? An agricultural use may be evidence of possession inconsistent with record ownership. Historical or archeological sites may also be inconsistent. Existence of wetlands may be of great importance. If any of these conditions exist, contact the surveyor.

20. Contact the surveyor regarding any unrecognizable symbols or other information that is unclear.

If there are any problems or unusual conditions indicated by the survey, have the purchaser execute a survey acceptance letter.

Did you find this checklist helpful? Do you think more information like this would help you? More information is available - *This checklist was republished with permission from the GP/Solo Publication: Real Estate Closing Deskbook, 2nd Edition – A Lawyer's Reference Guide & State by State Summary; pp38-39, by K.F. Boackle.* ***GP/ Solo members can purchase this book, which includes electronic forms, at a discount through the GP/Solo bookstore website: http://www.abanet.org/genpractice/books.***

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Construction Lending from the Ground Up

By David A. Weissmann

Construction lending is different in many respects from other real estate lending. It requires general knowledge of construction industry practices, engineering matters, and financing techniques. Although the pre-closing requirements are similar to other real estate loans, additional review is required to ensure that construction can commence and proceed without interruption.

Construction process and professionals: Architect, engineer, and contractor. The architect, engineer, and contractor constitute the triumvirate of professionals in the construction process. The developer begins with a tract of land and reviews the current zoning to ascertain the requirements that dictate the physical footprint of the planned project. The developer then has a rough idea of the square footage of improvements that can be constructed and can extrapolate the income potential.

The developer may take the general project design to an architect who will produce a set of plans and specifications, which can be distributed to a group of contractors for detailed pricing and contracting proposals. Construction contracts generally are based either on a fixed price or on the cost of construction plus a fee. The architect continues to serve as the owner's representative and contract administrator, approving the contractor's draw requests, monitoring the progress of the work, and inspecting the work for defects.

Construction lender's pre-closing requirements from construction professionals. The construction lender requires three basic items from each professional. First, the lender wants assurance that if it needs to foreclose and remove the developer from the project, the professionals will provide continued service to the lender so as to complete the project on time and within budget. Second, the lender seeks confirmation that the project complies with all applicable governmental requirements and can be constructed and operated as planned. Third, if work has commenced before loan closing, the lender seeks assurance, by way of lien waivers and subordinations, that it has and will continue to have a first-priority security interest in the underlying real estate.

A project may involve one or more engineers. The civil engineer usually prepares the site, drainage, and utility plans. Once the plans are prepared, the engineer's job is nearly complete. Therefore, although a continuation agreement can be requested from the engineer, it is not essential. But the engineer's certification is required regarding site conditions, availability of utilities, acquisition of required permits, and compliance of engineering plans with all applicable governmental requirements.

Many projects require that the contractor be bonded and require as a condition to closing that a bond be issued in favor of the lender, usually under a so-called dual obligee rider to a payment/performance bond. The payment bond guarantees the payment of sums due under the construction contract to potential lien claimants. The performance bond generally covers performance of the work up to the full contract.

Many construction lenders require that building permits be issued before loan funding. This requirement may present a practical difficulty when the cost of the permits is high and is to be funded out of loan proceeds. One compromise is for the professionals to issue letters indicating that all requirements for the issuance of the permits have been fulfilled, except payment of the fees. A lender will usually agree to advance funds for closing on this basis, expecting the permits to be obtained expeditiously thereafter.

The project budget is the key component to the evaluation of the loan budget. It should detail construction on a line-item basis and should separately delineate all major components of construction, such as concrete, steel, masonry, interest reserves, marketing, or other fees. The budget should also have a realistic contingency line item. If there is a cost saving in a line item, then the lender will usually agree to move the savings to the contingency line item, to be used for other items at the lender's reasonable discretion. If there is a shortfall in any line item, the lender may either use the contingency fund or require additional equity from the borrower. The construction loan agreement should provide that the failure of the borrower to provide the additional equity infusion is an event of default.

