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Report From Counsel

Insights and Developments in the Law **Summer 2012**

Confidential E-Mails: Proceed with Caution

Even the most technology-challenged among us would have to admit that the ease with which we can communicate by e-mail is an improvement over the forms of correspondence that have preceded it. For most of us, there is no going back to the days before e-mail. This is no less true for communications between attorneys and clients than it is for other types of communications.

Two recent cases have shown that e-mails can become legal headaches if great care is not taken to be sure that the e-mails are sent to and seen by only the intended recipient.

Two recent cases have shown that along with the speed and efficiency of e-mails between attorney and client can come legal headaches if great care is not taken to be sure that e-mails are sent to and seen by only the intended recipient.

Familiar e-mail tools—"cc," to copy a message to one or more additional recipients; "bcc," to blind copy a message without revealing any of the recipients' e-mail addresses but the one in the "to" field; the "reply all" feature, to reply not only to the sender but to every recipient whom the sender "cc'd" or "bcc'd"; and the "auto-complete" function, a function that suggests or finishes an e-mail address when the sender begins to type it—all have the potential for causing problems.

Reply to All

In one case, defense counsel in a civil matter sent an e-mail to opposing counsel, with a "cc" to his own co-counsel and a "bcc" to his client, one of the defendants. The client responded, using the "reply all" function, thereby unwittingly transmitting his response simultaneously to opposing counsel as well as his own. The content of the response left no room for doubt that the client had intended his

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The Company Is Worth How Much?

An investor put $28,000 into an oil and gas company owned by a friend of his from their teenage years. Ten years later, the company offered to buy out the investor's roughly 6% stake in the company for $6.5 million. The investor accepted the offer, figuring he had made a killing on the investment, as indeed he had. But all things are relative. Two years after the buyout, the investor's friend sold the company for $2.6 billion. Needless to say, the investor's suspicions were raised, and he eventually sued his friend for having committed fraud when the buyout offer was extended and accepted.

A jury ruled in the investor's favor, and the resulting judgment for the investor was $196 million. The jury was persuaded by evidence that the defendant owner and company had painted an erroneously gloomy picture of the company's prospects as it planned to explore for natural gas. The defendants did not share with the investor that the company had an enormous upside potential about which the defendants were enthusiastic and even excited. That upside became a reality, but only after the investor had sold his interest in the company.

The company and its owner tried to place the responsibility for the buyout on the investor, not only because of his sophistication but also because of a release he had signed at the time of the buyout. The court ruled that the release was no impediment to the lawsuit. With the benefit of hindsight, perhaps the investor could have shown more diligence in looking behind the contents of the letter that offered the buyout. But the jury was not inclined to make him responsible for, at worst, having his guard down when dealing with an old friend.

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Real Estate Roundup

Homebuyer Wins Tax Credit

The federal income tax code provides for a refundable tax credit to a first-time homebuyer of a "principal residence." In 2008, the year that Joseph took the plunge and bought his first home, the credit was 10% of the purchase price, up to $7,500. When he claimed the maximum credit on his 2008 tax return, the IRS came calling to challenge his eligibility for the credit.

First, the IRS said that Joseph did not qualify because he had acquired the home under a contract for deed, which is a type of land sale contract in which legal title initially remains with the seller but "equitable title" passes to the buyer while he makes payments on the property. The U.S. Tax Court sided with Joseph, finding that for purposes of the first-time buyer credit he "purchased" the home when he acquired equitable title under the contract.

The court also rejected a second argument by the IRS, that the credit was unavailable because during the relevant time period, the new home was not Joseph's "principal residence." The only reason that Joseph had not occupied the residence yet was that some renovations were not finished, and this was not sufficient to negate the principal-residence status of the property. Ironically, Joseph had been forced to suspend the renovations when he learned that the IRS had disallowed the tax credit.

Homeowner Loses Flood Insurance

When the owner of a home with a history of seasonal flooding from a nearby creek returned to the home after an extended vacation, he noticed damage to the home from flooding. Soon after that, he made an insurance claim on a policy administered by an insurance company under the National Flood Insurance Act.

The policy required the owner to promptly file a proof of loss when making a claim. As was also required by federal regulations, the proof-of-loss statement had to include the amount claimed under the policy, or, to be precise, "Specifications of damaged holdings and detailed repair estimates."

In what was a critical mistake, the owner had not specified monetary damages but, instead, had simply listed the value of the loss as "undetermined." When the insurance company then wrote the owner a letter rejecting his claim under the policy, that decision was upheld by the court.

