LeClairRyan Accountant and Attorney Liability Newsbrief

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Is Your Compliance Program Really Compliant?: Ten Steps Towards Effective Compliance *by David Z. Seide, Esq.*

Compliance programs -- policies and procedures designed to prevent violations of laws, rules and regulations – have become a big deal. That's because government regulators and enforcers closely scrutinize companies that regularly encounter fraud, bribery, theft, discrimination, employee harassment and other legal risks. Compliance programs are intended to eliminate or at least mitigate these problems.

When compliance falls short, federal agencies have made it clear that companies can expect mitigated sanctions when effective programs are in place. Conversely, violators can expect harsher sanctions when programs are found wanting. In other words, a company with a deficient program needs to be worried – especially when the problem could have been avoided through an effective program.

But what is an effective program? And when will a company's compliance program pass muster before the U.S. Department of Justice (DOJ) and the Securities and Exchange Commission (SEC)? In early February, DOJ and the SEC provided answers when they each issued new guidance, on consecutive days.

New SEC Guidance

To begin with, there is the SEC guidance, published on February 7 by its Office of Compliance and Inspections (OCIE) as a Risk Alert: *The Five Most Frequent Compliance Topics Identified in OCIE Examinations of Investment Advisers*. Available at https://www.sec.gov/ocie/Article/risk-alert-5-most-frequent-ia-compliance-topics.pdf, the alert focuses on investment advisors' compliance with SEC Rules.. Specifically, the SEC identified four "typical examples of deficiencies or weaknesses" in compliance requirements:

- Compliance manuals that are not tailored to an organization's particular business and business practices.
- Annual reviews that do not assess the adequacy of existing compliance programs policies and procedures, or that do not take place at all.
- Failures by the organization and its employees, officers and directors to follow existing compliance policies and procedures.
- Out-of-date compliance policies and procedures that do not account for changes in the business and its environment.

New DOJ Guidance

The day after the SEC alert was published, the DOJ criminal Fraud Section – responsible for investigating and prosecution of criminal fraud cases – posted its separate compliance guidance. That document, *Evaluation of Corporate Compliance Programs*, available at https://www. justice.gov/ criminal-fraud/page/file/937501/download, is built on more than a decade of corporate compliance guidance from DOJ, the SEC and three international organizations.

Citing six authoritative sources of civil and criminal compliance guidance,the Evaluation represents DOJ's view of current best practices for corporate compliance programs. According to the DOJ, the document provides "some important topics and sample questions that the Fraud Section has frequently found relevant in evaluating a corporate compliance program." Eleven compliance topics are identified, including Analysis and

Remediation of Underlying Conduct, Policies and Procedures, Risk Assessment, Confidential Reporting and Investigation, and Periodic Testing and Review.

Sample questions (46 in all) are provided for each topic. Section 1 (Analysis and Remediation of Underlying Conduct) illustrates the kinds of questions asked:

- **Root Cause Analysis** – What is the company's root cause analysis of the misconduct at issue? What systemic issues were identified? Who in the company was involved in making the analysis?
- **Prior Indications** – Were there prior opportunities to detect the misconduct in question, such as audit reports identifying relevant control failures or allegations, complaints or investigations involving similar issues? What is the company's analysis of why such opportunities were missed?
- **Remediation** – What specific changes has the company made to reduce the risk that the same or similar issues will not occur in the future? What specific remediation has addressed the issues identified in the root cause and missed opportunity analysis?

Like the SEC's Risk Alert, the *Evaluation* emphasizes that the DOJ Fraud Section makes individualized determinations in each case, and that the topics and questions provided "form neither a checklist nor a formula."

Ten Steps for Program Effectiveness

Although the *Evaluation* and the SEC's Risk Alert are concerned with corporate criminal cases and financial organizations, respectively, the examples and topics are likely to have wider application and can be expected to serve as a template for regulators and enforcers. They stand for the basic proposition that the effectiveness of corporate compliance programs will be judged on whether they "get" their companies' organization, industry, business models, continuous monitoring and changing circumstances. In other words, like business clothing, there is no "one-size- fits- all." Instead, a compliance program **must** be tailored to the specifics of the individual company.

Here are 10 steps to improve your compliance program:

1. **Know your business.** Are you a startup? Medium sized? Fast growing? Hoping to go public? The expected size and type of compliance programs will vary based on business size, longevity and goals.
2. **Know your industry.** Are you dealing with government entities? Are you working in regulated areas? Is your footprint international? Expected compliance programs will vary based on geography, customers, competitors, and regulators.
3. **Use that knowledge.** The knowledge of Steps 1 and 2 will be expected to be reflected in the tailored compliance program put in place. Failure to do so creates added risk.
4. **Take Compliance Seriously.** A compliance policy on paper is not enough. The expectation will be that meaningful compliance policies and procedures are being executed effectively and in good faith.
5. **Educate, Educate, Educate.** A key expectation will be that employees, officers, directors, vendors and outside advisors know the rules of the road – particularly the boundaries separating the permissible from the impermissible – and are regularly refreshed on those rules.
6. **Practice, Practice, Practice.** A compliance program will only be as good as what is actually implemented and followed.
7. **Monitor and Test.** Ongoing monitoring and testing are expected components of any effective compliance program.
8. **Regularly Review.** Effective programs are not static ones; they need to be regularly evaluated to ensure compliance with current business, industry, regulatory, and legal developments.
9. **Adjust.** Effective compliance programs need to be sufficiently nimble so timely changes can be made to adapt to changing circumstances.
10. **Repeat Above.** Compliance is a continuous process, not a one-shot affair.

