

section review

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Corrections

For Labor & Employment

Due to a production error, the title of Marjorie F. Wittner’s article in Vol. 10 #1 was misprinted. The correct title is: “*Bath Marine Draftsmen’s Association v. NLRB*: The First Circuit adopts a uniform standard of analysis for unilateral change/contract modification claims involving contract interpretation.”

For Individual Rights & Responsibilities

The following note was omitted from the REAL ID article in Vol. 10 #1.

This article was submitted for publication before the Department of Homeland Security issued final regulations that ignore many of the basic statutory requirements in the REAL ID Act and fail to fix most of its problems (for details, see the ACLU’s scorecard, <http://realnightmare.org/resources/19/>). Under the regulations, a REAL ID driver’s license won’t be required for people boarding planes and entering federal buildings until 2114 for those born after 1964, and the end of 2117 for those born before 1964.

Cover illustration by David Grotrian

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MASSACHUSETTS ATTORNEY GENERAL ISSUES MORTGAGE LENDING REGULATIONS THAT EMPLOY A SECURITY-BASED SUITABILITY STANDARD

By *Kevin S. Murphy*

In response to the growing subprime mortgage crisis, Massachusetts Attorney General Martha Coakley has promulgated new regulations under the Massachusetts Consumer Protection Act governing the conduct of mortgage brokers and mortgage lenders in Massachusetts. The regulations import a “suitability rule” from the world of securities trading, where a stockbroker is expected to know his or her customer’s financial situation and recommend only suitable stocks.



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Failure to comply with the regulations could lead to enforcement actions brought by the attorney general, and to civil liability in private suits brought by borrowers. The regulations apply to all mortgage lenders and brokers that advertise or do business in Massachusetts, regardless of whether the broker maintains an office in Massachusetts. They are of immediate importance to any company in the Massachusetts mortgage industry.

The regulations are broadly phrased and far-reaching. Industry groups have claimed that they will forever alter the landscape of mortgage lending in this state, foreclosing credit to many, and eliminating wholesale lending here. Major national lenders, such as Bank of America, have threatened to pull out of the Massachusetts wholesale lending market entirely.

The regulations

The new regulations address three main types of conduct: (1) advertising practices; (2) disclosure practices; and (3) conduct of mortgage brokers and lenders.

Advertising practices

Neither a lender nor broker may engage in “bait advertising,” meaning advertising which misrepresents, directly or by failure to disclose, the terms, conditions or charges incident to the mortgage loan. Specifically prohibited advertising includes:

Using the terms “immediate approval,” “immediate closing,” “instant closing” or words of similar import;

Advertising “no point” mortgage loans where points are required or accepted by the lender as a condition to close the loan, or advertising an incorrect number of points;

Using such terms as “bad credit no problem” or words implying unqualified access to credit without disclosing limitations such as income, higher rate or more points, or maximum principal;

Using such terms as “avoid foreclosure” unless the advertisements also clearly disclose: (1) that the borrower would be required to refinance and/or take a new loan; (2) that the borrower may be required to pay a high interest rate; and (3) the warning “you may lose your home if you cannot make all the payments or if you miss any of the payments on this loan.”

The advertising regulations contain categorical requirements requiring curative language and outlawing certain terminology altogether. On the other hand, “bait advertising” can include other types of advertising. The attorney general was concerned with advertising that promised certain loan terms which never materialized, and specifically referenced a transaction where the borrower was instructed not to talk to other lenders. The regulation also prohibits advertising that misrepresents, including by a failure to disclose. Interpretation may be analogous to the rule in security contexts prohibiting material misstatements of fact or material omission in stock sales.



Mortgage disclosures

Brokers and lenders must provide applicants with new disclosure forms within precisely designated time frames.

Brokers and lenders must also communicate the “material facts” of the transactions in a language the borrower understands, including, if necessary, using adult interpreters and providing translated copies of the mortgage disclosure forms.

It is unfair and deceptive to fail to disclose any fact relating to the loan transaction, disclosure of which may have influenced the borrower not to enter into the transaction with the broker or lender.

This regulation places a heavy affirmative burden on the lender or broker to determine all information that might influence a borrower not to enter into a loan transaction. There is no additional guidance provided by the AG with respect to the types of information that must be disclosed. Many obviously required disclosures — such as broker’s fee, loan origination fee, or points; whether the loan is fixed or adjustable; or the term of the loan — are already made on good faith statements. Other disclosures are implied. Coakley is concerned over short-term adjustable rate loans where the broker assures the borrower that the lender will refinance prior to the rate reset. The report cites examples where brokers do not explain to borrowers that a refinancing may result in a higher loan-to-value ratio. Brokers should consider avoiding such mention as a reason to enter the loan, or fully explaining the process and prospect of refinancing.

Of course, such examples do not exhaust the possibilities of what a lender or broker may be required to disclose, particularly given the enormously broad sweep of the regulatory language. Required disclosures may be judged by extant securities standards of material omissions.

Conduct of mortgage brokers and lenders

A broker or lender may not make a loan unless, based on information known at the time the loan is made, it reasonably

believes that the borrower will be able to repay based upon a consideration of the borrower’s income, assets, obligations, employment status, credit history and financial resources. The broker or lender must take into account: (1) the borrower’s ability to repay at the fully indexed rate, including any potential upward adjustments to the rate; (2) property taxes; and (3) reasonably anticipated insurance costs.

The attorney general is concerned that the trend of loan securitization and sale, combined with the appearance of thinly capitalized, highly debt-leveraged lenders, has reduced or eliminated underwriting standards. The regulation prevents lenders from qualifying borrowers based only on their ability to pay only the initial adjustable rate.

The lender or broker must analyze the repayment likelihood on the date the loan is made. Thus, the broker looks at the rate reset index and property taxes on that date, and presumably does not have to also calculate what that rate or those taxes might be in the future.

There is an objective and a subjective component to the test. The broker or lender must subjectively believe that repayment is likely and such a belief must be objectively reasonable. The objective aspect of the test is likely to be judged by what a reasonable industry professional would believe.

Brokers and lenders may not make loans without documentation to verify the borrower’s income unless the broker or lender provides a written document, signed by the borrower prior to closing, which: (1) identifies the borrower’s income and the source of that income; (2) provides detailed information, if true, that the no documentation loan carries with it higher interest rate or increased charges, or has less favorable loan terms. Further, this regulation prohibits a lender or broker from closing on the loan transaction if the stated income is not reasonable given the actual employment status or other circumstances known by the lender/broker.

This regulation essentially does away with “no doc” or “stated income” loans by requir-

ing, at the very least, some documentation of the borrower’s income and the source thereof. Further, it requires lenders and brokers to assess whether the borrower’s stated income and source are “reasonable” given the information known.

Coakley is concerned with lenders and brokers being “willfully blind” to whether a borrower is overextended. Thus, market participants must ascertain basic facts that would have demonstrated overextension. The regulation should not, however, make the broker a private investigator. Defense counsel’s position should be that the broker is entitled to rely upon the information the borrower provides unless it is patently absurd or inconsistent.

Brokers and lenders may not make a loan that is “not in the borrower’s best interest.” Further, where the broker’s interest conflicts with the borrower’s (i.e. where the broker’s compensation depends on securing a higher interest rate or other terms less favorable to the borrower), the broker must disclose the conflict and shall not process, make or arrange the loan so long as such a conflict exists. These duties cannot be disclaimed.

The attorney general is concerned about strategies that put broker compensation at odds with borrowers’ financial interest, particularly yield spread premiums or other ways a broker is rewarded for placing borrowers in less favorable vehicles than the most favorable for which they qualified. Such compensation must be disclosed.

The industry was concerned that yield spread premiums would be outlawed by the regulations. Coakley has reported to the Massachusetts Mortgage Bankers Association that the YSP must have an articulated benefit to the borrower that keeps the compensation scheme from being a conflict. The belief is that, so long as the YSP is consistent with overall business plan and consistent among like borrowers, it can be used.

The attorney general was also concerned with “steering” strategies, where a borrower is steered into a vehicle less favorable than another for which he was qualified. Deceptively simple to state, the issue is complex, since most vehicles contain trade-offs where some aspects are more expensive and



other less so, such as a no-closing-costs loan with a higher interest rate.