The oversight or error by the property owner may seem to have caused an unduly harsh result, but the court stressed some overriding principles that distinguished the situation before it from private insurance disputes. Where federal funds are involved, as they are for insurance policies in the National Flood Insurance Program, the person seeking those funds is obliged to familiarize himself with the legal requirements for receipt of the funds. Protection of federal money requires that those in the position of the insured owner act with "scrupulous regard" for the requirements of the law.

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Employee or Contractor? IRS Offers Amnesty

The Voluntary Classification Settlement Program (VCSP) is a voluntary amnesty program created by the IRS that provides an opportunity for taxpayers to reclassify their workers as employees for employment tax purposes for future tax periods, with partial relief from federal employment taxes. To participate, the taxpayer must meet certain eligibility requirements, apply to participate in the VCSP by filing Form 8952, "Application for Voluntary Classification Settlement Program," and enter into a closing agreement with the IRS.

The misclassification of employees as independent contractors keeps large sums of money out of the federal coffers, because for those employees the employer is not paying payroll taxes, such as contributions to Medicare and Social Security. Only so much of this money can be captured through the piecemeal use of audits, thus prompting creation of the VCSP. Employers who may have been improperly treating employees as independent contractors now can come in from the cold, so to speak.

In general terms, the difference between an employee and an independent contractor is in the level of control exercised by the company. Essentially, the more that the company can control about what a worker is to do and how to do it, the more likely it is that the worker is an employee for all purposes, including taxes. If, at the other end of the spectrum, a worker essentially is on his own as to such matters, he may well be an independent contractor. In that event, a company would have no need to take part in the VCSP.

The VCSP applies to taxpayers who are currently treating their workers (or a class or group of workers) as independent contractors and who want to prospectively treat the workers as employees. A taxpayer must have consistently treated the workers as nonemployees and must have filed all re-

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Retirement Account Overview

With traditional pensions for Americans steadily becoming more of an exception than the rule, it is all the more important to become familiar with the other "self-directed" retirement savings vehicles that are available. From a tax standpoint, there are two kinds of plans: those that are tax-deferred and those that are after-tax.

Tax-deferred plans, such as Individual Retirement Accounts (IRAs) and employer-sponsored 401(k)s, have the advantage of allowing taxable income to be reduced by the contributions each year, and growth of the account through appreciation and interest or dividends is tax-deferred. Of course, at some point in the future those taxes must be paid. Withdrawals after age $59^{1/2}$ are taxed as ordinary income, and a "required minimum distribution" must occur at age $70^{1/2}$. Tax-deferred accounts make the most sense for those who anticipate that their income tax rate will be lower in retirement than while working.

After-tax plans, like Roth IRAs and employer-sponsored Roth 401(k)s, are funded with contributions using after-tax dollars. If certain conditions are met, the retiree will not have to pay income tax on withdrawals, so the account will have grown tax-free. Unlike with tax-deferred plans, there is no mandatory distribution requirement at age $70^{1/2}$, giving more flexibility in estate planning. After-tax accounts usually appeal to those expecting to be in a higher tax bracket in retirement than while working.

A "self-directed" plan, of course, means that it is up to the account-holder, perhaps with the help of a financial advisor, to select the investments used for funds in the account.

There is no one-size-fits-all approach to this, but conventional wisdom is that there should be diversity among types of investments and that as someone approaches retirement, the mix of investments should move from growth-oriented investments carrying greater risk, such as stocks, to more conservative income-producing investments, such as bonds or certificates of deposit.

A measure of protection can be obtained by placing funds earmarked for retirement in certificates of deposit or other interest-bearing accounts at FDIC-insured institutions. There will be deposit insurance coverage up to $250,000 for the combined balance of all self-directed retirement accounts owned by the same individual in the same insured institution.

IRS Amnesty

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quired Forms 1099, reporting taxable earned income, for the workers to be reclassified under the VCSP for the previous three years.

A taxpayer participating in the VCSP must agree to treat the workers as employees for future tax periods. In exchange, the taxpayer will pay only 10% of the employment tax liability that may have been due on compensation paid to the workers for the most recent tax year; will not be liable for any interest and penalties on the amount; and will not be subject to an employment tax audit with respect to the worker classification of the workers being reclassified under the VCSP for prior years.