While these steps will not solve every issue, they will likely go a long way to demonstrating your commitment and your organization's commitment to a *genuinely* effective compliance program.

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An Impossible Standard? *by Chad Mandell, Esq.*

Headline-grabbing data breaches at retailing, banking and media companies have underscored the importance of cybersecurity and data privacy for those involved in risk-management and corporate compliance. Back in January 2015, the health care sector in particular was alarmed to learn that hackers had broken into the IT system of Indianapolis-based health care giant Anthem and made off with the personal data of as many as 80 million Americans.

But while data breaches might be PR nightmares, they are not necessarily open-and-shut legal cases for plaintiffs. Standing can be an obstacle for some plaintiffs, and class certification remains an obstacle that has yet to be successfully overcome. Despite 12 years of litigation, in fact, no court has yet certified a consumer data breach class. The aforementioned Anthem case also highlights another question worth considering in these suits — namely, whether plaintiffs are attempting to hold companies to standards of data-privacy protection that are realistic or fair in today's cybersecurity environment.

By way of background, in January 2017, several plaintiffs in one of the earliest-filed cases arising out of the Anthem data breach voluntarily asked a judge in the Northern District of California to dismiss the lawsuits they themselves had filed. The judge had ordered select plaintiffs to comply with a discovery request by Anthem that required them to submit their computers to an independent forensic examiner.

Anthem wanted to determine whether malware had caused data or credentials to be stolen from the plaintiffs' computers even before the breach of Anthem's systems. If that proved to be true, it would call into question whether the plaintiffs' alleged injuries had truly been caused by the Anthem hack.

Legally, it isn't surprising that Anthem should be entitled to this kind of confidential information through discovery because it pertains to the issue of causation. And yet it appears that certain plaintiffs dropped out of the suit in order to avoid disclosing this possibly confidential information via discovery. Arguably, the process might well have shown that these plaintiffs' data or credentials had been compromised prior to the Anthem breach.

Some internet users are their own worst enemies with respect to data privacy. They essentially take zero safety precautions to reduce the risk that their personal information is not needlessly exposed. Instead of checking the privacy policies of the websites they visit and "opting out" of potentially invasive requests, they reflexively give permission to any and all requests. People still use "password" as their password or fail to take advantage of enhanced measures such as two-factor authentication. Instead of checking free credit reports via services like Credit Karma, they just assume their data has never been compromised.

Even U.S. intelligence agencies have been hacked. No organization, no matter how large and no matter what security protocols are in place, is immune from its systems being compromised. Thus, it is reasonable to ask whether alleged damages in a data-breach case truly can be traced to a given hack of a particular company or whether they stem from a prior breach or multiple prior breaches of the plaintiff's own computer.

Courts, for one, recognize the need to protect plaintiffs' data privacy as part of the discovery process. In the Anthem case, the court, having found the information Anthem sought to be highly relevant, framed an order that drastically limited the amount of information that could be culled from forensic examination of the plaintiffs' computers. The court also put in place multiple and extensive measures that called for tightly controlled access to the plaintiffs' confidential information — so much so that one could safely state that the degree of protection afforded to these plaintiffs' personal information in the course of the forensic examination would actually have been greater than under most everyday circumstances.

Even with this heightened protection, certain plaintiffs balked. As a result, one has to wonder whether they had reasonable expectations regarding their personal privacy to begin with. In suing Anthem, were they seeking to hold the company to an almost impossible standard?

It's a question that could prove useful for other firms as they seek to defend themselves in data breach cases.

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Suffolk Superior Court Tackles Issue of Enforcing a Non-Compete Agreement Following Merger Versus Acquisition *by Catherine Bednar, Esq.*

In this action before the Suffolk Superior Court Business Litigation Session, the Plaintiff, Netscout, sought a preliminary injunction to enforce a non-competition provision of an employment agreement signed by a former employee, Carl Hohenstein. Hohenstein did not dispute other obligations (including provisions barring him from disclosing Netscout's proprietary information or soliciting its employees), but challenged the applicability of the non-competition provision.

Hohenstein worked for subsidiaries of Danaher Corporation: Fluke Networks, Inc. (from 2004 until 2015) and AirMagnet, Inc. (during 2015). Hohenstein was a sales engineer, selling applications and products for managing IT networks. In 2011, Hohenstein signed an employment agreement while at Fluke, which contained a promise that Hohenstein would "… not compete with 'the Company' by soliciting potential customers to purchase, selling or offering to sell, or helping to develop competing products while employed by 'the Company' and for twelve months thereafter." The term "the Company" was defined as Danaher and its subsidiaries or affiliates.