Construction loan agreement. In addition to the representations and warranties contained in most commercial real property loan agreements, a construction loan agreement should contain representations and warranties about the following matters: that the plans and specification delivered to the lender constitute a complete and final set of all plans and specifications required; that true and correct copies of the construction contract, architect's contract, and engineer's contract have been delivered to the lender; that the plans and specifications and the use of the project contemplated thereby comply with all applicable laws, ordinances, and regulations; that all utilities and rights of way necessary for the construction, use, operation, and maintenance of the project are available through public rights of way or through private easements; that all permits, certificates, and authorizations required for the project have been obtained; and that the borrower has not caused any labor to be furnished in connection with the construction of the project, or entered into any contract that could give rise to a lien against the project, except for parties who have been paid in full or have delivered lien subordinations or waivers.

The construction loan agreement will also contain certain covenants to allow the lender control over the construction process. Matters to which the borrower must agree include: to begin construction on a timely basis and to pursue it diligently to completion; to complete construction in accordance with all applicable laws, ordinances, rules, and regulations using sound construction practices and new materials; not to alter the plans and specifications without lender consent; to give the lender access to the project for inspection; to perform such tests as may be required by the lender; to correct defects in construction; to provide builder's risk insurance; and to use loan proceeds solely for purposes allowed under the project budget.

The loan agreement will provide for specific instructions for drawing funds and include a list of conditions to be satisfied for each draw. These conditions include confirmation that: the total advances will not exceed the maximum loan amount; hard cost expenditures do not exceed the progress of construction on a percentage of completion basis; no potential or unmatured default or event of default exists; and the inspecting architects and lender believe that the construction is on schedule, can be completed on time, and has progressed in accordance with approved plans and can be completed within budget. Final disbursement at the time of completion may be subject to the lender's receipt of: a final, as-built survey; a final contractor's lien waiver; certificates from the borrower, architect, and inspecting architect; the appropriate occupancy permit or certificate of occupancy; approval and acceptance by any key tenant; and permanent casualty insurance.

Other key provisions provide additional administrative or oversight power to the lender. For example, draws should occur no more than monthly. The lender will typically withhold 10 percent of each draw request as retainage. It will also want the right to make advances to the title company or to third parties to ensure payment gets to those entitled to funds. The right to reallocate line items is often negotiated.

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- Website:www.abanet.org/rppt/.

- Periodicals: Probate & Property, bimonthly magazine; Real Property, Probate and Trust Journal, quarterly journal.

- Books and Other Recent Publications: Probate and Trust: An Estate Planner's Guide to Buy-Sell Agreements for the Closely Held Business; An Estate Planner's Guide to Family Business Entities, 2d ed. ; An Estate Planner's Guide to Qualified Retirement Plan Benefits, 3d ed. ; An Estate Planner's Guide to Life Insurance; Wills, Trusts, and Technology: An Estate and Trust Lawyer's Guide to Automation, 2d ed.; The Family Limited Partnership Deskbook; Third Party and Self-Created Trusts, 3d ed. and Client Brochures; Asset Protection Strategies; A Guide to International Estate Planning.

Real Property: The Commercial Lease Formbook; Expert Tools for Drafting and Negotiation; The Commercial Office Lease Handbook: New York Model Clauses and Commentary; Land Use Regulation: A Legal Analysis and Practical Application of Land Use Law, 2d ed.; Synthetic Lease Financing; A Practical Guide to Commercial Real Estate Transactions; Anatomy of a Mortgage; The Commercial Property Lease, vol. 3; Accessibility under the Americans with Disabilities Act and Other Laws; Land Surveys, 2d ed.

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The Marital Residence: Who Benefits from the Sale and Deductions?

By Joseph W. Cunningham

A family residence is involved in almost every divorce, regardless of whether the parties have accumulated a substantial estate or a modest one. Tax considerations regarding the residence center principally on (1) sale of the home and (2) deduction of mortgage interest and real estate taxes.

In general, § 121 of the Internal Revenue Code provides for the exclusion of up to $250,000 of gain—$500,00 for married taxpayers satisfying the requirements summarized below—on the sale of a home owned and used as a principal residence by the taxpayer for two of the five years preceding the date of sale.

Married taxpayers qualify for the $500,000 exclusion under the following conditions:

- The parties file a joint return for the year of sale.
- At least one spouse satisfies the two-out-of-five-years ownership requirement.
- Both spouses satisfy the two-out-of-five-years use requirement.
- Neither spouse is ineligible because he or she used the exclusion in conjunction with a previous sale within two years of the date of the current sale.