Real Estate Roundup

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Condemnation Award Increased Fivefold

James owned an undeveloped 29-acre tract of land, 2.6 acres of which had been condemned for use in a highway widening project. As is typical in condemnation cases, the fight in court was over the amount of compensation owed, not the government's right to condemn the property. As is also typical, the parties' experts were far apart in their opinion on the amount of compensation that had to be paid to James. In the end, a jury awarded James $1.2 million, which was nearly five times the amount that the state had argued for and that had been paid into court at an earlier stage of the case.

The key to the higher award was that it took into account not just the loss of the 2.6 acres but also the effect of the taking on the remainder of James's property, which was generally suitable for development as a shopping center. The award also included damages for the temporary loss of an area taken for a construction site during the building of the highway and economic damages from the loss of a billboard on the property.

One of the points stressed by James's attorney and contested unsuccessfully by the state was the impact that the condemnation would have on a proposed second entrance for the remaining property, which was described as critical to the viability of the shopping center development.

Confidential E-Mails

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communication for his own counsel only. A mere 28 minutes later, the client's counsel noticed what had happened and sent an e-mail to opposing counsel, demanding deletion of the e-mail. Opposing counsel declined.

When plaintiff's counsel used the confidential e-mail as an exhibit in opposing the defendants' partial summary judgment motion, the defense counsel moved to strike the e-mail. It did not help the defendants' argument that the same attorney and client had made the same error on one previous occasion, some six months earlier. But it was unclear whether the defendant or his counsel had become aware of that prior incident at any time before receiving the opposition to the summary judgment motion.

In the end, the court granted the defendants' motion to make the mistaken e-mail off-limits for any purpose in connection with the case. With the win, however, came an admonition from the court for the defendants and their lawyer: A client who wants to preserve the attorney-client privilege must be careful when using a means of communication having known and obvious risks of inadvertent disclosure, and the attorney should advise the client to that effect. A third such mistake, said the court, would not be met with such indulgence.

Beware of "Auto Complete"

E-mail mix-ups can be a double-edged sword, in that aggressively trying to gain an advantage upon receiving a privileged communication by mistake can backfire. That's what happened, in a big way, in another case.

A group of engineers hired a law firm to protect them against interference from a former employer after they began their own business. The law firm accidentally sent a confidential e-mail to the engineers' ex-employer. The mistake happened because an "autocomplete" function used by the law firm filled in an old e-mail address for one of the engineers.

When the misaddressed e-mail landed in the legal department for the former employer, some of its contents made their way into a counterclaim filed against the engineers by the former employer. That's when the attorney for the engineers sought and was granted a far-reaching protective order from the court.

The former employer's outside law firm was disqualified from the case, as was one of its in-house lawyers, and its general counsel was walled off from day-to-day management of the case because he had read the misdirected e-mail. The court required that the counterclaim be refiled with no references to the material from the e-mail. To top off the debacle for the former employer, it was required to pay thousands of dollars to the engineers, representing their attorney's fees and costs expended in bringing the motion for a protective order.

The object lessons from these cases are clear: First, take care to avoid misdirecting e-mailed messages containing attorney-client communications; second, be equally careful not to treat such an e-mail that may fall into your lap by mistake as an opportunity to try to tip the scales of justice in your favor.

"Y'all" = Marital Property

When the marriage of Gina and Edward ended in divorce and it became necessary to allocate property, the trial court charged with ruling on this matter had to sort through multiple gifts made by Gina's father while the couple was married. Understandably, Edward generally argued as much as possible that such gifts were made to the couple jointly, whereas Gina's position was that at least some of these gifts were made to her alone.

Some of the gifts were easier to classify than others. The court found, for example, that a 1993 Buick had been given by the father only to Gina, and not for the use of both husband and wife. Four different gifts of $10,000 each from the father, made to qualify for the annual gift tax exemption, had clearly been made to one or the other of the parties, making it easy for the court to put each such gift in Gina's or Edward's column. When considering that Gina's father had paid off a credit card debt of $12,500, the court treated the payoff as a gift to both parties because Gina and Edward had both purchased items with the credit card, so that payment of the debt benefited both of them.

As to one gift from Gina's father, you could say that one critical word (or contraction) made the court regard the gift as having been made to both parties. Gina's father had given $15,000 towards bricking the jointly owned house and garage. This obviously enhanced the value of the marital home and benefited both Gina and Edward. More than that, there was evidence that when Gina's father made that particular gift, he had said it was for "ya'll." Some outside the South think that "ya'll" is used below the Mason-Dixon line to refer to one person or more than one. In this instance, though, as in most cases, "ya'll" was a plural pronoun referring to both Gina and Edward, thus supporting a ruling that the gift had been to them both.