Following a corporate transaction, Hohenstein became a Netscout employee on July 14, 2015. He then left Netscout in January 2017 to work for a competitor, Riverbed Technologies, Inc., a company selling competing products for managing IT networks. At Riverbed, Hohenstein is responsible for managing sales for the New England states, North New York state and Eastern Canada.

At oral argument, Netscout presented evidence that it had acquired Danaher's business through an acquisition. Netscout argued that Danaher had assigned Hohenstein's employment agreement to Netscout as part of the transfer of assets. The Court held that the agreement had not defined "the Company" to include *assigns* of Danaher or its subsidiaries/affiliates, and therefore held that the non-compete provision expired on July 14, 2016, i.e. one year after the Netscout acquisition.

One week later, however, Netscout moved for reconsideration of the Court's Order. Whereas Netscout had previously argued it acquired selected assets of Danaher, Netscout now offered new evidence that Danaher's subsidiaries had been merged into Netscout through a series of statutory mergers. Although the Court questioned why Netscout had not presented this earlier argument, it concluded that Netscout's new theory was correct and that Netscout was the legal successor to the agreement. Accordingly, the Court allowed the motion for reconsideration and entered a preliminary injunction enforcing the non-compete until January 12, 2018.

Massachusetts law will only enforce restrictive employment covenants to the extent necessary to protect the employer's legitimate business interests, and requires reasonable limits on the scope of non-compete provisions. Accordingly, the Court limited the injunction to customers in the mid-Atlantic states, the region where Hohenstein had principally focused his sales while at Netscout. The Court held that although Hohenstein had contact with customers in other states while at Netscout, Netscout had not met its burden of proving that its good will would suffer irreparable harm by Hohenstein selling products in competing territories.

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Testing a New Franchise Concept *by Tom Pitegoff, Esq.*

One of the toughest challenges an aspiring franchisor may face is selling its first franchise. Who would take the risk of buying a franchise from a franchise company that has no franchisees?

For a few successful business owners, the idea of franchising may come from one or more customers who love the business concept and initiate the idea of buying a franchise even before the owner has taken the first step to prepare a franchise offering. But this rarely happens.

Here's another suggestion: If the aspiring franchisor has a successful business unit (a store or a restaurant, for example) that is operated well by a trusted manager, that manager might be a good candidate to buy the business at that location and become the company's first franchisee. The manager will already know the business inside out, having successfully managed the business as an employee. The transaction would entail the sale of the existing business at a single location in which the buyer undertakes to continue operating as a franchisee of the seller. The buyer's newly-formed company would sign a franchise agreement as part of the purchase of the business.

To enhance the appeal of the transaction, the franchisor may extend credit for a portion of the purchase price or may waive the payment of any initial fee and give a grace period on the payment of any ongoing royalty or marketing fee. The idea is to maximize the fledgling franchisee's chances of success. The franchisee's success is crucial. This franchisee will be the first validator of the system for subsequent franchise buyers. With only one franchisee, the franchisor is unlikely to include financial performance representations in Item 19 of its franchise disclosure document (FDD). And without providing numbers in Item 19, the franchisor may not discuss numbers orally. Only an existing franchisee can do that.

But what about the legal requirements of franchise registration and disclosure, which may include the requirement to prepare and disclose audited financial statements and much more? Is there a way that the aspiring franchisor can avoid the cost, the time and effort of preparing a detailed FDD and possibly registering it with the state? This answer is yes. There are ways to start small and test the concept before the franchisor is ready to prepare a disclosure document and to register the offering.

The Federal Trade Commission's trade regulation rule on franchising (the FTC Rule) excludes from the definition of a franchise the grant of the right to use a trademark where the license is the only one of its general nature and type to be granted by the licensor. So a single license should not trigger the federal requirement to prepare a disclosure document. State laws will usually not be a concern if the outlet is located in a nonregistration state, although the business opportunity laws may pose an issue.

What if the outlet is located in a registration state? A few states (Indiana, Minnesota, New York and Washington) exempt the isolated sale of a franchise.

New York's single sale exemption calls for some explanation. The exemption applies when (i) the franchisor makes an offer to no more than two persons, (ii) the franchisor does not grant the franchisee the right to offer subfranchises, (iii) no commission or other remuneration is paid for soliciting the prospective franchisee, and (iv) the franchisor is domiciled in the state or has filed with the NY Department of Law its consent to service of process. (N.Y. Gen. Bus. Law §684(3)(c).)

The single sale exemption in New York only applies by its terms to the state's registration requirement. What about the disclosure requirement? Does this exemption save the franchisor from the time and expense if preparing a detailed FDD? Fortunately, the exemption does apply to both the registration and disclosure requirements. A franchisor's obligation to provide disclosure arises under New York law when the franchise is subject to registration. Section 683(8) of the NY General Business Law states that "[a] franchise ***which is subject to registration*** under this article shall not be sold without first providing to the prospective franchisee, a copy of the offering prospectus, together with a copy of all proposed agreements relating to the sale of the franchise …."