Although the exclusion generally is not available to a taxpayer who has claimed such an exclusion during the preceding two years, if his or her failure to satisfy the two-years requirement results from a change of employment, health problems, or other unforeseen circumstances, a percentage of the $250,000 is allowed, equal to the percentage of the two years the ownership and use requirements were met. For example, a taxpayer lived in a home for six months, at which point he sold it and moved to accommodate a job transfer. Because 25 percent of the two-out-of-five-years requirement was satisfied, 25 percent of the $250,000/$500,000—or $62,500 for a single taxpayer and $125,000 for married taxpayers—would be available.

The IRS issued regulations for I.R.C. § 121 in 2002. They provide more detail regarding circumstances under which a taxpayer is entitled to a prorated exclusion. Of particular relevance is inclusion of a sale resulting from a divorce or legal separation as a "safe harbor" event in the "unforeseen circumstances" category. Thus, if the sale of the residence in the example resulted from a divorce, 25 percent of the exclusion would be available, as if the sale resulted from a change in employment or health problems. Although the "safe harbor" list does not include an annulment or de facto separation, such an event would likely qualify under the "unforeseen circumstances" criteria.

Pertinent rules. The regulations illustrate application of the exclusion (1) when an unmarried couple sells a home they have been living in and (2) when newlyweds sell the homes each had lived in prior to the marriage.

As for unmarried cohabitants, assume A and B have jointly owned and used their home as a principal residence for the last seven years. They are now selling the home at a gain of $256,000. A and B are unmarried at the time of the sale. Because each satisfied the two-out-of-five-years ownership and use requirements, each is entitled to a $250,000 exclusion, which is more than adequate to shelter their respective $128,000 or 50 percent share of the gain. It does not matter whether A and B were ever married or were divorced before the sale.

As for newlyweds, assume A and B plan to buy a new home together and sell the homes each lived in prior to the marriage. Neither party satisfies the ownership and use requirements with respect to the other's premarital home. A and B have gains of $200,000 and $300,000, respectively, incident to the sales. Whether they file jointly or individually, A's $200,000 will be fully excluded by the $250,000 exclusion, whereas $50,000 of B's gain—the excess over the $250,000—will be subject to tax. B may not use A's unused exclusion on B's gain in excess of the $250,000 limit.

If a single taxpayer who otherwise qualifies for the exclusion marries a new spouse who has used the exclusion within the two-year period, the newly married taxpayer's exclusion is limited to $250,000. To qualify for a $500,000 exclusion, the taxpayer's new spouse must occupy the home for two years, and two years must have elapsed since either party previously used the exclusion.

For purposes of the two-out-of-five-years ownership requirement, a spouse who acquires an interest in a principal residence from a spouse or former spouse incident to a divorce settlement is considered to have owned the residence or the interest in the residence for as long as it was owned by the transferor spouse. Further, use by one spouse or former spouse, specifically provided for in the divorce settlement, is attributed to the other spouse.

The marital status on the date of sale is used to determine whether the available exclusion is $250,000 or $500,000. However, even if parties are married on the date of sale, to qualify for the $500,000 exclusion they must satisfy the three other requirements noted above, including filing a joint return for the year of sale. Thus, they will not qualify if divorced after the sale but before December 31 of the same year.

Mortgage interest and taxes. General rules regarding deduction of mortgage interest and real estate taxes on a jointly owned principal residence are based largely on IRS rulings and case law.

In the case of a joint tenancy with survivorship rights, the joint owner who makes the payment is entitled to the deduction. If spouses own a home as tenants in common, the payer of mortgage interest and real estate taxes may deduct them only to the extent of his or her interest—usually 50 percent.

Payments made in a divorce context. The deductibility of mortgage interest, property taxes, utilities, maintenance, etc., in a divorce context depend on: (1) ownership of the home; (2) use of the home as a personal residence; (3) liability on the mortgage loan; and (4) whether payments are pursuant to a divorce or separation instrument.

The tax treatment of mortgage interest and real property taxes related to a home in common situations following a divorce is based on the following assumptions:

- The husband is the payer of all expenses pursuant to the governing divorce document.

- The wife is living in the former marital residence with the parties' child.
- The husband has selected the former marital residence as an "other residence" for purposes of deducting mortgage interest.

If the husband and wife are tenants in common and jointly obligated on the mortgage loan, then half the payments are taxable/deductible as alimony, and the husband and wife are each entitled to deduct half the mortgage interest and real estate taxes as itemized deductions.