This regulation, and the two preceding it, establish a “suitability rule” for mortgage lenders and brokers. Coakley believes that the mortgage professionals are in the best position — even better than the borrower — to determine if a particular loan is suitable for the borrower. The suitability concept is lifted directly, and expressly, from the securities industry where self-regulatory organizations have long required broker-dealers to “know their customer” and recommend only securities suitable for that customer.

It is questionable whether the securities suitability concept makes sense in the mortgage context. Some argue that suitability for a security purchase is a simpler analysis, done primarily by comparison of rate-of-return to risk, with an eye toward the customer’s risk tolerance and goals. Conversely, determining whether a mortgage loan is suitable can

involve such inquiries as whether and how a borrower may invest excess cash from a lower monthly rate, or how important a certain residence is to a borrower, for instance, due to family circumstances.

Moreover, there are protections within the security context that may not exist under the attorney general’s regulations. There is traditionally no private cause of action for violation of the suitability or “know-your-customer” rules promulgated by self-regulatory organizations in the security industry. Stockbrokers are generally required reasonably to believe the recommendation suitable. To be civilly liable, the broker must have known the securities were unsuitable, but recklessly stated they were suitable. Finally, a securities customer must show reliance on the unsuitable recommendation, which can often be deflected by written materials detailing the nature of the investment. It is too early to tell whether such protections will apply to the mortgage con-

text, but they should and will be advanced by defense lawyers in litigation.

The regulations prohibit mortgage lenders from (1) using a pricing model that treats borrowers with similar credit and qualification criteria differently; or (2) making a loan when any or all of the cost features of the loan are based on criteria other than the borrower’s credit and other bona fide credit criteria. “Bona fide credit criteria” includes income, assets, credit history, credit score, income-to-debt ratios or loan-to-value ratios. The list is not exhaustive.

This appears to be an attempt to prohibit discriminatory lending practices without overtly stating so. Coakley’s “Principal Findings” state that “racial and ethnic minorities were more likely to be sold subprime loans with unfair and deceptive terms.” This is the only provision of the new regulations that deal with potentially discriminatory loan-making practices.



PLAY MONEY, REAL LAWSUITS

By Anthony B. Fioravanti and Douglas W. Salvesen

Depending on your metaphysical bent, Marc Wobegone may or may not exist. Sure, he could walk — and sometimes fly — but it was as a collection of pixels in the virtual world of Second Life created by Linden Research Inc. in San Francisco. Nevertheless, real or not, Marc Wobegone was at the center of a lawsuit in the Eastern District of the U.S. District Court of Pennsylvania that wrestled for a time with the application of real world laws to MMORPGs, or massively multiplayer online role-playing games.

In a MMORPG, players create and control a fictional character known as an avatar. “World of Warcraft” is a typical MMORPG in which players wander through virtual landscapes, associate with other players to battle monsters and perform quests on behalf of their computer controlled characters.

Second Life is another world altogether. Oh sure, the role-playing aspect of the game is still significant; however, you can have a furry tail, wear a Scottish kilt or be a dome-headed alien. But instead of battling zoids, the avatars in Second Life chat with friends and create virtual homes on plots of imaginary land. They can get married and adopt children. It goes without saying that they can have virtual sex. But the most important feature about Second Life is that its residents can conduct business.

Second Life’s economy is based on a currency referred to as linden dollars (L\$). Like euros or yen, linden dollars can be exchanged for real dollars. The exchange rate fluctuates and is currently around L\$ 265 to one dollar. Residents use linden dollars to purchase virtual real estate, goods and services.

The residents themselves create the goods

and services, using “modeling tools” available in Second Life. Through the use of these tools, the residents can create virtually any virtual product — such as clothing, houses, furniture, cars or art — which they sell to other residents. Some residents spend thousands of hours producing such products. Linden Labs, which created Second Life, allows the residents to retain full ownership of their virtual creations. Some players have turned their virtual endeavors into significant real-world incomes by creating virtual clothing stores, dance bars and adult night clubs. Others have made a significant profit by buying and selling virtual land. It has been speculated that there are a handful of residents who are collecting six-figure real-world incomes from their virtual entrepreneurial efforts. A German woman, Aileen Graef, has reported that she earned \$1 million from Second Life real estate investments by her avatar, Ansche Chung, from an initial investment of less than \$10. Ansche Chung Studios Ltd., Graef’s virtual business, now has 20 employees developing real estate and creating virtual fashion design. There is little doubt that the Second Life economy is substantial and growing. Reuters, which has a virtual presence in Second Life, estimates that there is \$1.4 million of goods and services transacted every day between residents.

Not surprisingly, this virtual economy reflects the real one in other ways.

For instance, in the summer of 2007, Ginko Financial, a Second Life “savings bank,” collapsed. At its height, Ginko Financial held deposits from 10,000 residents and offered them interest rates that amounted to an eye-popping annual rate of 44 percent. It turned out that Ginko Financial was a classic Ponzi scheme, using new deposits to pay early investors. It is estimated that Second Life residents collectively lost \$750,000 of real money as a result of the collapse.

In October 2007, Second Life residents filed an action in the Eastern District of New York claiming copyright and trademark in-



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fringement. Stroker Serpentine, Munchflower Zauis, Nephilaine Protagonist and three other Second Life residents with equally ludicrous names alleged that Rase Kenzo (a/k/a Thomas Simon) had duplicated and sold unauthorized copies of their virtual products to other residents. *Eros, LLC v. Thomas Simon, a/k/a Rase Kenzo*, Eastern District of New York, 2007-cv-04447. While the case raised interesting issues, it was reportedly settled for a very small sum within weeks after being filed, without definitively resolving any of those issues.

The most well-known legal action concerning virtual property in a MMORPG involved Marc Woebegone, the avatar created by Marc Bragg, who purchased Second Life real estate. Typically, after real estate is created by Linden Research, Inc. in the Second Life world, it is auctioned to the highest bidder. Bragg learned of a glitch in the system that permitted him to purchase virtual land before it was auctioned. He bought thousands of dollars of Second Life real estate significantly below its virtual market value in order to resell it at a very real profit.

When Linden Research Inc. learned of Bragg's actions, they froze his account.

Understandably, Linden Research Inc. invalidated the transactions that resulted from the glitch uncovered by Bragg. However, it also deprived him of all of the virtual real estate and other virtual assets that he had purchased validly and confiscated more than \$2,000 in cash in Bragg's account.

In October 2006, Bragg filed a lawsuit in state court seeking damages in the thousands and specific performance to recover possession of the virtual land that was taken in a digital form of eminent domain. The complaint claimed that the virtual land was unique, just like real land, and that damages alone will not fully compensate Bragg. It noted that the Second Life Web site represented that "Second Life is a 3D Online Digital World imagined, created and owned by its residents."

Bragg reportedly stated, "I was hit over the head with a virtual club and my real world money taken." He claimed that his case was "not just about the money," but was "about the fundamental importance of players' rights and requiring the creators of these virtual economic universes to respect real-world laws and real-world peoples' rights in these virtual worlds."

The case was removed by Linden Research Inc. to federal court. In January 2007, Federal Judge Eduardo Robremo held that the federal court had jurisdiction as damages in the case could exceed \$75,000.

While many Second Life residents anticipated a judicial decision articulating what rights they had in their digital creations, no decision will be forthcoming. The parties resolved their dispute in October 2007 as part of a confidential settlement.

Before it settled, the case did get an appropriate hearing. As part of an evidence course taught at Harvard Law School, there was a mock trial of Bragg's claim conducted in a virtual courtroom in Second Life. Following the trial, the mock jury found that Bragg was the owner of the virtual real estate. However, the jury also found that Bragg's exploit was improper and that Linden Research Inc. was justified in taking the real estate that Bragg had acquired using the exploit. Finally, the mock jury found by a vote of 6-3 that Linden Research Inc. was not justified in taking the digital property that Bragg had acquired without using the exploit.

There were no reports of a virtual appeal.



PROTECTING THE PROCESS OF PICKING A PRESIDENT: POLITICAL PARTIES AND CONGRESS NEED RULES REFORM TO GUARD AGAINST AL-QAEDA

By James Kossuth and Daniel B. Winslow

Former Pakistani Prime Minister Benazir Bhutto was assassinated last December as she campaigned to return to office in Pakistan after years in exile. This June marks the 40th anniversary of Robert F. Kennedy's assassination by Sirhan Sirhan on the night that he won the California primary and stood poised to sweep to the Democratic nomination for president. Hubert Humphrey won the party's nomina-

tion instead, and Richard Nixon captured the presidency. What if it were to happen here again? Does our process of picking a president guard against violent disruption of democracy by terrorists or encourage it? With basic reforms, Congress and the major political parties can eliminate any incentive for violence and protect the candidates and the presidential election process.