This exemption will not extend beyond the first franchise sale in New York or any other state. Unless another exemption applies, the franchisor will be required to prepare a franchise disclosure document and possibly register the offering before selling its second franchise. That would be the time to form a new franchisor entity, open a bank account in the name of the franchisor entity and prepare an audit of the franchisor's opening balance sheet. The licensor of the test franchise might be the operating company that owns the trademark. The test franchise agreement should allow the franchisor to assign the agreement to its affiliates so that the brand owner may assign the agreement to the newly-formed franchisor. In any event, the contact information for the first franchised business should be listed in the first FDD.

Another approach that works for some companies in nonregistration states is to use the minimal payment exemption under the FTC Rule. A franchise sale is exempt from the FTC Rule if less than $570 is paid to the franchisor or an affiliate at any time before the franchisee's business has been in operation for six months.

Another exemption under the FTC Rule that can facilitate the first franchise sale without the need for an FDD is the insider exemption. In order to benefit from the insider exemption under the FTC Rule, one of the owners of the franchisor company must become a franchisee. This exemption applies when, within 60 days of the sale, the purchaser (or a person who owns at least 50% of the purchaser) has been for at least two years, an owner of at least a 25% interest in the franchisor. A few states also exempt insider sales (California, Rhode Island, South Dakota and Washington).

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Massachusetts Appeals Court Holds Client Waives Attorney-Client Privilege by Bringing Malpractice Suit *by Ben N. Dunlap, Esq.*

The Massachusetts Appeals Court has held a client suing his former attorney for alleged malpractice in handling an earlier case waives the attorney-client privilege with respect to communications shared with the attorney in the course of the representation.

In *Doe v. American Guaranty and Liability Co.*, et al., 16-P-183 (March 1, 2017), the attorney represented Doe in a criminal case and related tort action. In the course of that representation, Doe shared information with his attorney regarding Doe's abuse of his foster children. Doe later brought a legal malpractice action against the attorney, based on the handling of the tort case. The malpractice action was settled, and Doe then filed another complaint against his former attorney, this time alleging the attorney improperly used attorney-client privileged information in defending the malpractice action. The trial court allowed the attorney's motion to dismiss, and the Appeals Court affirmed, holding that in bringing the malpractice action, Doe waived any privilege with respect to the communications at issue.

The underlying tort action arose from alleged abuse of a foster child. The communications at issue concerned certain admissions by Doe about a second victim. During the defense of the later malpractice case, the attorney shared information about Doe's admissions, and the second victim, with his defense counsel. The defense counsel used the information in a motion to compel deposition testimony from Doe regarding the second victim.

Almost two years after the malpractice case was settled, Doe sued the former attorney, the attorney's professional liability insurer, and his defense counsel, alleging that in defending the malpractice action, the defendants "intentionally misused privileged information regarding Doe's statement that he abused Foster 2" (the second victim). Specifically, Doe alleged the disclosure of the privileged information exposed him to additional civil and criminal liability and also gave the defendants unfair leverage in the malpractice action.

In reviewing the trial court's dismissal of Doe's claims, the Appeals Court articulated the standard governing whether Doe waived the attorney-client privilege as follows: "if evidence of Doe's statement regarding Foster 2 was relevant to the malpractice action, the privilege was waived."

The Appeals Court noted that admissibility of testimony regarding abuse of Foster 2 would be relevant in the malpractice case, because the extent of any damages in the malpractice case would rest on the outcome of the tort case, as compared to the results that would have been obtained in the absence of any malpractice. Doe argued information regarding Foster 2 would have had no effect on the outcome of the tort case, because Foster 2 would not have testified, as the plaintiff's attorney in the tort case did not know Foster 2's whereabouts. The Appeals Court rejected Doe's argument, concluding the Foster 2 issues were "relevant to the malpractice action" and Doe had failed to plead otherwise.

Thus, because the disclosed information was "relevant" in the malpractice action, Doe had waived any privilege, and the defendants could not be liable for using the information in their defense.

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SDNY District Court Upholds Rejection of Mineral Gathering Agreements *by Travis Powers, Esq.*

The U.S. District Court for the Southern District of New York, in the case of *HPIP Gonzalez Holding, LLC v. Sabine Oil & Gas Corp. (In re Sabine Oil & Gas Corp.)*, recently affirmed three decisions of the U.S. Bankruptcy Court for the Southern District of New York, finding that certain mineral gathering agreements could be rejected as executory contracts pursuant to 11 U.S.C. § 365(a).

Facts

Sabine Oil & Gas Corp. was a counterparty to three agreements (HPIP agreement and Nordheim agreements, and, collectively, the agreements) individually entered into with HPIP Gonzalez Holdings, LLC (HPIP) and Nordheim Eagle Ford Gathering, LLC (Nordheim, and, collectively with HPIP, the appellants, which are "midstream gatherers" that gather, transport and process oil and gas after extracted from the land).

