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Report From Counsel

Insights and Developments in the Law **Fall 2004**

Business Alert: New Overtime Regulations

The Department of Labor recently issued sweeping new regulations on the eligibility of workers, especially "white-collar" employees, for overtime pay. Federal law requires that overtime be paid for nonexempt employees at a rate of one and one-half of regular pay for all hours worked over 40 hours in a week. To be "exempt" is to be ineligible for overtime. Employers should update their employee handbooks to reflect the new law on overtime pay.

Applying the new rules correctly is highly dependent on the facts and circumstances of each case.

Salary Tests

Since 1975, workers paid a salary of less than $155 per week ($8,060 per year) have been eligible for overtime, regardless of their job duties or how they are paid. Now that threshold has been raised considerably, to $455 per week ($23,660 per year). The "highly compensated employee" test will make workers with an annual salary of at least $100,000 exempt, if they perform office or nonmanual work and "customarily and regularly" perform one of the duties of either an exempt executive, administrative, or professional employee. The exempt duty need not be the employee's "primary duty."

Manual laborers, other blue-collar workers, licensed practical nurses, and "first responders," such as police officers and firefighters, will be eligible for overtime regardless of salary.

Executive Exemption

In the middle ground of compensation, between $23,660 and $100,000 per year, individuals will be exempt as executives if their primary duty is management of the enterprise or one of its departments or subdivisions, and if they "customarily and regularly" direct the work of at least two full-time employees. A new requirement is that would-be executives must either have the power to hire and fire or at least their recommendations in such matters must be given "particular weight." This tighter focus on hiring and firing is a change from the former regulations in which employees could fall within an executive exemption because of their general managerial authority. The

Continued on page four.

Real Estate Letters of Intent

A letter of intent (LOI) reduces to writing a preliminary understanding of parties who intend to enter into a contract, including contracts to purchase real property. The concept falls somewhere on the continuum between the first informal talk about a possible deal and a binding written agreement covering all of the essential terms. By its nature, an LOI does not bind the parties to the transaction, raising the question as to how it can still be useful. An LOI is evidence of some commitment, albeit more moral than legal, to the deal. A potential buyer with an LOI in hand has an edge over others who may have an eye on the property. Having laid a foundation on which a deal could be built, the buyer and the seller can feel more comfortable about putting in the effort, energy, and money that may be necessary to actually close the deal.

LOIs have potential drawbacks and should not be entered into without advice of counsel. First, if an LOI is produced only after extensive proposals and counter-proposals, or if it becomes stuffed with details you would normally expect to find in the fine print of a contract, it may be more trouble than a nonbinding document is worth.

Continued on page four.

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Technology and the Law

Lost Database Is Not Insured

"If you can't reach out and touch it, it is not insured." That was the gist of a court's ruling in a lawsuit brought by a company that lost a large amount of electronically stored data when an employee inadvertently pressed the "delete" key on a keyboard. The company looked to its insurer to cover the expenses for restoring the data and to recover lost income caused by the disruption. The insurer denied coverage on the basis of policy language that limited coverage to a "direct physical loss of or damage to" covered property.

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The language from the policy was meant to be interpreted in its ordinary and popular sense. Thus, "physical" means "tangible" or capable of being touched. The information in a computerized database, in and of itself, has no material or tangible existence, unlike a storage medium for information, such as a disk, tape, or even papers in a file cabinet. The court concluded that when the employee sent the data into thin air with an unintended keystroke, there was no direct physical loss within the meaning of the insurance policy. (The court distinguished this case from another case in which the loss of a computer tape and the data on it *were covered* under a policy covering "physical injury or destruction of tangible property.")

Recognizing that the dictionary was not on its side, the company that lost its data also argued that public policy should weigh heavily in favor of insurance coverage. After all, loss of information in the same manner as occurred in this case is common, and our economy unquestionably is highly dependent on computers and the intangible information that they contain. However, the court declined to use public policy as an "interpretive aid." There are plenty of useful legal principles for construing insurance contracts, but using public policy to redefine the scope of coverage agreed to by parties to a contract is not one of them. The lesson: Questions of insurance coverage are to be answered solely in the language of the policies and, therefore, careful drafting of policy language is critical.