The Constitution already provides for suc-

cession should the president-elect die or be unable to take office. In 1872, that could have happened. After Ulysses S. Grant handily beat Horace Greeley on Election Day but before the Electoral College met to cast their votes, Greeley died. Had Greeley been the victor on Election Day, there would have been no procedure to deal with the situation. More than 60 years later, the 20th Amendment was ratified, at least partly in response to the 1872 election. If the president-elect dies before taking office, the 20th Amendment states that the vice president-elect becomes president. If both the president-elect and vice president-elect die before taking office, then Congress may either pass a law to name who will act as president, or it may instead declare the method for choosing the president. But the 20th Amendment does not expressly address what could have happened in 1872, where the winner on Election Day died before the Electoral College officially voted in December.

If a party's nominee dies before Election Day, the national committees provide the solution. Rule 9 of the Republican National Committee's bylaws "authorizes and empowers" the RNC either to fill a vacancy caused by the death or disability of the Republican nominee for either president or vice president or to reconvene the national convention to choose another nominee if sufficient time remains to do so. Article II, section 1 of the Democratic National Committee's bylaws provide that the responsibilities of the DNC include "filling vacancies in the nominations for the office of the President and Vice President," which allows the DNC either to appoint a replacement nominee or re-



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convene the national convention to choose a replacement.

But what happens if a nominee dies the day before Election Day? Does Congress have the power to postpone the election while another candidate is chosen? Can the political parties designate the successor nominee and have all votes for the deceased nominee count as votes for the successor? Or what if the winner on Election Day dies before the Electoral College votes? May Congress treat that situation like the one described in the 20th Amendment? Or may the electors simply vote for a new candidate, however chosen?

The president-elect and vice president-elect are chosen by the Electoral College — electors from each state whose votes are cast in mid-December and tallied in the first week of January. Each state sets its own rules for how the electors vote. In about half the states, state law requires the electors to vote for the nominee of the party that they represent. For example, Massachusetts General Laws, c. 53, §8, requires that each potential elector pledge to vote for the party's candidate. California Elections Code §6906 requires that the electors vote for the nominees for president and vice president chosen by the electors' party, but only if both candidates are alive. The electors may presumably vote for any person chosen to replace a dead candidate. In South Carolina, section 7-19-80 of the state code requires a person seeking to become an elector to declare, at least 60 days before the election, which candidate he or she will vote for. The failure to vote for that candidate makes the elector subject to criminal prosecution. The elector may vote for someone else when the state

political party decides "it would not be in the best interest of the State for the elector to cast his ballot for such a candidate." New Mexico Code §1-15-9 makes it a felony for an elector to vote for someone other than his or her party's nominee. In other states, no specific law binds an elector to vote for a particular person. The result is a hodge-podge of competing state laws (or no laws) for the most important decision that the people of this country make.

Sadly, these may not be just academic questions forever. Uncertainty in presidential succession creates a needless incentive for al-Qaeda to disrupt the democratic process. The best solution is for Congress to fill these gaps in the presidential selection process by enacting emergency legislation now. If Congress fails to act, the major political parties should adopt rules at the national conventions or enter into a memorandum of understanding that explicitly address these scenarios. For example, the rules or agreement should define the solutions at each critical stage of the process where gaps exist:

1. If a candidate dies before a primary election, individual state laws should govern. For example, Massachusetts General Laws c. 53, §49, allows the state's party committee to name a replacement, but only if there are no other candidates running;
2. If the party's nominee dies before the election, the national political parties (and if there is sufficient time, the party convention delegates) select the replacement nominee. If there is insufficient time to replace the ballots with the correct name, votes for the

deceased nominee should be counted as votes for the replacement nominee. Because the voters actually vote for a slate of electors rather than a nominee, this solution most closely follows the Constitution. The national political parties would then have until the Electoral College votes in mid-December to name a successor, regardless of whether the nominee dies on Election Day or two weeks after;

3. If the nominee dies after the Electoral College votes but before the results are tallied in January, the 20th Amendment should control. The 20th Amendment applies to the "president-elect," and Congress should define when a person becomes a "president-elect" — the minute all the electoral votes are cast. There is no reason for postponing the moment a person becomes "president-elect" by another three weeks and possibly throwing the country into chaos if a nominee dies after the electors have voted in December but before their votes are counted in January.

Because tragedy can strike at any time, the major political parties should adopt explicit rules now to fill vacancies caused by the death of a nominee or election winner. Congress should act to fill in the gaps left in the Constitution and to provide for postponing the election, if necessary, to make sure that a fair election take place, no matter what happens beforehand. The safety of our candidates, the security of our nation and public confidence in the integrity of our democratic process require action now.



THE IMPORTANCE OF E-DISCOVERY IN A SUPERIOR COURT RULE 9C CONFERENCE

By Daniel K. Gelb

In December 2006, the Federal Rules of Civil Procedure were amended to address issues regarding electronic discovery. On the state level, in Massachusetts, there are no mandated rules concerning e-discovery. However, court and counsel may be guided by the *Guidelines For State Trial Courts Regarding Discovery of Electronically-Stored Information* promulgated by the Conference of Chief Justices for the National Center for State Courts (See www.ncsconline.org/images/EDiscCCJGuidelinesFinal.pdf).

E-discovery has captured the attention of the federal trial bar because failure to comply with the amended rules can have dire consequences (e.g., sanctions for spoliation of electronically stored evidence (ESI)).



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In each civil case in federal court, counsel must meet and confer regarding the handling of ESI in accordance with FRCP 26(f). In addition, if the parties have discovery disputes with respect to ESI, they must comply with the U.S. District Court for the District of Massachusetts Local Rule 7.1, which states that “[n]o motion shall be filed unless counsel certified that they have conferred and have attempted in good-faith to resolve or narrow the issue.”

On May 12, 2007, during the Massachusetts Superior Court Judicial Conference’s semi-annual meeting, the justices of the Superior Court revised Superior Court Rule 9C, which states, in part:

Counsel for each of the parties shall confer in advance of serving any motion under Mass. R. Civ. P. 26 or 37 and make a good faith effort to narrow areas of disagreement to the fullest extent. Counsel for the party who intends to serve the motion shall be responsible for initiating the conference, which conference shall be by telephone or in person.

(See Superior Court Chief Justice Barbara J. Rouse’s Jan. 29, 2007, letter and its enclosure containing the newly amended Rule 9C at www.mass.gov/courts/sjc/docs/amendment_rule_9c.pdf)

The proliferation of ESI on computers, PDAs, electronic facsimiles, voicemail and removable digital media storage devices make it inevitable that ESI will have to be mined from various sources in order for counsel to effectively represent a client.

Unlike hard documents, ESI is dynamic and, therefore, may be easily destroyed or altered. Therefore, preservation and retrieval of ESI can be burdensome and costly. Moreover, the assistance of digital forensic experts in order to properly process ESI in anticipation of production, retrieval and introduction into evidence may be necessary. Therefore, counsel at the state level should be as conversant as counsel at the federal level, even in the absence of

mandatory rules.

In order to successfully approach e-discovery and handle issues that may arise during discovery disputes in Rule 9C conferences, counsel must be aware of the issues that must be addressed, such as: When is litigation reasonably anticipated so that ESI has been preserved? Is the ESI readily accessible? Will metadata have to be produced? Will there be a claw-back provision for the inadvertent production of privileged information? Will the costs of production, which can be substantial, be shifted to the requesting party? Will a party’s failure to produce ESI or the destruction of ESI result in sanctions?

Superior Court Rule 9C requires the parties to cooperate in good faith prior to filing discovery motions under the Mass. R. Civ. P. 26 and 37. The purpose of Rule 9C is to foster judicial economy by requiring the parties to resolve discovery disputes or narrow the issues in good faith. For example, principle number 3 of *The Sedona Principles Addressing Electronic Document Production, Second Edition* (June, 2007) states that “[p]arties should confer early in discovery regarding the preservation and production of electronically stored information when these matters are at issue in the litigation and seek to agree on the scope of the parties’ rights and responsibilities.”