Appellants agreed to gather and process certain minerals extracted from designated parcels of Sabine's real property (collectively, the dedicated areas). Under the Nordheim agreements, Sabine retained title to the minerals and agreed to compensate Nordheim should certain production benchmarks not be met. Under the HPIP agreement, Sabine dedicated certain leases on the dedicated areas (leases) to performance of the HPIP agreement but retained title thereto. Both agreements stated that they were covenants that ran with the dedicated areas.

Sabine and certain affiliates (collectively, the debtors) filed chapter 11 in July 2015, and subsequently moved to reject the agreements pursuant to 11 U.S.C. § 365(a) (rejection motion). The appellants argued that the agreements could not be rejected, as they were covenants that ran with the dedicated areas. The bankruptcy court granted the rejection motion but held that it could not decide the issue of whether the agreements were covenants that ran with the land, except in the context of an adversary proceeding. The debtors initiated adversary proceedings seeking declaratory judgments that the agreements did not run with the land. The appellants each asserted counterclaims seeking declaratory judgments to the opposite effect. The bankruptcy court found in the debtors' favor and the instant appeal followed.

Decision

Bankruptcy code section 365(a) allows a debtor to reject certain executory contracts unless the contract is, or contains, a covenant that runs with the land. Under Texas law, a covenant runs with the land if:

1. It touches and concerns the land;
2. It relates to a thing in existence or specifically binds the parties and their assigns;
3. It is intended by the original parties to run with the land; and
4. The successor to the burden has notice.

The court limited its opinion to the first factor, finding that, under Texas law, a covenant touches and concerns the land if:

1. It affects the nature, quality, or value of the thing demised, independently of collateral circumstances, or it affects the mode of enjoying it (first test); or
2. The promisor's legal relations in respect to the land in question are lessened, or the promisee's legal relations in respect to the land are increased (second test).

Nordheim argued that the first test was satisfied because Sabine's interests in the dedicated areas were negatively affected due to fluctuating hydrocarbon and gathering market rates. However, the court found such circumstances to be collateral to the agreements in that they would affect the value of any oil-producing land and not just the dedicated areas. As such, Sabine's interests in the dedicated areas were not reduced and the first test was unsatisfied.

As to the second test, Nordheim argued that it acquired an interest in the minerals in the ground, which, under Texas law, is a real property interest. However, the court found that Nordheim was simply contractually obligated to process and then return the minerals. As such, Nordheim's legal relations with respect to the dedicated areas were not increased.

Similarly, HPIP argued that it acquired an interest in the leases dedicated to the performance of the HPIP gathering agreement. The court held that Sabine explicitly retained title to the leases, and it was unclear what property interest HPIP was claiming. HPIP, like

Nordheim, was merely contractually entitled to be the exclusive provider of certain services for Sabine.

Additionally, Sabine's legal relations to its property interests in the dedicated areas were not decreased. Sabine (a) did not convey an interest in real property, (b) was free to produce any amount of minerals it chose, and (c) was not obligated under the agreements until the minerals were extracted. Rather, Sabine was contractually obligated to use the appellants' services, which was not sufficient to restrict Sabine's enjoyment of its land.

Finally, the court found that the agreements were not equitable servitudes, as alternatively argued by the appellants. An equitable servitude restricts the use of the subject land. As was noted during the court's analysis above, Sabine's property interests in the dedicated areas were unaffected by the agreements.

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The War on Employee Misclassification: Will Trump Call a Cease Fire? *by Betsy Davis, Esq.*

During its two terms, the Obama Administration declared war on misclassification of employees as independent contractors. The U.S. Department of Labor (DOL) issued additional guidance on the proper classification of workers. The guidance made clear that the DOL, under the Obama Administration, would view most workers as employees. During this period, investigators were hired and trained to detect and deter misclassification. In addition, the DOL entered into partnerships with 37 states to work together to combat misclassification.

Companies that supplement workforces with independent contractors should not view the change in Washington as an invitation to misclassify workers. Employers should expect DOL enforcement to continue. If federal government enforcement efforts are given a lower priority by a DOL under the Trump Administration, then employers should expect state departments of labor to fill the void under their joint enforcement initiatives. Employers should also anticipate that plaintiffs' class action lawyers will continue to target misclassification.

Employers who are determined to have misclassified employees as independent contractors may be liable for:

- Unpaid minimum wage
- Unpaid overtime compensation
- Health and other benefits
- Denied medical leave
- State and federal taxes
- Unemployment insurance and claims
- Workers' compensation insurance and claims

To date, the DOL guidance issued during the Obama Administration remains in effect. To properly classify workers, employers should "determine whether the worker is economically dependent on the employer (and thus its employee) or is really in business for him or herself (and thus its independent contractor)."