Got a Gripe? Start a Website

Joseph was planning to buy a new house from a builder until he came to the conclusion that the builder's sales representative had misled him about the availability of a particular model. In an earlier time, he might have been content to vent to a sympathetic neighbor across his backyard fence, but this is the age of cyberspace. Joseph registered an Internet name that was very similar to that of the builder and then created a website as a forum for relating the reasons for his frustration with the builder. He included a disclaimer making it clear that visitors were not on the builder's website. There was no charge to access the site and the site contained no paid advertisements. Once in a while, an e-mail intended for the builder came to Joseph's site, but he promptly forwarded it to the builder.

Also on the website was something Joseph called the "Treasure Chest," a place where readers could exchange information about contractors and tradespeople who had done good work. During the entire time the site

Continued on page three.

IRS Gets Tough on Estate Tax Fraud

Prosecutions for filing a false Form 706, the federal estate tax return, have been rare. Recently, a federal prosecutor announced a guilty plea by an individual charged with estate tax fraud. The guilty plea may well be a harbinger of a new "get tough" policy by the IRS in an area that up until now has not had a reputation for vigorous criminal enforcement.

The defendant in this case was the executor of her mother's estate. She admitted that she intentionally filed a Form 706 that omitted assets worth about $400,000 that should have been included in the estate. The executor could face a term of imprisonment, followed by a term of supervised release, and a large fine.

Individuals who stand to be affected by the new emphasis from the IRS on using a carrot *and* a stick include executors, tax return preparers, and essentially anyone responsible for the completeness and accuracy of an estate tax return. It is important to remember that old income tax returns and other documents that the IRS can obtain in an audit often will allow it to discover assets that have gone unreported. The recently publicized guilty plea by an executor is a not-very-subtle warning by the IRS that estate tax fraud can have consequences beyond dollars and cents.

Withdrawal Rules for Inherited IRAs

The IRS has established rules for determining the minimum amount that must be withdrawn each year from an inherited traditional IRA. When an individual inherits an IRA, the rules differ somewhat depending on whether the individual was the decedent's spouse. In any case, there is a substantial incentive for following the rules, because the failure to take minimum withdrawals results in a stiff penalty equal to 50% of the shortage. Since complying with the rules can be a convoluted process and a mistake could be costly, it makes sense to be guided by professional advice.

Surviving Spouses

The starting point is the general requirement that minimum withdrawals must begin at the age of 70 1/2. If an IRA owner dies before April 1 of the year after he or she turned 70 1/2, or at any earlier time, the surviving spouse can handle the IRA in any of three different ways. First, the spouse can transfer the account to his or her own name, so that it is treated as if it always belonged to the survivor. If the survivor is substantially younger than 70 1/2, this has the benefit of putting off mandatory withdrawals for years, during which time there will be more tax-deferred growth in the IRA. This choice also has the benefit of using a longer joint life expectancy figure in calculating the minimum withdrawals, meaning less is taken out and taxes are reduced.

Second, the surviving spouse simply can leave the IRA in the deceased spouse's name and begin taking minimum withdrawals when the deceased spouse would have been able to do so. The third approach is to invoke the "five-year rule," which allows the surviving spouse to do whatever he or she wants with the account until December 31 of the fifth year after the year in which the other spouse died. By that date, however, the account must be emptied and the resulting taxes must be paid. The five-year approach is not available if the deceased spouse died on or after April 1 of the year after turning 70 1/2.

Other Individual Heirs

If the deceased individual named a nonspouse beneficiary for the IRA, the beneficiary must begin taking minimum withdrawals over his or her own life expectancy, starting by December 31 of the year after the year in which the account owner died. Additional withdrawals must be taken by December 31 of each successive year. To calculate the minimum amount to be withdrawn, the beneficiary must divide the account balance for the previous year by his or her life expectancy, as given in tables published by the IRS.

As with surviving spouses, an heir can use the five-year rule to liquidate the inherited account by the end of the fifth year after the original owner died, before which time the heir can withdraw as little or as much as desired. Also as with surviving spouses, the five-year rule is not available if the IRA owner died on or after April 1 of the year after turning 70 1/2.

Technology

Continued from page two.

was up and running, only one person was mentioned in the Treasure Chest. Although it was nearly empty, the Treasure Chest prompted the builder to sue Joseph under the federal Anti-Cybersquatting Consumer Protection Act (ACPA).

The ACPA only applies to someone who, with "a bad-faith intent to profit," registers or uses a domain name that is identical or confusingly similar to that owned by someone else. Everyone agreed that the part of Joseph's website in which he aired his own complaints against the builder had no profit motive or commercial aspects, but the builder tried to argue that the Treasure Chest was a mingling of commercial activities with personal gripes.