Therefore, it is incumbent upon counsel to be familiar with e-discovery and ESI on a continuing basis so that during a Rule 9C conference, the relevant issues can be identified, the parties can attempt in good faith to resolve the issues, and the parties can articulate the issues and possible resolutions to the court in a clear and concise manner. In order to conduct a good faith Rule 9C conference in the area of e-discovery, counsel should consider whether a member of the client’s information technology department or a digital forensics expert should participate. Otherwise, counsel may place his or her client in jeopardy when the parties appear before the court.

HIV TESTING — IT'S TIME TO CHANGE THE LAW IN MASSACHUSETTS

By Mark C. Rogers

Introduction

The Commonwealth of Massachusetts has a strong history of recognizing the importance of keeping a patient's medical information confidential. Perhaps nowhere is this commitment more evident than in the enactment of the HIV Testing Statute, M.G.L., c. 111, §70F, by the Massachusetts Legislature in 1985. The statute sets forth the parameters pursuant to which a health care provider can test a patient for HIV and disclose the results of such testing. The extraordinary informed consent requirements of the statute, however, hinder the ability of health care providers to treat infected or potentially in-

fectured patients and fight the spread of HIV and AIDS. Therefore, although there may be objections from some who believe the informed consent requirements of the statute are important to maintaining an optimal patient care environment, the Massachusetts Legislature should remove the stringent confidentiality standards of the statute.

HIV testing statute

The statute, unique in comparison with other Massachusetts clinical disease testing statutes and regulations, provides, in relevant part:

No health care facility . . . physician or health care provider shall (1) test any person for the presence of HTLV-III antibody or antigen without first obtaining his written informed consent; (2) disclose the results of such test to any person other than the subject thereof without first obtaining the subject's written informed consent; or (3) identify the subject of such test to any person without first obtaining the subject's written informed consent.

The import of the statute is that a Massachusetts health care professional is precluded from testing a patient for HIV, or releasing the results of such testing, without first obtaining the patient's written informed consent. The impetus behind the enactment of the statute was the social stigma and discrimination associated with HIV/AIDS. The Massachusetts Legislature reacted to this stigma and discrimination by passing a law that to this day is unparalleled in comparison with other Massachusetts medical-screening statutes and regulations in terms of the stringency of its informed consent requirements.

To date, the Massachusetts Supreme Judicial Court has held that there is only one exception to the statute. In *Commonwealth v.*

Maxwell, 441 Mass. 773 (2004), the criminal defendant sought the victim's medical records on the basis that such records might contain information necessary to the defense of the case. The defendant served a subpoena on a hospital to obtain the medical records, and the hospital moved to quash the subpoena on the basis of the statute. On appeal, the SJC held that the confidentiality requirements associated with the informed consent provisions of the statute may be trumped by a defendant's constitutional right to a fair trial.

The statute's impact on health care providers

Although the statute was enacted because of the stigma and discrimination associated with HIV/AIDS, the primary argument of today's patient care advocates to the possible removal of the statute's confidentiality requirements appears to be that the statute encourages an important dialogue between a physician and his/her patient about informed consent issues. More specifically, certain patient advocates view the informed consent requirements of the statute as one of the counterbalances to the pressure upon physicians in today's competitive health care environment to see more patients in less time. However, other initiatives in the health care field exist that address the problem of the time constraints impacting the physician-patient relationship, and those initiatives will not affect the care and treatment of infected or potentially infected patients. As one example, the Joint Commission on Accreditation of Health Care Organizations is strongly pursuing a policy of "teach-back" in the area of informed consent. This policy calls for providers to ask patients to state in their own words the elements of the informed consent form they are being asked to sign. Such an initiative is much more likely to have a positive impact upon the phy-



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sician-patient relationship than the statute currently does and will not sacrifice the ability of health care providers to treat infected or potentially-infected patients.

The informed consent requirements of the statute have negatively impacted health care providers in two distinct ways. First, without the ability to test an individual or release the results of such testing without first obtaining the individual's written informed consent, a provider who is treating a patient who may have been occupationally exposed to HIV is limited in his or her treatment options. Second, and more importantly, by not being able to test a patient for HIV like other communicable diseases in Massachusetts, providers are substantially restricted in their ability to stop the spread of the disease and to treat the significant number of people infected with HIV but who are not aware they are infected.

Occupational exposure

The effect of the statute's informed consent requirements on a provider treating a patient who may have been occupationally exposed to HIV is perhaps best demonstrated by the SJC's decision in the matter of *Commonwealth v. Ortiz*, 2001 WL 34129741 (February 15, 2001). In *Ortiz*, several police officers from the Springfield Police Department were exposed to the defendant's blood during his arrest. The commonwealth asked the district court to order the defendant to disclose any or all medical conditions from which he suffers or has been diagnosed in the past relating to infectious disease(s). The district court granted the request, but solely for use by the officers in their medical treatment. The defendant appealed to the SJC, and the appeal was heard by the single justice, Martha Sosman. Sosman reversed the decision of the district court and held that as worded, "§70F provides absolute confidentiality for HIV testing." She distinguished the statute from other Massachusetts statutes that protect the confidentiality of medical information by noting that unlike other such statutes, M.G.L., c. 111, §70F does not provide exceptions that allow for disclosure of the information under certain circumstances. She also noted that the "absence of any such exceptions in §70F strongly suggests that the Legislature did not intend there to

be any exceptions." In summation, Sosman held that the "import of §70F is clear: The results of HIV testing are not to be disclosed without the patient's consent."

The *Ortiz* case demonstrates the limited treatment options a provider can present to his or her patient who may have been occupationally exposed to HIV. If the individual refuses to disclose whether he/she is positive for HIV/AIDS, the provider is often left with little choice but to recommend to the patient the use of post-exposure prophylaxis (PEP). PEP usually involves a four-week regimen of antiretroviral agents from certain classes of drugs that are available to treat HIV infections. Many individuals, however, are unable to complete the four-week course of HIV PEP due to the toxicity and side effects of the antiretroviral agents. If the statute did not contain the rigid informed consent requirements, those who were occupationally exposed to HIV would have the opportunity (most likely through court order) to discover whether the individual is HIV positive, and would therefore potentially avoid unnecessary PEP treatment.

Fighting the spread of HIV/AIDS

The more significant impacts of the informed consent requirements of the statute are the inability of health care providers to appropriately treat some individuals infected with HIV and to stop the overall spread of the disease. Fortunately, the development of new therapeutic strategies for treating HIV over the past several years has helped people infected with HIV live longer and healthier lives. But, it is estimated that 40 percent of patients in the United States who test positive for HIV develop AIDS within a year of their diagnosis, and the more time which passes before a patient receives treatment for HIV, the more damage the virus does.

A provider in Massachusetts can test a patient's blood sample for communicable diseases, such as tuberculosis, gonorrhea and syphilis, without obtaining the patient's written informed consent. Without a written informed consent to test that same sample for HIV, providers are unable to diagnose, and thus treat, an individual who may be infected with HIV. Dr. Dale Magee, president of the Massachusetts Medical Society, explains that presenting the patient with an informed

consent form for HIV testing can cause the patient to retract. "It carries with it the innuendo that there is something that is more stigmatized by this test," states Magee.

The informed consent requirements of the statute also inhibit the ability of providers to stop the spread of the disease. Estimates are that 250,000 Americans are infected with HIV, but are not aware they are infected. If providers were allowed to test blood samples for HIV without having to obtain the patient's written informed consent, they could inform the patients and help them to prevent transmitting the disease to others.

Initiatives to revise HIV testing

Last year, the Public Health Council of the Massachusetts Department of Public Health approved emergency amendments to the Code of Massachusetts Regulations applicable to the DPH. Those emergency amendments require physicians and other health care providers in Massachusetts, including laboratories, to report to DPH the name of any patient who tests positive for HIV. Although physicians and other health care providers in Massachusetts were already required to disclose the names of AIDS patients to DPH, they were previously only required to report HIV cases using a code-based system. Although the emergency amendments to the regulations are not inconsistent with the statute, in order to comply with both the statute and the emergency amendments, health care providers must alter their HIV informed consent forms to provide that if a patient tests positive for HIV, he/she will be reported by name to the DPH.