The DOL directs employers to focus on the broad definition of "employ" under the Fair Labor Standards Act (FLSA) and the "economic realities" test developed by the courts. The DOL instructs that the application of the factors "should be guided by the overarching principle that the FLSA should be liberally construed to provide broad coverage for workers." The guidance summarizes the factors of the economic realities test as:

1. **The extent to which the worker's services are an integral part of the employer's business.** If the worker performs the primary type of work that the employer performs for its customers, then the factor weighs in favor of an employee relationship. If the worker provides a service to the employer's business, then the factor weighs in favor of an independent contractor relationship.
2. **The worker's opportunities for profit and loss depending on his or her managerial skill.** The worker who is paid by the hour with no risk of loss is more likely an employee than the worker who may suffer a loss of capital investment based on the manner in which he or she managed the project.
3. **The extent of relative investment of the employer and the worker.** The worker who performs services only for one company and uses company equipment is more likely an employee than a worker who has formed an LLC, uses his or her own equipment and supplies, and performs services for a number of customers. It is important to note that the DOL takes the position that simply providing tools does not create an independent contractor relationship if the worker's investment is small when compared to the investment of the employer.
4. **Whether the work performed requires special skills and initiative.** The worker who provides only specialized skill is more likely an employee, while the worker who provides specialized skill, offers services to a number of customers, markets his or her services, and makes decisions about materials is more likely an independent contractor.
5. **The permanency of the relationship.** A longer work history weighs in favor of an employee relationship. A discrete project-based engagement weighs in favor of an independent contractor relationship.

6. **The degree of control exercised or retained by the employer.** The worker who is subject to the company handbook, conduct rules, and specific direction for completing a project is likely an employee, while the worker who is tasked with a project and a deadline only is more likely an independent contractor.

DOL cautions throughout the guidance that this control factor should not be given "an oversized role in the analysis." On its website, the DOL characterizes misclassification as "one of the most serious problems facing affected workers, employers and the entire economy." The change in leadership in Washington will not impact an employer's need to comply. Government investigators and plaintiffs' attorneys are focused on the issue. Employers should focus on and review their worker classifications as well.

LeClairRyan's national labor and employment team offers employers legal counsel related to a full spectrum of issues, including complying with federal labor laws and how to determine whether a worker is properly classified as either an employee or independent contractor.

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Once Offered, Fee Write Offs Are Binding on Attorneys *by David A. Slocum, Esq.*

Lawyers in Massachusetts should take note of a recent appellate decision holding that fee write offs offered by attorneys cannot later be rescinded even when the client refuses to pay the remaining portions of the lawyer's invoices.

In *BourgeoisWhite, LLP v. Sterling Lion, LLC*, 91 Mass. App. Ct. 114, 71 N.E.3d 171 (2017), an attorney of BourgeoisWhite, LLP represented Sterling Lion and its owner David Massad in an employment dispute involving claims brought against Sterling Lion and Massad by a former business associate who alleged violations of the Massachusetts Wage Act. The attorney and Massad had known each other for many years, and the firm had represented Massad previously in other matters.

Before beginning work on the new matter, the attorney sent Massad an engagement letter listing his firm's hourly rates and advising that Massad would receive monthly invoices throughout the course of the representation. When the attorney issued his initial invoice on the matter, it contained a twenty percent "professional courtesy credit." For approximately the next year, invoices were issued and paid without any discounts.

As time progressed and the total amount billed on the matter increased, the attorney began to offer discounts and credits in subsequent invoices. In one such invoice, the attorney wrote: "I know you hate getting these bills (and frankly I hate sending them to you), but I did issue a fairly substantial discount simply because I think the case is really unfair to you." On another occasion, when Massad indicated that he was "upset" with how much time an associate at the law firm had spent on the matter, the attorney told Massad to "throw away" that invoice.

The employment claim against Massad and his company went to trial and resulted in a verdict unfavorable to Massad. In the attorney's next invoice, he gave Massad a "professional courtesy credit" of over $22,000 representing all of the work the firm had done for the trial. The attorney explained in an accompanying letter: "Even though I wrote off all of the January bill I still decided to give you a very substantial discount on the February/March bill. I did this because you are a friend in a bad situation and I am not looking to make a profit from that."

Thereafter, as the attorney continued to perform post-trial work on the matter, Massad fell behind and ultimately stopped paying the firm's invoices. After several months and further unpaid invoices issued with credits and discounts, the attorney withdrew as counsel. The attorney issued a final invoice rescinding his most recent write offs of nearly $30,000. The attorney explained: "The reason for those credits is no longer valid. We give professional courtesy credits to long-term clients who pay their bills." The attorney requested payment on the full outstanding unpaid balance including the $30,000 of rescinded write offs. Massad refused to pay, and the firm brought suit seeking to recover his unpaid fees totally nearly $84,000.

A Superior Court Judge ruled in the firm's favor, holding that because the credits and discounts had been offered "gratuitously," they did not affect the firm's contractual right to collect under the engagement letter.

The Massachusetts Appeals Court reversed. The three justice panel unanimously agreed with Massad that due to the fiduciary nature of the attorney-client relationship, the attorney had waived his right to collect the fees that he and his firm had written off. The Appeals Court rejected the firm's argument that the credits were conditional on Massad staying current on his bills. The Court did not address whether such a condition would have been valid, but found there was no evidence to support that the attorney had ever communicated such a condition to Massad at any time before revoking the credits.

