



## REPORT FROM COUNSEL

## FALL 2008

### GET IT IN WRITING

When an Internet executive held a meeting with the chairman of a telecommunications company, the agenda was a new business idea that the Internet executive had. The discussion was transformed into a recruitment when the telecommunications executive suggested that the idea should be pursued within the company he headed. For two men in the upper echelons of hightech businesses, they then chose a decidedly lowtech way to memorialize their agreement. The end result, however, shows how substance can sometimes triumph over form in the law of contracts formation.

At the end of their meeting, the telecommunications executive simply wrote out the agreement by hand on two notebook pages, and both men signed it. The writing included specifics as to how the newly hired executive would be compensated, the terms on which he could quit if he became unhappy, and what would happen if intellectual property involved in the deal could not be transferred to the telecommunications firm. It also included the statement that “[t]he parties will complete formal contracts as soon as possible but this is binding.” This would turn out to be pivotal language in the litigation that followed.

Unfortunately, the new arrangement quickly went downhill, and after about six months the new employee was fired. The relationship ended with the “formal contracts” never having been drafted and executed. When the former employee sued for breach of contract and other wrongs, more than six years of litigation ensued, with two trials and two appeals.

Much of the case focused on whether the handwritten agreement that started everything was a valid, binding contract. The telecommunications company argued that it was merely an “agreement to agree.” However, a jury eventually ruled that the agreement was valid, and that the telecommunications firm had breached the terms of the contract represented by the two notebook pages.

Four factors are usually considered in determining whether a “preliminary agreement” is binding. In this case, the first two clearly favored the fired executive: There was no explicit reservation of a right not to be bound (in fact, the handwritten agreement said the opposite) and the executive had partially performed the contract. The third factor is whether all of the terms of the alleged contract were agreed upon. On that point, the agreement, although it may have lacked some details, addressed all of the essentials for a binding contract.

The final factor is whether the agreement was a type of contract that is usually committed to writing in a formal manner. When millions are at stake, as was the case here, it may be unusual to seal the deal with a handwritten document, in outline form, and drafted on the spot by one of the principals without benefit of legal counsel.

The agreement was not much to look at, barely surpassing in formality the proverbial agreement scribbled on a cocktail napkin. Still, that it was unorthodox did not mean that the method was unprecedented. In the end, this factor, balanced against the other three, was not enough to discard the agreement and deprive the departed executive of the benefits of his bargain.

### **EMPLOYERS: DON'T LET TIPS TRIP YOU**

Employers in service industries are well advised to pay close attention to their practices and policies affecting customers' tips for their employees. There are a variety of ways in which missteps can run afoul of federal or state laws, including the federal Fair Labor Standards Act (FLSA).

Employees might contend, for example, that the employer is effectively reducing their tip income by imposing various fees or other charges on customers. Or, contrary to a requirement in the FLSA, employees who are paid less than the minimum wage might not be getting enough in tip income to make up the difference between their hourly rate and the minimum wage. Recent cases in the news involved yet another alleged violation, sometimes taking place on a very large scale, where employees are made to share tip income with fellow employees who supervise them.

In one of the tipsharing cases, a state court ruled in favor of a class of plaintiffs consisting of baristas, or coffee counter servers, whose tips were required to be shared with their shift supervisors, in violation of state law. Change left for tips apparently adds up, as the judgment for the tens of thousands of servers, for about an eightyyear period, topped \$100 million, including interest.

The case was not cutanddried, as the supervisors were themselves hourly workers who had customer service duties in addition to the responsibility of scheduling workers and giving directions to the baristas. It was not a case of highly paid bosses dipping into the tip jars filled by customers they never saw in person.

When a shift supervisor hands a customer his latte and muffin, and the customer responds with a tip, the customer may assume that the money, or at least part of it, goes to the supervisor. Instead, under the ruling, the supervisors must now keep their hands off the tips, and the employers must ensure such an outcome.

In the wake of this case, similar lawsuits have been filed against the same employer, a national chain, and against other employers in other states. Companies in the restaurant, hotel, gaming, transportation, and delivery businesses face the largest risks for mishandling the treatment of tips. There is another pending case in which casino dealers have complained that an employer's new policy illegally requires them to share tips with floor supervisors.

The legal issues surrounding the treatment of tips are murky enough in any one state, but further complicating the matter is the fact that there are variations among the states and between the statutes for a state and for the federal government. This makes it especially risky for national employers to assume that a onesizefitsall policy on tips will be sufficient for all of their locations.