If the home is solely owned by the wife, and if she and the husband are both liable on the mortgage loan, then half the mortgage interest and all the real estate taxes are taxable/deductible alimony, the husband and wife are each entitled to deduct half the mortgage interest, and the wife may deduct all the real estate taxes.

If the wife is the sole owner of the home and is solely obligated on the mortgage loan, then all payments are taxable/deductible alimony, and the wife may deduct all mortgage interest and real estate taxes.

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For More Information About the Section of Family Law

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-For more information or to obtain a copy of the periodical in which the full article appears, please call the ABA Service Center at 800/285-2221.

-Website: www.abanet.org/family.

-Periodicals: Family Advocate, 64-page quarterly magazine; Family Law Quarterly, quarterly journal.

-Books and Other Recent Publications: Collaborative Law; The Complete QDRO Handbook; The Divorce Trial Manual; 101+ Practical Solutions for the Family Lawyer; Balancing Competing Interests in Family Law; Frequently Asked Questions About Divorce: A Client Manual.

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The Structure and Use of Letters of Intent

By Gregory G. Gosfield

The primary utility of a letter of intent is setting the binding ground rules of a negotiation. A secondary use is to raise issues or allude to special circumstances in a vague, nonbinding fashion to provide some context to the interest of the parties. The fundamental source of contention over the intent of the letter is that it usually attempts to accomplish two purposes—and these purposes assume contradictory positions. The prime cause of problems is that the parties fail to accept the practical situation that some provisions must be static, concrete, and contractually binding and that other provisions must be fluid, perhaps vague, and nonbinding.

In distinguishing the two types of provisions, the touchstone is that only some provisions are agreed upon as enforceable obligations as a condition of negotiations. These binding provisions are the preconditions to contractual negotiation for a transaction and comprise a prenegotiation contract. These provisions should be valid, binding, legal, and enforceable.

The other provisions, the hypothetical terms of the possible business transaction, are optional contract terms that, if agreed upon, would create a purchase-and-sale contract. However, these hypothetical terms of the potential transaction should not be valid, binding, legal, or enforceable until intended to be as reflected by the fact that the circumstances match the conditions of enforceability. The distinction can be signified with more decisiveness: the drafter can prepare one writing, in the form of a binding letter agreement, to establish the conditions to negotiation, and prepare in a separate writing the nonbinding business terms.

Choosing the purpose. Absent a manifested resolution of the purpose, the court will step in to find the meaning that will bind the parties, whether by interpreting what is or construing what ought to be. The court characterizes the purpose of the letter, either as: (1) a mere gesture showing interest in the possibility of a transaction (agreement of interest); (2) a serious commitment to negotiate toward agreement upon a possible transaction (contract to negotiate); (3) an orderly collection of the necessary contractual terms ready to be binding, but missing the key ingredient—the intent to be bound (agreement subject to written contract); and (4) a patently enforceable contract, albeit in an abbreviated or informal format (contract for settlement).

Is there a contract, a duty, or a liability? The most ironic part of the ambiguity surrounding letters of intent is that even though this type of writing is generally captioned "Letter of Intent," the most contentious element is, first, whether intent exists, and second, if it does, whether it is the intent to form or not form a contract. There are usually four indicia of lessening significance to find what intent exists in the letter of intent: (1) does it contain an express statement by the parties, (2) did one party perform based either on the terms of the letter or on the party's reliance that the letter would reflect the performance, (3) are the essential terms of a contract included or determinable, and (4) does it contain formalities and other displays of solemnity that are customary for contracts of that kind?

Along with intent and essential terms, consideration is a third requisite element of enforceability that distinguishes private agreements from enforceable agreements. Consideration is generally considered to exist when one party either diminishes its own position, enhances the other party's position, gives a promise in exchange for a promise, or when sufficient solemnity has been demonstrated. But, when one party has an exclusive right of discretion to proceed under an irrevocable offer (in the case of a buyer, when there is an unfettered inspection right, and in the case of a seller, when there is an unfettered approval right by the board of directors), there is a threat that the exclusive discretion prevents the existence of consideration. The legal formality of consideration may be circumvented under the doctrine of promissory estoppel to the extent a party is seeking only damages rather than specific performance. When the party claiming promissory estoppel expects the other party to rely on the letter of intent to commence performance, a court can use its discretionary power to find that the promisee relying on the letter is entitled to damages notwithstanding the promisor's reservation of discretion.