The Appeals Court focused on both the absence of any facts to establish Massad was told the credits were conditional on paying his bills in a timely manner, and also on the highly fiduciary nature of the attorney-client relationship. Thus, the Court held, although the attorney and his firm were entitled to recover those portions of the invoices that had not been written off, the discounts and credits were binding and could not be rescinded.

Attorneys in Massachusetts should take note of this decision when considering offering "credits," "discounts," "fee reductions," or "write offs" of any kind on client invoices. Offering such discounts may be a valuable way of fostering good will and maintaining positive relationships with clients.

Massachusetts attorneys may continue to offer such credits, but it is now clear under this decision that such write offs cannot subsequently be rescinded even if the client refuses to pay its bills.

It remains to be seen whether Massachusetts Courts would hold valid a conditional write off that is made expressly contingent upon the client staying current on its invoices. The decision in *BourgeoisWhite v. Sterling Lion* leaves open that possibility. Massachusetts attorneys who want to retain the right to rescind a discount should consider expressly establishing such a right in the client engagement letter and in any invoice extending a credit. Ultimately, however, given the fiduciary nature of the attorney-client relationship, there may be circumstances where such conditional write offs would not be enforced.

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Massachusetts SJC Upholds Dismissal of Individual Shareholder Claims Against the Board of Directors of a Publically Traded Corporation *by Marc E. Finkel, Esq.*

In *International Brotherhood of Electrical Workers Local 129 Benefit Fund v. Tucci & Others*, 476 Mass. 553 (2017), the Massachusetts Supreme Judicial Court ("SJC") upheld the dismissal by a Massachusetts Superior Court judge of a lawsuit brought by a group of shareholders directly against the board of directors of a publically traded Massachusetts corporation. In upholding the lower court decision, the SJC found that under Massachusetts corporate law, except under limited circumstances, a corporate director owes a fiduciary duty to the corporation itself and not its shareholders. *Id.* at 561. Accordingly, the SJC determined a shareholder's challenge to a merger of a publically traded corporation, among several claims of alleged misconduct, must be brought as a derivative claim on behalf of the corporation rather than directly against the individual members of the board of directors. *Id.* at 554.

In *Tucci*, several shareholders of the EMC Corporation ("EMC") filed a class action complaint against EMC's board of directors alleging they breached their fiduciary duties stemming from a proposed merger between EMC and Denali Holding, Inc. and Dell, Inc. (collectively "Dell"). *Id.* Specifically, the shareholders alleged the board of directors breached their fiduciary duties to both EMC and the shareholders by "(i) failing to take steps to maximize the value of EMC stock; and (ii) agreeing to unreasonably preclusive deal protection provisions, thereby hindering any potential bid that may have been superior" to the deal between EMC and Dell. *Id.*

Prior to its proposed merger with Dell, EMC had a federation structure in which it was the parent company to several independently run businesses. *Id.* at 555. As a result of this structure, EMC's shares traded at a "conglomerate discount." *Id.* The dispute litigated in *Tucci* began when one of EMC's major investors started to push EMC to sell off some of the more valuable subsidiaries of the federation in order to obtain maximum value for its shareholders. *Id.* The longtime chief executive officer of EMC, who helped to create the federation, was afraid that the federation would be broken up if EMC began to individually sell off its subsidiaries. *Id.* Thus, EMC and the investor reached an agreement in which the investor would participate in the appointment of new directors, but for a period of time would be limited as to the amount of stock it could purchase. *Id.* Subsequently, the chief executive officer and EMC used that period of time to negotiate the sale of EMC and all of its subsidiaries to Dell for approximately $67 billion. *Id.*

EMC's board of directors agreed to the proposed merger, which included a $2 billion termination fee that any competing bidders would be required to pay before making a bid in excess of Dell's bid. *Id.* at 556. Additionally, EMC shareholders were to receive $24.05 in cash per share of stock and an estimated 0.111 shares of less lucrative "tracking stock" in EMC's most valuable subsidiary. *Id.* According to the Tucci plaintiffs, the shareholders could have received upwards of $40.00 in cash per share of EMC's most valuable subsidiary had it been sold separately. *Id.*

Ultimately, the SJC in *Tucci* found that under the Massachusetts Business Corporation Act (*G.L. c. 156D*), the board of directors did not owe a fiduciary duty directly to the shareholders and that the claims brought by plaintiffs were "necessarily derivative because any alleged harm to shareholders was not distinct from harm to the corporation." *Id.* The SJC further articulated that the plain words of the Massachusetts Business Corporation Act clearly state that the duties of a board of director, including the duty to act in good faith and with care, is to be in a manner the director reasonably believes to be in the best interests of the corporation itself. *Id.* at 559. The SJC was also careful to distinguish Tucci, which involved a publically traded corporation, with prior cases that established fiduciary duties to shareholders in the context of either a close corporation or a corporation with majority and minority shareholders. *Id.* at 561-62. In those limited circumstances, the SJC reaffirmed that a director owes a fiduciary duty to its shareholders. *Id.* The SJC also declined to follow the law in other jurisdictions, such as Delaware, where challenges to a corporate merger on grounds of inadequate consideration can be brought as a direct claim rather than by a derivative claim. *Id.* at 563. Here, the SJC made it clear that plaintiff's claims were claims that belonged to the corporation and must have been brought as a derivative action. *Id.* at 564.