The purpose of the emergency amendments was to ensure access to federal funding. The Ryan White HIV/AIDS Treatment Modernization Act of 2006 mandates that states which receive funding under the act must have implemented an HIV reporting system acceptable to the Federal Centers for Disease Control and Prevention by April 1, 2008, to be eligible for further funding under the law. The CDC subsequently indicated that it would only find full-named based systems acceptable. According to DPH, in order for the data to be sufficiently mature to be counted for funding, Massachusetts had to begin the reporting process as of Jan. 1,

2007. Physicians and other health care providers, including laboratories, who submitted code-based reports after Jan. 1, 2007, were permitted to amend these reports by the end of 2007 by inserting full names.

The CDC's policy of basing further federal funding on compliance with a names-based reporting standard is part of a broader effort by the CDC to standardize HIV testing. In September 2006, the CDC issued *Revised Recommendations for HIV Testing of Adults, Adolescents, and Pregnant Women in Health-Care Setting*. The objectives of the CDC recommendations are to "increase HIV screening of patients, including pregnant women, in health-care settings; foster earlier detection of HIV infection; identify and coun-

sel persons with unrecognized HIV infection and link them to clinical and prevention services; and further reduce perinatal transmission of HIV in the United States." The CDC recommendations advocate that a separate written consent should not be required for HIV testing. Rather, the CDC recommendations state that general consent for medical care should be considered sufficient to encompass consent for HIV testing.

A bill (H.B. No. 2209) filed in 2007 in the Massachusetts House of Representatives by Rep. Vincent A. Pedone attempts to amend the statute to comply with the CDC recommendations. Specifically, the legislation seeks to remove the informed consent requirements of the statute. The proposed

legislation sets forth a formal stage for the ongoing debate regarding the confidentiality requirements of the statute.

Conclusion

The informed consent requirements of the statute are a polarizing issue for health care providers and patient advocates. However, if health care providers are to be able to effectively treat patients who have been infected, or potentially infected, with HIV, then it is critical that the Massachusetts Legislature remove the statute's stringent informed consent standards.



COMPANY E-MAIL POLICIES IN THE WAKE OF THE NLRB'S *GUARD PUBLISHING* DECISION

By Catherine E. Reuben and Rita B. Trivedi

Can an employer lawfully issue a policy restricting its employees from using e-mail for non-job-related solicitations, including union-related solicitations, if it permits employees to use e-mail for other non-business purposes? Unionized and non-unionized employers alike have faced this question all too often in recent years as they attempted to craft policies that are both practical and legally enforceable. New guid-

ance in the analysis has come in the recent case of *The Guard Publishing Co.*, 351 NLRB No. 70 (12/16/07), in which the National Labor Relations Board suggests that the answer to that key question may now be “yes.”

By way of background, Section 7 of the National Labor Relations Act gives employees (whether unionized or not) the right to engage in “protected, concerted activity” at the workplace, including soliciting coworkers to join a union and discussing their col-

lective interests. While employers can, and do, implement policies limiting such solicitation at work, it is well established that (1) the employer cannot ban solicitation during an employee’s non-working time and in non-working areas, such as the cafeteria, and (2) the employer cannot discriminate based on the purpose or nature of the solicitation. For example, if the employer allows employees to solicit for the Girl Scouts, it has to allow them to solicit for a union as well.

With the advent of e-mail, however, the legal landscape became more complicated. The NLRB’s general counsel took the position that e-mail had become a “natural gathering place” for employees to communicate in the workplace; supporters added that “e-mail is becoming the predominant means of business communication....” Thus, if employees had an absolute legal right to talk about a union in the cafeteria, they arguably had the right to do so in cyberspace as well. Further, if an employer regularly permitted employees to use e-mail for personal communications, the general counsel argued, prohibiting them from using e-mail for union-related solicitations would constitute unlawful discrimination. Such arguments left employers in a quandary: Could they lawfully adopt a policy prohibiting employees from using company equipment for non-work-related solicitation? And, if they did, would the NLRB prevent them from enforcing that policy if they allowed an occasional personal e-mail to get through?

The NLRB was given an opportunity to address these issues head on in *Guard Publishing*. Guard had issued a policy stating that the company’s communication systems and equipment could not be used to solicit for “commercial venture, religious or political causes, outside organizations, or other non-job-related solicitations.” In practice, however, employees were permitted to use e-mail for some non-job-related reasons, including party invitations, baby announcements and the like. In this context, an employee named Suzi Prozanski sent several e-mails to coworkers at the company regard-



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Labor & Employment

ing union matters. One message in particular, sent by her from her work station during a break, attempted to clarify what she believed were misstatements by Guard regarding union activity. Prozanski sent a second e-mail to her coworkers at their Guard e-mail addresses, but this time did so from a computer in the union's office, off the Guard's premises. In the second e-mail, she asked her fellow employees to participate in the union's entry in a local parade and to wear green in support of the union during negotiations with Guard. Guard disciplined Prozanski for both e-mails. She, in turn, claimed the company had unlawfully interfered with her Section 7 rights.

In its decision, the NLRB began by recognizing that employees do not have a Section 7 right to use their employer's *equipment or media* as long as the restrictions on use are nondiscriminatory. With this first step, the NLRB distinguished between the face-to-face solicitations taking place on company-owned property, such as in a cafeteria, and electronic solicitations taking place on a company-owned computer or a company-owned communication system. Because Guard's employees could (and did) frequently speak face-to-face and had no limitations on their ability to discuss union or other protected activity, the limit on e-mail use was not unlawful on its face. Critically, this conclusion also meant that even Prozanski's second e-mail, sent from a union computer off-site, used Guard's communication system because it was received by employees at their Guard e-mail addresses.

The NLRB then tackled the question of whether the policy had been enforced in a discriminatory manner. Discrimination occurs, the NLRB stated, when an employer accords different treatment to "like" activi-

ties on the basis of Section 7 protected versus nonprotected status. For example, it would clearly be discriminatory for an employer to permit anti-union e-mails, but prohibit pro-union e-mails. The NLRB found that Guard's policy was not discriminatory because it compared two "unlike" types of communications – solicitations for outside organizations on the one hand, and personal solicitations on the other. Despite its relationship to the workplace, in this context a union constituted an outside organization. The NLRB went on to provide employers with a road map for drafting a lawful ban on certain types of e-mail solicitations:

[A]n employer may draw a line between charitable solicitations and noncharitable solicitations, between solicitations of a personal nature (e.g., a car for sale) and solicitations for the commercial sale of a product (e.g., Avon products), between invitations for an organization and invitations of a personal nature, between solicitations and mere talk, and between business-related use and non-business-related use. In each of these examples, the fact that union solicitation would fall on the prohibited side of some of these distinctions does not establish that the rule discriminates along Section 7 lines.

Even in this new framework, however, employers must still watch for nuances in how they enforce policies. The board stated that Prozanski's e-mail clarifying what she believed was a misstatement by Guard with regard to union activity did not solicit support for the organization itself, and thus Guard should not have disciplined her for sending it. As it explained, "[t]he only difference between [that]

e-mail and the e-mails permitted by [Guard] is that Prozanski's e-mail is union related." That kind of distinction, according to the NLRB's analysis, *is* discriminatory and constitutes a violation of employees' Section 7 rights.

Furthermore, there are some work settings, such as those with large numbers of telecommuters, where there is no cafeteria or other place where employees can gather in person to engage in Section 7 activity. Indeed, the NLRB specifically commented that there had been no contention that Guard's employees rarely saw each other in person or that they communicated with each other solely by electronic means. Had the facts been different and the traditional verbal means of communication been rendered functionally insignificant, the NLRB suggests, the policy could have been deemed to unlawfully restrict Section 7 rights.

In sum, *Guard Publishing* allows employers more freedom to adopt policies that prohibit employees from using company computer systems to solicit for outside organizations, while still permitting solicitations of a personal nature. While this decision expands the scope of lawful limitations on e-mail use, it also requires employers to carefully define permitted and prohibited content, take care that the distinctions between the two are based on criteria other than protected Section 7 activity, and ensure that enforcement is done in a consistent, nondiscriminatory manner to avoid setting a precedent that could undermine the classifications it has so carefully drawn. Understanding the difference between "like" and "unlike" communications as well as the broader definition of an employer's equipment, systems or media will be key to an employer's success in crafting a legally enforceable e-mail use policy.