Assuming the three fundamental contractual elements are present, real estate agreements generally are expected to be written contracts and subject to the statute of frauds. If the aggrieved party cannot prove a contract complies with the statute, then specific performance is not available to the aggrieved party. Courts are traditionally reluctant to insert missing terms to rehabilitate the contract for it to comply with the statute. On the other hand, when a sequence of writings can be combined and all essential terms for a binding agreement can be found, the contract may be enforceable. A parallel doctrine of "part performance" was adopted to provide relief from the statute of frauds and to reinforce that partially performed contracts can be specifically enforced, even if they otherwise fail to comply with the statute of frauds. Therefore, courts can continue to find a different path to relief for the plaintiffs by using the part performance doctrine. With part performance, because no contract is found, the court may find damages equivalent to reliance damages, rather than expectation damages.

Generally, because specific performance requires a showing that money damages are an inadequate remedy, money damages are the more common remedy. But because of the unique nature and quality of real estate as an asset, specific performance is a meaningful and available remedy. Courts may fashion damage calculations commonly grouped under expectation damages, reliance damages, and restitution damages. Expectation damages are the monetary equivalent of specific damages because they pay the amount of value the buyer would have had if the contract had been specifically performed. Reliance damages are measured by the amount necessary to put the buyer in as good a position as it would have been if it had never entered into the contract. Restitution damages are the amounts needed to restore to the buyer any benefits obtained by the seller from third parties for not having completed the sale to the buyer.

Separating binding and nonbinding provisions. There are essentially 11 binding provisions: (1) intent; (2) good faith; (3) disclaimer of exclusivity; (4) disclaimer, release, indemnification, assumption, and waiver; (5) limitation of liability; (6) confidentiality; (7) approval and authority; (8) expenses; (9) access; (10) termination; and (11) miscellaneous provisions. Miscellaneous provisions include such things as compliance with applicable laws and requirements of governmental authority; choice of law and venue; merger provisions as to the binding provisions to avoid parol evidence and to retain enforceability to the extent the owner believes it retains significant rights with respect to the obligations it has taken on; and prohibitions on assignment to confirm the party negotiating will be responsible for contracting and settling.

Nonbinding provisions are ordinarily terms that continue to be negotiated to reach a final definitive purchase-and-sale contract. The terms include price: how much is to be paid, when it is to be paid, and adjustments if the payor pays expenses that the payee might otherwise be expected to pay, such as broker commissions, transfer taxes, and permit fees.

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For More Information About The Real Property, Probate And Trust Law Section

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- Books and Other Recent Publications:Probate and Trust: Wills, Trusts, and Technology: An Estate and Trust Lawyer's Guide to Automation, 2d ed.; The Family Limited Partnership Deskbook: Forming and Funding FLPs and Other Closely Held Business Entities; Third Party and Self-Created Trusts, 3d ed. and Client Brochures; Asset Protection Strategies; A Guide to International Estate Planning; Bridging the Gap: Drafting for Tax and Administration Issues; S Corporations and Life Insurance, 2d ed. Real Property: Land Use Regulation: A Legal Analysis and Practical Application of Land Use Law, 2d ed.; Synthetic Lease Financing; A Practical Guide to Commercial Real Estate Transactions; Anatomy of a Mortgage; Title Insurance, 2d ed.; The Commercial Property Lease, vol. 3; Accessibility under the Americans with Disabilities Act and Other Laws; Land Surveys, 2d ed.; A State-by-State Guide to Construction and Design Law.

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The Value Provided by the 2006 ALTA Title Insurance Policies

By Dwight Bickel

On June 17, 2006, the American Land Title Association (ALTA) adopted many new and revised forms for use by title insurance companies throughout the United States. This article is a brief guide for Washington property lawyers to help them understand the changes made to the basic title insurance forms. A detailed comparison essay and copies of all the forms are available at www.wltaonline.org/resources.

The 2006 policy forms have been designed to more adequately satisfy the needs of the commercial market. The new forms continue to be the basic policy form and appropriate for any property type. Where the ALTA Homeowner's Policy is available, it continues to be significantly more coverage for residential property.