Tucci serves as an important decision with respect to Massachusetts corporate law, as it provides clarity to the rights and responsibilities of both shareholders and boards of directors of publically traded Massachusetts corporations.

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Supreme Judicial Court Clarifies One of the Outer Limits of Punitive Damages Awards for an Insurers' Bad Faith Settlement Practices *by Michael T. Grant, Esq.*

In *Anderson v. Nat'l Union Fire Ins. Co. of Pittsburgh PA*, 476 Mass. 377 (2017), the Massachusetts Supreme Judicial Court held that post -judgment interest is not included in the "amount of the judgment" which is multiplied as punitive damages for willful or knowing violations of Massachusetts' unfair trade practices statute.

The plaintiffs—Odin Anderson, his wife, and his daughter—filed a personal injury action in the Superior Court for serious injuries Odin suffered after being struck by a bus owned by Partners Healthcare Systems, Inc. (Partners). The plaintiffs filed a separate action, under M.G.L. c. 176D, and M.G.L. c. 93A, against Partner's insurers; proceedings in that action were stayed pending resolution of the underlying tort claims. After a trial, a Superior Court jury awarded Anderson $2,961,0004 in damages in the personal injury action, and awarded his wife and daughter $110,000 each. At a subsequent, jury-waived trial, a different Superior Court judge found that the insurers and claims representatives violated M.G.L. c. 93A and M.G.L. c. 176D by their "egregious," "deliberate or callously indifferent" actions, "designed to conceal the truth, improperly skew the legal system and deprive the Andersons of fair compensation for their injuries for almost a decade." Based on these findings, the judge concluded that the insurers' "misconduct warrants the maximum available sanction ..., both as punishment for what transpired and as a deterrent to similar conduct in the future." He awarded the plaintiffs treble damages, using as the "amount of the judgment" to be multiplied the combined amount of the underlying tort judgment and the accrued post -judgment interest on that judgment. The Appeals Court affirmed the judgment of liability and the amount of the award of damages, in an unpublished memorandum and order issued pursuant to its rule 1:28.

The Supreme Judicial Court accepted the insurers' application for further appellate review to answer the following question: whether "the amount of the judgment" that serves as the measure of "actual damages" to be doubled or trebled under M.G.L. c. 93A, § 9(3), includes the amount of any post -judgment interest that accrued on that judgment before it was paid. While the Court followed earlier jurisprudence holding that pre-judgment interest "is included in the judgment because it compensates the prevailing party for the time value of money accrued before resolution of the legal dispute," the Court concluded the post -judgment interest is not included in the "amount of the judgment," because it "serves to provide compensation to the prevailing party for delay in payment after a nonprevailing party's underlying obligation has been established." Accordingly, the Supreme Judicial Court vacated the portion of the underlying judgment which had included post-judgment interest in the amount of damages trebled under M.G.L. c. 93A, § 9(3).

Anderson clarifies one of the outer limits of punitive damages awards for bad faith insurance settlement practices and other violations of M.G.L. c. 93A, § 9(3).

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Like Shooting "Phish" in a Barrel: Familiar Names and Programs Seek to Target Your Email Inbox

All professionals, whether working at the office or at home, need to be vigilant about carefully reading the subject lines of their incoming email. The recent flurry of requests for "Google Docs" access – and it's not the real Google Docs – is just another attempt by hackers to gain access to individuals' email contacts and valuable information.

In the Google Docs scam, the email sender's information looks similar in name to someone the recipient knows. Therefore, recipients may be inclined to quickly respond or open the attachments. The scammers are banking on this sense of familiarity.

Some emails are simple requests for information, and others will have an attachment – "XYZ is sharing a document with you" or "has a file to share with you on Google docs." In the fake Google Docs scheme, Google is working to disable the accounts generating this recent scam and requests that recipients report the attempt directly to Google. Many insurers are also sending reminders to their clients to be wary of inbox activity.

Here are three ways email users can protect themselves from online scams:

1. **Don't click any links in suspicious emails or open any attachments**. Even if the email address looks familiar, call your contact directly or send him/her an email from your contact email (do not forward the one you received) to find out if he/she actually sent the file/file request. You may learn that your contact has been hacked and spare yourself from lost hours and stolen data, which can disrupt personal and business activity in numerous ways.
2. **Consider using a secure file sharing system for document sharing.** Many firms have client portals; others use encryption-based subscription providers when working with vendors, clients or third-party professionals.
3. **Take the time to do more than just scan your email or open them automatically.** You have spent years building your client list and more importantly, your contacts' trust. Don't risk losing that trust with just the click of a mouse.

Taking these precautionary steps could mean the difference between continuing with business as usual or spending time and resources to recover from an email phishing scheme.

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