PROPERTY TAX ABATEMENTS 101: A TIMELY PRIMER IN TODAY'S REAL ESTATE MARKET

By Marc C. Lovell

The current downslide in the real estate market conditions for both residential and commercial properties have made the notion of obtaining a property tax abatement a most appropriate focal point for many types of clients. This is particularly relevant for those clients with high residential values who may have felt the most impact of a soft residential real estate market and business clients with commercial or industrial properties that have arguably declined significantly in value due to slowing business and market conditions. With this trend of declining real estate values having every appearance of continuing for awhile, the time might be just right to advise your client to apply for a property tax abatement.



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Overview

The reach of the commonwealth's taxation arm extends over all real property situated within the commonwealth unless there is an express exemption from such taxation.¹ While the commissioner of revenue is the primary official vested with the responsibility to oversee, assess and collect property taxes in Massachusetts, the actual process happens with each municipality's local Board of Assessors, which drives the whole procedure. The Department of Revenue has within its ambit a Division of Local Services that is the principal contact department for all assessors within the various municipalities of the commonwealth.

Generally, Massachusetts law provides for training courses for assessors² and these courses are administered by the Massachusetts Association of Assessing Officers³ to ensure that the assessors are trained to appropriately value property and address various valuation and other administrative issues that arise in the course of assessing properties of various types throughout the commonwealth.

Under statutory law, the assessors must assess property at 100 percent of the property's full fair cash value⁴ and the Massachusetts Supreme Judicial Court has ruled that any valuation less than this is a clear violation of the statute.⁵ Fair cash value has been defined as the price at which a willing seller and a willing buyer in a free and open market will agree upon where both parties are fully informed and neither is under duress or compulsion.⁶

Timing is everything

The most important procedural factor in connection with applying for an abatement is the timing in the filing of the application itself. All 351 municipalities in the commonwealth use a fiscal year that runs from each first of July to the 30th of June of the

following year. However, some municipalities will use a quarterly billing system for property taxes and some use a semi-annual system. The statute states that application for an abatement must be made "... on or before the last day for payment, without incurring interest ... of the first installment of the actual tax bill issued upon the establishment of the tax rate for the fiscal year to which the tax relates"⁷ As a practical matter, for most municipalities that operate on a quarterly billing system, the deadline to file an abatement will be the first of February, and for those municipalities on a semi-annual system, the deadline will be Nov. 1 (since these are the due dates for the first payments after which interest will begin to accrue if payment hasn't been made by that date) but it is always advisable to check with the local assessor's office on what the applicable deadline is. The deadline requirement is generally strictly construed and failure to timely file the application for abatement is fatal to any claim for an abatement for that particular year. The statute itself provides for some very limited exceptions in instances, for example, where the property was erroneously omitted from assessment records or where there was a clerical or data processing error made in the course of valuating the property.⁸

The application must be made on a form approved by the commissioner, and for most municipalities, this is a rather simple one-page form that asks for some basic information that identifies the subject property and provides for a brief explanation as to why the abatement is being sought. The form will also ask the applicant to state what he or she believes the assessed value of the property should be and a dollar value must be stated. The form and its corresponding instructions can often be downloaded from the municipality's Web site; otherwise, it can be obtained from the assessor's office. While



the form appears rather simple to complete, great care should be taken to clearly establish the grounds for a valid abatement claim.

In addition, while statutory law requires your client to have appropriate “standing” to apply for an abatement, as a practical matter it would be unlikely for this to be an issue in most routine abatement situations for property owners. The statute first provides that the proper party for application for abatement is the person upon whom the tax has been assessed.¹⁰ Assessment occurs on “tax day,” which is Jan. 1 of each year. Further, the statute allows a subsequent owner who later acquired title equivalent standing to apply for an abatement as well so long as application can be made before the statutory deadline.¹¹ The administrator or executor of the property owner likewise can apply, as can a tenant who pays more than half of the property taxes on the property that is the subject of the abatement. Where someone else other than the owner has an interest in the property (such as a pure possessory interest) and pays the property taxes, that person, likewise, can generally properly apply for an abatement.

Haggling with those assessors

Simply stating that the property taxes are too high isn’t sufficient for a successful abatement argument. There are generally four grounds to focus on when forming a good and potentially successful abatement argument for the local Board of Assessors to consider:

- i) the property has been overvalued by the assessor;
- ii) the property has been disproportionately assessed in comparison to other properties;
- iii) the property has been incorrectly classified; or
- iv) the property is partially or fully exempt from taxation.¹²

Overvaluation and disproportionate assessment

For our purposes within a market that has seen declining real estate prices, the first two grounds are most relevant since valuation is at issue (the latter two grounds typically in-

volve definitional aspects).

The assessor is required to take into account any and all factors that may affect the value of the subject property. Among the factors to be considered are depreciated replacement cost of the property, its rental value, sales of similar properties, the use to which the property is put and perhaps the most important one in today’s economy: the nature of general market conditions.

Overvaluation of the property simply means that the assessor has placed too high a valuation on the property given the inherent nature of that property itself, whereas a disproportionate assessment refers to a high valuation relative to other comparable properties in the area. While either ground itself can be used successfully, these two grounds can also be used together. An overvaluation argument often focuses on factors about the property itself that causes it to fall short of the valuation the assessor provided for that property. Perhaps the assessor’s information on a three-bathroom home doesn’t indicate that one of the bathrooms is inoperable due to plumbing issues or that part of the house isn’t heated (this is common with older, historic homes where heating systems were retrofitted). You may be rather surprised at just how much incorrect information exists in the assessor’s records about the particular property which is being used in connection with arriving at an accurate valuation.

Arguments that bring in today’s deflated market prices will necessarily focus more on a disproportionate assessment approach. Professional property appraisers can be most helpful in providing 3-5 different appraisals of “comparables,” or properties that compare to the subject property in living space, neighborhood and amenities that have an impact on value. This is where today’s lower, deflated market prices can be most successfully invoked in establishing that the client’s property simply isn’t worth what the current valuation says it was worth (and as noted, general market conditions must be taken into account in the valuation process). Typically, property assessments can be very slow to recognize sharp market declines in value.

For business clients owning commercial or industrial properties, the current slowing business and economic climate most certainly will have an adverse impact on prop-

erty value. For example, within a growing, booming economy, a busy small manufacturing firm’s property manufacturing consistently at full capacity will have a higher value given a higher demand for its property and that property’s income-producing capabilities within its industry. In today’s slower economy, such a property may not be nearly as high in demand within the industry due to much slower production. Many manufacturing facilities arguably can become partially or fully obsolete given present slow economic conditions, particularly as certain items in their product line fall out of favor and are no longer produced in large numbers or perhaps not produced any longer at all. Typically, the value of a commercial or industrial property largely depends upon the strength of the economy within the particular area of business or industry in which the property is involved. Many arguments can be made that in present slowing economic times, there is a much narrower market for particular properties of that nature (perhaps not much of a market at all exists for some industries) and therefore, a present market valuation that still reflects a value when economic times were strong, is far too high under present economic circumstances. This is true whether the commercial property is owner-used or rented. Key factors such as vacancy rates for rented space are most appropriate to take into account in arriving at an appropriate valuation figure.

In addition, it can be argued that as nearby commercial or industrial properties begin to slow or even close, surrounding properties also likewise decline in value. Houses and commercial retail establishments adjacent to a bustling, busy industrial facility are very likely higher in value than what those same houses and commercial establishments would be worth when the nearby industrial plant has wound up its business and become a closed or boarded-up eyesore without the volume of people coming to paying jobs with money to spend in the immediate area like they once did. There are many features of a property that affect value and the surrounding area and economy certainly play a role in value determination.¹³

The law considers every property different and unique, but clearly, current slowing economic times can have a major adverse impact on the appropriate values of properties



of virtually every type.