There should be very little impact on the parties to a real estate transaction or their agents. The new policy forms have the same component parts and look about the same. Commitments will look the same. The changes are primarily on the jacket of the policy. Schedule A will look almost the same and Schedule B is not changed at all.

Just like the prior forms, the new forms automatically provide extended coverage, expecting Schedule B to contain general exceptions where standard coverage is issued. There is very little change to the process of preparing a commitment or underwriting to issue the policy.

The 2006 policy forms provide new value to the Insureds: improved coverage provisions, improved definitions, improved claim administration procedures and substantially improved Conditions describing the rights and duties of both parties.

Policy Coverage

There are many new covered risk paragraphs. Upon analysis, there is not such a significant increase in the covered risks. Many of the specific risks that are now detailed were previously included within the few, broad coverage paragraphs. Several of the new coverage paragraphs are matters that were previously an exception contained within the exclusions. This responds to judicial policy interpretation that coverage must be found within the covered risks, rather than construed from exceptions within the exclusions.

For example, the 2006 policy forms are designed to give coverage for creditors' rights in those circumstances where the 1992 exclusion contained an exception. Although oversimplified, the 2006 forms provide coverage against two creditors' rights risks. First, the policy protects against any attack against the prior chain of conveyances. Second, the policy protects against any attack against the present transaction due to the failure to record, or the failure of the recording to give legal notice binding upon the bankruptcy trustee.

The 2006 forms continue to exclude coverage against all further creditors' rights attacks. The only proper method to obtain creditors' rights coverage with the new policy form is to request the ALTA Form 21-06 Endorsement.

Both the 2006 policy forms include coverage for matters created after the date of policy through the time of recording the insured instruments. Most Washington transactions do not require delivery of a policy dated prior to recordation. The new coverage may provide comfort enabling a change of settlement practices here.

Both new forms state a new Covered Risk against loss caused by encroachments of the neighboring property onto the Insured's land and encroachments of the Insured's improvements onto adjoining land. This is probably new coverage in Washington. Any known encroachment of an improvement should be listed as an exception in Schedule B.

Revised Conditions

The primary value of the new basic policy forms is realized from the revisions of the definitions and conditions paragraphs. There are several very significant changes to definitions improving the rights of the Insureds.

Both policy forms improve the rights of successors and assigns as an Insured. These changes should avoid the need for Insureds to obtain endorsements in many circumstances to acknowledge rights to the policy, such as transfers to a trust, mergers, or changes in entity form. This will avoid concern about coverage, avoid the need for an endorsement, and in many cases avoid premium charges for subsequent assurance endorsements.

The 2006 Loan Policy significantly expands the definition of Indebtedness, requiring payment of more types of financial loss to the lender in the event the title company elects to pay the indebtedness to settle a claim.

The new forms respond to several issues that have troubled customers. For example, paragraph 9(b) of the prior loan policies reduced the amount of insurance upon a borrower payment. The 2006 Loan Policy avoids the need for "last dollar" endorsements by defining the Amount of Insurance and deleting that paragraph.

The claim administration paragraphs have been simplified for the Insured. Giving prompt Notice of Claim remains the initial and the critical duty of the Insured. Thereafter, a Proof of Loss is only required in the event the Company is unable to determine the amount of loss or damage and only when requested.

The 2006 policy forms include two new provisions in response to customer complaints about cases where the title insurance company chooses to defend, or prosecute, in order to avoid loss to the insured payable under the policy. That important title company option to establish the title, or to prevent or reduce loss is essentially the same as ALTA policies since 1970.

However, if the title company litigation is not successful, the new forms provide two benefits to more adequately compensate the Insured. Condition paragraph 8(b) provides (1) the Amount of Insurance is increased by 10% and (2) the Insured may determine or measure its loss either when the claim was made or at the conclusion of the litigation.

Deleted Conditions

Several provisions have been entirely eliminated from the new forms.

1.The Owner's Policy Coinsurance Paragraph is Gone

Condition paragraph 7(b) first appeared in the 1987 Owner's Policy. It reduced the amount of the Insured's claim in several circumstances, both where the policy amount was less than the land value, but also in cases where the Insured made significant improvements subsequent to the acquisition. Removal of this limitation will increase Insured's indemnification significantly in many circumstances.