A federal court ruled in favor of Joseph. The facts of the case did not amount to the conduct that the ACPA was meant to address, that is, setting up a business whose sole purpose is to register domain names that closely resemble the names of established businesses, and then attempting to sell the names to those businesses. The fact that Joseph meant to use the Treasure Chest to draw more people to his site to read his story did not convert the site into a commercial undertaking. He took no money either for being listed on the site or for viewing it, and the absence of paid advertising or links to other sites belied any profit motive. The website, especially with its very similar name, was no doubt a source of annoyance to the builder, but it was not a source of damages under the ACPA.

Letters of Intent

Continued from page one.

All of that work is better saved for the "main event."

Second, while it may be appropriate and even desirable to describe the key terms of the subsequent contract in the LOI, it must be made very clear that the terms are not yet binding. In fact, an LOI should state generally that the parties do not intend to be legally bound to consummate any transaction until they have signed and delivered a written agreement in which they agree to be bound. It helps in this regard to avoid using boilerplate contract terms like "agree," "offer," and "accept" in an LOI. Language to the effect that an agreement is subject to formal documentation may be helpful, but by itself it may not rule out a conclusion that the parties intended to be bound. Similarly, while it may not settle the issue, calling the document a "letter of intent" implies a nonbinding expression in contemplation of a future contract.

In an LOI, the buyer and the seller may need to bind themselves to certain preliminary matters leading up to the contract, however, such as access to the property for inspections. In that case, it is essential to distinguish clearly between nonbinding and binding items in the LOI. Even when the language of the LOI is in good order, a party to the LOI should take care to avoid conduct or statements that are at odds with the LOI's preliminary nature. Otherwise, the other party may attempt to argue, in effect, that actions speak louder than even written words, and that both parties meant to be, and are, bound by everything in the LOI.

In a recent case, a court ruled that a "letter offer" sent by a developer and signed by the owner of undeveloped land was not a binding agreement. The factors that led to the decision are instructive. The language in the letter stating that it "will serve to set forth some of the parameters for an offer" suggested the setting of negotiating boundaries, rather than final terms. The letter expressly anticipated that a contract of purchase and sale would be executed later.

It was also significant that several key obligations and events concerning the expected sale, such as the beginning of an inspection period, were to be triggered only by the execution of a contract, not by the offer itself. Finally, the letter offer omitted some terms one would expect to find in a multimillion-dollar contract for the sale of property, such as a closing date, warranties, conveyance provisions, responsibility for taxes, and how the parties were to notify each other of contractually significant events.

Overtime

Continued from page one.

term "particular weight" invites differing interpretations, but courts can be expected to look at factors such as whether hiring and firing recommendations are part of an employee's regular job duties and how frequently such recommendations are made. An employee who owns at least 20% of a business and is actively engaged in managing it will also be exempt, without regard to salary thresholds.

Administrative Exemption

For employees in the same mid-range of compensation used for the executive exemption, but whose primary duty is "the performance of office or nonmanual work directly related to the management of the general business operations of the employer or [its] customers," the administrative exemption will apply. The employee's primary duty must also include work that involves the "exercise of discretion and independent judgment with respect to matters of significance." These criteria are too broad to allow an exhaustive list of "administrative" positions, but some examples from the new regulations include insurance claims adjusters, financial service employees, policymaking human resource managers, and team leaders for major projects.

Professional Exemption

"Learned professionals" earning between $23,660 and $100,000 will continue to be exempt from overtime as long as their primary duty is the performance of work requiring advanced knowledge in a field of science or learning that is customarily acquired by a "prolonged course of specialized intellectual instruction." The learned professional's work must include work "requiring the consistent exercise of discretion and judgment," as opposed to routine mental, manual, mechanical, or physical work.

Safe Harbor

Coming into compliance with the new regulations could be a daunting task, given their length, complexity, and lack of specific terminology. Ironclad advice that applies across the board is also in short supply because applying the new rules correctly is highly dependent on the facts and circumstances of each case. But balancing the difficulty of compliance is some leniency in enforcement. A "safe harbor" in the new regulations protects employers who make improper salary deductions. Employers with clear policies and procedures for addressing salary deduction errors will not lose an exemption for a class of employees unless the employer continues to make improper deductions after receiving complaints.