Beyond the board of assessors

Once the local Board of Assessors has received the timely filed application for abatement, they have three months to respond.¹⁴

If the client isn't satisfied with the decision of the Board of Assessors, an appeal can generally be made to the Appellate Tax Board.¹⁵ Importantly, the ATB will only have jurisdiction to hear the abatement appeal if the claimant paid the amount of property tax in full on or before the due date without incurring any interest.¹⁶ A hardship exception is built into the statute that still requires at least half of the tax to be timely paid before the jurisdiction of the ATB can be invoked.¹⁷

Two cases decided in 2006 reaffirmed some key burden of proof principles of which appellants should be acutely aware. First, the ATB will generally operate with the presumption that the assessed valuation of the property is valid and it is up to the appellant to provide sufficient evidence to overcome this presumption.¹⁸ The Board of Assessors can win the ATB appeal simply by resting on this presumption that their assessment is valid without providing any further evidence if it is believed that the appellant hasn't overcome that presumption.¹⁹

Accordingly, in order to rebut the presumption of assessment validity, it is generally imperative to provide evidence of a lower property value using one or more established valuation methodologies with figures and estimates that have substantial support. Professional real estate appraisers are most familiar with these valuation methodologies and can prove to be indispensable as expert witnesses in an ATB hearing. Typically, the appraiser will prepare a detailed appraisal report with an explanation of the method(s) used and a discussion as to how they arrived at their final valuation amounts, and this will form the basis of the appellant's argument in rebutting the presumption that rests in favor of the assessors.

A rather recent ATB case underscored the need to ensure that solid, experienced, professional expert witnesses are used. In *Bodwell Extension, LLC v. Board of Assessors of the Town of Avon* (May 17, 2006), the "expert witness" was one of the members of the appellant two-member LLC, who admitted he

had never prepared an appraisal report prior to the one he had created in connection with the ATB hearing. Moreover, this "expert witness" indicated that a tax consultant (who was notoriously absent from the ATB hearing and thus not able to be cross-examined on his role in the process) assisted him in preparing the report and it was admitted that the tax consultant was to be paid a part of any abatement award for his assisting efforts. The ATB commented that these circumstances seriously undermined the credibility of this expert witness and further concluded that he failed to explain the most basic elements of his report.

Second, in the somewhat rare circumstance where there is an appeal of the assessment in the two-year period following a year within which the ATB has already made a determination of the full fair cash value of the property, the burden of proof shifts to the assessors to demonstrate that any incremental increase in valuation over and above the value previously determined by the ATB is warranted.²⁰

Higher ground

Briefly, where the desired relief isn't obtained from the ATB, it may be possible to appeal further to the Massachusetts Appeals Court. However, the Appeals Court largely defers to the ATB's final determinations given the ATB's expertise in addressing tax issues. Accordingly, only a largely deferential standard of review of ATB decisions is available.²¹

A more appropriate valuation

Typically, when the economy slows and real estate values begin to dip, assessor valuations are rather slow to take these more depreciated values into account, so taking a proactive approach for your client in arriving at a more appropriate valuation in today's soft market conditions may be advisable.

Given today's soft real estate market, it may be the right time to consider advising certain clients to apply for an abatement at the next possible opportunity. Fortunately, this needn't be a big-ticket item when it is addressed at the local Board of Assessors level (but economics and costs may certainly play a role if the decision is further appealed to the Appellate Tax Board). In addition, the

arguments will generally be far less technical with the local Board of Assessors than they will at the ATB level, where the particular methodologies of valuation used and the underlying logic and reasonableness of the figures and calculations made become major factors. Accordingly, it is best to put substantial preparation into a rather compelling argument at the Board of Assessor level in an attempt to obtain an abatement and eliminate the more technical and involved requirements at the ATB level, where the taxpayer must overcome the additional hurdle in the form of the presumption of validity of the assessment.

End notes

1. G.L.M. c.59, §2.
2. G.L.M. c.59, §21B.
3. For further information on the particular courses and the various different professional designations that exist for assessing officers throughout the commonwealth, visit the Massachusetts Association of Assessing Officers' Web site at www.Maaao.Org which is replete with valuable contact information for their executive board, staff members and for the respective assessors association for each county within Massachusetts.
4. G.L.M. c.59, §38.
5. See *Bennett v. Board of Assessors of Whitman*, 354 Mass. 239 (1968).
6. *Boston Gas Co. v. Assessors of Boston*, 334 Mass. 549, 566 (1956).
7. G.L.M. c.59, §59.
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.*
13. There are a handful of established methodologies that are used to value real estate, such as the income capitalization approach or the sales comparison approach. While a detailed discussion of these approaches is beyond the scope of this article, a qualified real estate appraiser will be most familiar with these approaches and when to use them. Generally, for income-producing properties, the income capitalization approach



is preferred (See *Columbia Electric Corp. v. Board of Assessors of the Town of Framingham*, Nos. F268356, F273200 (Mass. App. Tax Board, June 26, 2006) (where the income capitalization approach was preferred over the sales comparison approach for a manufacturing warehouse facility with office space)). *Columbia Electric* provides a rather detailed discussion of some of the established principles of the income capitalization methodology with extensive case citations.

14. G.L.M. c.59, §63. Note that G.L.M. c.59, §64 states that where the local Board of Assessors fails to act on the application for abatement within the three-month period, the application is deemed to be denied and the claimant can treat it as such and appeal that denial.
15. G.L.M. c.59, §65. The property owner appealing the Board of Assessors' decision has three months from either the date of the decision (or three months from the date the original application is deemed denied due to inaction of the local Board of Assessors) to file the appeal with the ATB.
16. G.L.M. c.59, §64 as amended through St. 1982, c.653, §6 and G.L.M. c.59, §65. The rather recent case of *William B. Rice Eventide Home, Inc. v. Board of Assessors of Quincy*, 69 Mass. App. Ct. 867 (2007), outlines this jurisdictional *sine qua non* in greater detail. In order to success-

fully invoke ATB jurisdiction, the amount of tax not less than the average assessed tax, less abatements, if any, during the immediately preceding three-year period preceding the year at issue may be deemed to be the amount of tax due. However, if there is a year where no tax was due within that three-year period, then the full amount of tax due, without interest, must be paid in order to preserve appeal rights with the ATB.

17. G.L.M. c.59, §65B provides that where the appellant has timely paid at least half of the amount of required tax and successfully demonstrates the inability to pay the full amount, the appeal may be allowed to proceed. This demonstration is accomplished by filing a motion along with appropriate evidence of hardship and if the motion is successful, the appellant must adhere to the terms of the resulting ATB order which, as G.L.M. c.59, §65B states in relevant part: "...may or may not require such petitioner to pay, in whole or by installments, the amount of the tax remaining unpaid, as a prerequisite to any hearing on the merits of the appeal."
18. *Judson Freight Forwarding Co. v. Commonwealth*, 242 Mass. 47, 55 (1922). See *Schlaiker v. Board of Assessors of Great Barrington*, 365 Mass. 243, 245 (1974); *Foxboro Associates v. Board of Assessors of Foxborough*, 385 Mass. 679, 691 (1982). This ATB presumption was

recently invoked in the recent ATB decision in *Columbia Electric Corp. v. Board of Assessors of the Town of Framingham*, where the ATB opinion, taking from the *Schlaiker* decision, stated in relevant part that the ATB "... is entitled to presume that the assessment is valid until the taxpayer sustains his or her burden of proving otherwise Accordingly, the burden of proof is upon the taxpayer to make out his or her right as a matter of law to an abatement of the tax." *Columbia Electric Corp. v. Board of Assessors of the Town of Framingham*, Nos. F268356, F273200 (Mass. App. Tax Board, June 26, 2006).

19. This was precisely the strategy successfully used by the Framingham assessors in *Columbia Electric*.
20. This shift in presumption is codified in the ATB rules at G.L.M. c.58A, §12A. This shift in presumption was recently used in *Hugh Coffman and Thomas Mulhern v. Board of Assessors of the Town of Brookline*, No. F275415, (Mass. App. Tax Board, Feb 15, 2006).
21. See *472 Main Street Realty Trust v. Board of Assessors of Wakefield*, 66 Mass. App. Ct. 1104 (2006); *Braintree Real Estate Management Company LLC v. Board of Assessors of Braintree*, 66 Mass. App. Ct. 1112 (2006). Both of these are unpublished opinions yet serve as prime examples of the great deference the Appeals Court will give to ATB decisions.



THE *KNIGHT* DECISION: THE “2 PERCENT FLOOR” APPLIES TO TRUST

By Lisa M. Rico

In a unanimous decision, the U.S. Supreme Court, in *Michael J. Knight, Trustee of the William L. Rudkin Testamentary Trust v. Commissioner of Internal Revenue*, 128 S. Ct. 782 (2008), has determined that deductions for investment advisory fees by a trust or an estate are subject to the 2 percent floor for miscellaneous itemized deductions pursuant to Internal Revenue Code section 67(a) if such fees would have been incurred if the property were not held in a trust.