2.The Owner's Policy Apportionment Paragraph Is Gone

Condition paragraph 8 has existed since the 1970 forms. Contained only in owner's policies, it applies to limit the recovery for loss incurred on one parcel affected by a title claim, when the policy includes more than one parcel of land. Removal of this paragraph provides the full amount of insurance to compensate an Insured's loss affecting only one parcel.

3.Mechanic's Lien Exclusion Is Gone

From 1970 through 1992, coverage against unrecorded labor and material liens required interpretation of the broad coverage paragraphs, Exclusion 6 that specified conditions of a lien that would not be covered and Condition paragraph 8(d)(ii) that further specified conditions. The 2006 loan policy specifies the circumstances for mechanic's lien coverage in one Covered Risk, deletes Exclusion 6 and deletes Condition 8(d).

4. The Lender's Policy "Subsequent Advance" Limitation Is Gone

Condition paragraph 8(d)(i) stated that the title company was not liable for any indebtedness created subsequent to the Date of Policy. That was a significant limitation on the amount a lender was entitled to receive in the event the title company elected to pay the amount of indebtedness to discharge its obligations. The 2006 Loan Policy clearly includes subsequent advances in the definition of indebtedness.

However, the 2006 Loan Policy does not insure against loss of priority of the lien of the mortgage to the extent of the additional advance. Priority of additional advances is insured by using ALTA form 14, 14.1 or 14.2 endorsements, issued at the date of policy or at the date of the advance.

5.The Lender's Policy "Liability Noncumulative" Provision Is Gone

Since the 1970 Loan Policy, Condition paragraph 10 provided that a policy insuring a second lien would have a reduction in policy amount if a claim payment was made to an unrelated loan policy insuring a prior lien. Removal of that reduction to the policy liability provides junior mortgage lenders with the full protection of their policy amount.

New Endorsements

The Forms Committee of the American Land Title Association in the past four years drafted many new endorsement forms intended to satisfy the growing demand of the title company customers. Review the full list of new and revised endorsement forms at www.wltaonline.org/resources.

The 2006 basic policy forms are substantially different in coverage and formatting, using new definitions. Therefore, the ALTA has adopted a parallel list of endorsements that refer to the new paragraphs, the new definitions and new formatting of the 2006 basic policy forms. The numbering convention that was adopted simply adds “-06" to each endorsement form number, to distinguish the revised forms to be issued with the 2006 policy forms. Substantively, the coverage of the new “-06” endorsements has not been changed.

Dwight was a member of the ALTA Forms Committee during development of the new title insurance forms.

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When Wrap-Around Mortgages Return: The Time To Plan Is Now

By R. Kymn Harp

With interest rates near historic lows and lenders clamoring to make loans secured by quality commercial real estate, now is the time for investors to lock in attractive loan rates for extended periods, if possible, and to make sure they have the flexibility to keep those rates when economic conditions and future needs change. Now is the time for borrowers to negotiate provisions in their commercial real estate mortgages that allow them to leverage current low interest rates to their advantage when interest rates rise. Here's how.

Consider the following hypothetical facts. The investor acquires investment property for $2 million. The investor obtains a $1.5 million loan (75 percent loan to value) with a fixed interest rate of 6.25 percent amortized and payable over 20 years, secured by a first mortgage on the property. Five years into the future, interest rates on the first mortgage loans have risen to 9.5 percent. Interest rates on loans secured by second-position mortgages are 10.5 percent to 11 percent. Because of built-in rental increases under existing leases, the property has appreciated in value to $2.2 million. Perhaps the tax shelter benefits of the property to the investor have diminished because the investor used segregated cost accounting to accelerate cost recovery in the early years of the investment, so the investor has decided to sell. The sales price is $2.2 million. The investor could simply sell the property to a willing buyer who would be responsible for obtaining its own financing. Or, if the mortgage is assumable, the buyer could, if it chose to do so and the seller agrees, pay the original investor an amount equal to the investor's equity in the property and assume or take subject to the mortgage obligation with its low 6.25 percent interest rate for the balance of the loan term.

But assume at the time of obtaining the original mortgage the investor was able to negotiate a mortgage that did not include a due-on-sale clause and did not prohibit additional debt secured by the property. In this case, the investor has two additional choices if the buyer wishes to leverage the property by financing 75 percent of the purchase price.

Option One: The investor can offer to hold a standard second mortgage in the amount of $371,293.37 at an agreed-upon rate close to market rates for second mortgage loans, amortized over an agreed-upon period, and the buyer can assume or take subject to the existing first mortgage bearing interest at 6.25 percent. The buyer would get the benefit of the lower interest rate on the first mortgage but would pay a l0.5 percent market rate of interest on the second mortgage.

Option Two: The investor might offer a wrap-around mortgage for the entire amount being financed ($1.65 million) at a below-market interest rate for a first mortgage loan with interest of 9 percent on the entire amount, amortized over 20 years with a 15-year balloon.

If Option One is chosen, the investor receives at closing the sum of $550,000 in cash and will "hold paper" for $371,293.37 secured by a second mortgage, earning 10.5 percent interest per year, generating a monthly payment of $3,706.92, and a final balloon payment of $172,463.73 in 15 years. The effective yield to the investor would be 10.5 percent.

If Option Two is chosen, the investor receives at closing the sum of $550,000 in cash and will "hold paper" for $1.65 million bearing interest of 9 percent (desirable to the buyer because it is 0.5 percent less than market and results in a monthly payment of only $14,845.48, an amount of $534.68 per month less than available at the hypothetical current market rate of 9.5 percent). Of the $1.65 million held by the investor, only $371,293.37 represents funds actually "loaned" by the investor, which is the balance of equity the investor would have received if the property had been sold outright, without the need for the investor to provide any financing.

At first glance, it may seem that these funds will earn interest at only 9 percent instead of 10.5 percent available under Option One, but consider further: Through use of a wrap-around mortgage, the investor would also earn a 2.75 percent return on funds of the original lender because of the spread between the 6.25 percent interest rate on the first mortgage loan and the 9 percent interest rate on the wrap-around mortgage loan. Because the mortgage wraps around the original first mortgage loan, the balance of the wrap-around mortgage amount, $1,278,706.63, represents funds actually advanced by (and remaining unpaid to) the original first mortgage lender. The effective yield on funds actually invested by the wrap-around investor would improve to 14.32 percent.

Consequently, the monthly payment received on the wrap-around mortgage would be $14,845.48. After payment of the underlying monthly payment of $10,963.92 due on the existing first mortgage, the net amount retained from the wrap-around mortgage payment during the life of the underlying first mortgage is $3,881.56 (compared to only $3,706.92 under Option One). More significantly, at the end of 15 years, when the underlying first mortgage has been fully amortized and paid off, the balloon payment receivable under the wrap-around mortgage proposed in Option Two would be $715,156.77 ($542,693.04 greater than in Option One). In fact, the investor would receive nearly double the amount originally loaned because of accumulated interest from negative amortization.

Under Option Two, both the investor and the buyer benefit, and the original lender continues to receive the rate of return originally contracted for under the first mortgage.

Potential legal advantages and documentation. In addition to the yield enhancement benefits enjoyed by the wrap-around lender, another advantage of a wrap-around mortgage as compared to a simple second mortgage is that the collateral priority of a wrap-around mortgage may, over time, migrate to a collateral priority on par with the first mortgage.

For the most part, a wrap-around mortgage should mirror the provisions of the senior mortgage around which it wraps, with a pass-through to the mortgagor of virtually all mortgagor covenants. An essential element of a wrap-around mortgage, however, is that it must require the borrower to make all payments to the wrap- around mortgagee, who will, in turn, be obligated to pay the senior mortgagee. The wrap-around mortgage and related documentation must not permit the mortgagor to pay the first mortgagee directly. It is this arrangement that, legally, may enhance the wrap-around mortgagee's collateral position.

The wrap-around mortgage and supporting documentation should include covenants of subrogation to establish the clear intent of the parties that subrogation to the lien of the senior loan is to occur with each payment by the wrap-around mortgagee to the senior lender. By including specific language to this effect, the doctrine of conventional subrogation may be sufficient to achieve this result.

Some commentators have raised the additional issue of whether future payments by a wrap-around mortgagee to a senior lender enjoy priority over liens filed after the date of recording a wrap-around mortgage but before the date of payment of future installments to the senior lender. The prevailing view is that this issue is adequately resolved through conventional subrogation and through the rule of tacking, which provides that a mortgagee who pays a prior encumbrance is entitled to include such amount in the indebtedness secured by the lien of its mortgage.

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- This article is an abridged and edited version of one that originally appeared on page 42 of Probate & Property, July/August 2004 (18:4).

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