Background

Section 67

Code section 67(a) provides that miscellaneous itemized deductions for any individu-

al's taxable year shall be allowed only to the extent the aggregate of such deductions exceeds 2 percent of the adjusted gross income of the taxpayer. All deductions for individuals are considered miscellaneous itemized deductions except for those deductions described in code section 67(b). Accordingly, miscellaneous itemized deductions include, but are not limited to: (1) itemized deductions other than interest deductions; (2) deductions for taxes; (3) certain casualty, theft and loss deductions; (4) charitable deductions; and (5) deductions for medical and dental expenses. Pursuant to code section 212, investment advisory fees are miscellaneous itemized deductions for individual taxpayers. As investment advisory fees are not excluded from the definition of miscellaneous itemized deductions, they are subject to the 2 percent floor of code section 67(a). See Treas. Reg. section 1.67-1T(a)(1)(ii) (1988). Code section 67(e) provides that code section 67(a) applies to miscellaneous itemized deductions of trusts or estates. Code section 67(e)(1) articulates exceptions to the applicability of section 67(a) to miscellaneous itemized deductions of estates or trusts if two requirements are met. First, the deduction for costs are paid or incurred in connection with the administration of the estate or trust *and* second, the cost would not have been incurred if the property were not held in such trust or estate.

Split among the circuits

Prior to the Supreme Court's decision in the Knight case, the Circuit Courts of Appeals have been split on the issue of whether investment advisory fees incurred by a trust or estate are subject to the 2 percent floor.

The Court of Appeals for the Sixth Circuit, in *William J. O'Neill, Jr. Irrevocable Trust v. Commissioner*, 994 F.2d 302 (6th Cir. 1993),

concluded that because a trustee has a fiduciary duty to invest and manage trust assets as a prudent investor would manage his own assets, the investment advisory fees are necessary to the continued growth of the trust. Therefore, a trustee that incurs investment advisory fees on behalf of a trust may fully deduct those fees and is *not* subject to the 2 percent floor for miscellaneous itemized deductions. The Sixth Circuit in *O'Neill* stated that unlike a trustee, individuals may consult investment advisors, but are not required to do so and suffer no penalties or potential liability if they act negligently. Accordingly, the Sixth Circuit held that investment advisory fees were incurred because the property was held in trust and would not have been incurred if the property had not been held in trust. The *O'Neill* decision reversed the Tax Court, which held that investment advisory fees were costs deductible by the trust subject to the 2 percent floor of Section 67(a). The Tax Court determined that Section 67(e) applies only to those expenses which are unique to the administration of an estate or trust and investment advisory fees are not unique to the administration of a trust because individual investors routinely incur costs for investment advice.

In contrast to the Sixth Circuit, the Court of Appeals for the Federal Circuit, in *Mellon Bank, N.A., et al v. U.S.*, 265 F.3d 1275 (Fed. Cir. 2001), concluded that investment advisory fees were subject to the 2 percent floor for miscellaneous itemized deductions and that the section 67(e) exception was not available. The Federal Circuit, in interpreting the second requirement of section 67(e) (1) focused not on the relationship between the trust and the costs, but instead focused on the type of costs and whether those costs would have been incurred even if the asset were not held in a trust or estate. The second requirement allows a deduction for only those trust-related administration expenses



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es that are unique to the administration of a trust and not customarily incurred outside of trusts. Since the Federal Circuit Court of Appeals determined that investment advice and management fees are commonly incurred outside a trust or estate and that an individual taxpayer, not bound by a fiduciary duty, is also likely to incur these type of expenses when managing its own assets, investment advisory and management fees are not exempt from the 2 percent floor under Section 67(e)(1). The Federal Circuit Court rejected Mellon Bank's argument that the investment advisory fees were costs paid or incurred in connection with the administration of the estate or trust because they were incurred as a result of the trustee complying with its fiduciary duty. This court indicated that the costs resulting from a trustee's fiduciary obligations satisfies the first requirement of section 67(e)(1), but both requirements must be taken into consideration. An analysis that only took into account the first requirement would result in all incurred expenses by a trustee in connection with the administration of a trust being fully deductible.

The Court of Appeals for the Fourth Circuit, in *Scott v. United States*, 326 F. 3d 12 (4th Cir. 2003) agreed with the Federal Circuit Court of Appeals and concluded that because investment advice is commonly incurred outside of a trust, investment advisory fees incurred by a trustee were subject to the 2 percent floor for miscellaneous itemized deduction under code section 67(e).

The Court of Appeals for the Second Circuit, in *Rudkin Testamentary Trust v. Commissioner*, 467 F. 3d 149 (2nd Cir. 2006) held that because investment advisory fees were a type of expense that could be incurred if the property were held individually rather than in trust, the deductions of such fees by the trust were subject to the 2 percent floor. While the Second Circuit agreed with the Fourth and Federal Circuit Courts of Appeals, it disagreed with the statements regarding costs that are not customarily or commonly incurred outside of trusts being costs not subject to the 2 percent floor. The Second Circuit took a more restrictive view in concluding that the statute requires that it

must be determined with certainty that costs could not have been incurred if the property were held by an individual.

The Supreme Court grants certiorari

The petition to the U.S. Supreme Court for *certiorari* by the trustee of the Rudkin Testamentary Trust was granted to resolve the conflict among the circuit courts. The Supreme Court agreed with the approach taken by the Fourth and Federal Circuits, that costs incurred by trusts that are not subject to the 2 percent floor are those that would not "commonly" or "customarily" be incurred by individuals. The Supreme Court suggested the approach of looking to a particular type of cost and determining whether such cost would have been incurred if the property were held by an individual. Section 67(e)(1) excepts from the 2 percent floor only those costs that would be uncommon (or unusual, or unlikely) for such a hypothetical individual to incur. The Supreme Court then turned to determine whether investment advisory fees incurred by a trust are excepted from the 2 percent floor under section 67(e)(1). The trustee's argument was that he engaged an investment advisor to fulfill his fiduciary duties required by state law to follow the prudent investor rule. To satisfy this standard, the trustee must invest and manage the trust assets as a prudent investor would by considering the purposes, terms, distribution requirements and other circumstances of the trust. The Supreme Court noted that the standard looks to what a prudent investor with the same investment objectives would do while handling his own affairs: this standard considers a prudent individual investor not a prudent trustee. Accordingly, the Supreme Court held that it was difficult to say that the investment advisory fees would not have been incurred and that it would not be unusual or uncommon for an individual investor with the same objectives as the trustee to incur such fees. Therefore, the investment advisory fees in this case were subject to the 2 percent floor under section 67(c)(1). The Supreme Court did indicate that it is possible for a trust to have an unusual investment

objective, or require a special balancing of interest of various parties, such that a comparison with an individual investor would not be proper, in which case that portion of the investment advisory fee allocable to those expenses that are beyond what would normally be required for the ordinary taxpayer would not be subject to the 2 percent floor.

Proposed regulations

On July 27, 2007, prior to the Supreme Court's decision in the *Knight* case, the Internal Revenue Service issued proposed regulations with respect to code section 67 limitations on estates' or trusts' miscellaneous itemized deductions. The proposed regulations provide that only costs unique to a trust or estate are not subject to the 2 percent floor of section 67(a) under section 67(e)(1). The proposed regulations provide that costs are unique to a trust or estate only if an individual could not have incurred that cost in connection with property not held in a trust or estate. The proposed regulations went on to provide that where a trust or an estate pays a single fee for both costs that are unique to estates and trusts and costs that are not (i.e., a "bundled fee"), then the estate or trust must identify the portion of the bundled fee that is unique to estates or trusts and the portion that is not. The portion that is unique to trusts and estates would be fully deductible. The taxpayer must use a reasonable method to allocate the bundled fee between costs unique to trusts and estates and other costs.

After the *Knight* decision, the IRS announced in Notice 2008-32 that it would issue final regulations under code section 67 that are consistent with the Supreme Court's holding. The final regulations will also address issues surrounding bundled fees. For tax years beginning prior to Jan. 1, 2008, taxpayers will not be required to allocate a bundled fee between costs subject to the 2 percent floor and those that are not. For such taxable years, the taxpayer may deduct the entire bundled fee. Any fees paid by a trust or estate to third parties that are clearly identifiable as subject to the 2 percent floor must be treated separately from the bundled fee and be subject to the 2 percent floor.

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