“Backroom personnel, shift supervisors, hostesses, greeters, drink servers, and other similar positions could be treated differently depending on what state

you are in. Employers should regularly assess their job descriptions and tipsharing policies against applicable state and federal laws. This kind of audit is useful not only for detecting or avoiding possible violations, but for laying the groundwork for a potential “goodfaith” defense under the FLSA if litigation ensues.

### **LANDOWNER GETS SETTLEMENT FOR “TAKING”**

When the government takes aim at private property to be taken for some public purpose, more often than not any resulting litigation is a contest over how much the property owner should be paid, rather than whether the exercise of the power of eminent domain was appropriate in the first place.

From the landowner’s standpoint, it is important to realize that adequate compensation is not determined simply on the basis of the current use of the property. Instead, the landowner is entitled to the value of the property based on its “highest and best” use (whether that use already exists or is only in the eye of a developer), so long as such a potential use is not too speculative or otherwise foreclosed by applicable laws and regulations.

The importance to a property owner of negotiating compensation on the basis of a bestcase, but realistic, development scenario for the property is illustrated by a recent case in which the owner of a vacant, 22,000squarefoot lot settled with a town for compensation in an amount that was about 27 times higher than the amount initially offered by the town.

The lot was zoned for residential use, although at the time of the condemnation action the owner had no building or development plans. Appraisers hired by the town offered an opinion that the vacant lot’s best use was only as open space, or as a buffer for an abutting lot. They reasoned that compliance with the town’s lot area and frontage requirements, as well as with its road standards for improving the dirt road on which the lot was located, would be so burdensome as to make any development of the property prohibitively expensive. They also indicated that extensive development costs would preclude development even if the lot was considered to have grandfathered status that would protect it from certain town requirements.

For its part, the landowner retained experts who opined that the lot was, in fact, suitable for residential purposes and should be valued as such when arriving at a compensation figure for the taking. As the town’s experts had noted, there were various requirements on the books that, in theory, could be costly to comply with. However, an examination of past rulings by the town’s zoning and conservation officials showed that the lot was likely to be exempted from some of the requirements. Moreover, improvement of the dirt road, which would have been an especially big-ticket item, was not likely to be required.

Both sides were necessarily looking into the future to some extent, but the landowner was able to depict a scenario for the lot that was optimistic enough to bring about a favorable monetary settlement with the town.

## CYBER INSURANCE FOR BUSINESSES

Businesses have been dependent on computerized information for some time now, but it has been only relatively recently that insurance companies have devised and offered insurance policies specifically tailored to the potential losses from a variety of problems that can affect a computer system.

An early impetus for cyber insurance was anticipation in the late 1990s of losses associated with the coming of “Y2K.” That concern turned out to be overblown, but the threats that have spurred cyber insurance offerings since then are real enough, including viruses, hackers, and legal injuries to others from information on a company’s website. One study has found that the average annual technology-related financial loss for United States companies more than doubled just from 2006 to 2007.

Another development that prompted more cyber insurance policies was the realization, which sometimes came as a surprise to insured businesses, that general liability policies did not cover computer problems. Cyber insurance is a good idea for all of the usual reasons associated with insuring against business losses. But it also makes sense because of the particular costs associated with responding to a computer data breach, especially now that many states have adopted data breach notification laws.

This kind of postmortem after a breach could include such measures as notifying affected customers, paying for credit monitoring for those customers, replacing compromised credit or debit cards, and undertaking forensic analyses of affected databases. All in all, there are some expensive scenarios to insure against.

### Categories of Losses

The losses covered by cyber insurance generally fall into two categories: firstparty losses, meaning those affecting the business itself; and thirdparty losses, meaning incidents mainly affecting outside parties, including the customers of a business. Of course, the same underlying problem can cause both kinds of losses, such as when unauthorized access to a computer system shuts down the computer system of a company whose customers or clients rely on that system through an extranet.

A comprehensive cyber insurance policy should encompass both kinds of risks. These are the typical categories of coverage:

- Firstparty business interruption, covering lost revenue experienced during downtime due to accidents or security breaches (but typically not losses due to catastrophic regional power outages);
- Firstparty electronic data damage, such as the compromise of data from a virus infection;
- Firstparty extortion, including the demands made by hackers;
- Thirdparty network security liability, arising from compromise and misuse of data stemming from identity theft and creditcard fraud;
- Thirdparty network liability in the form of court judgments obtained by persons harmed by problems originating with a business’s computer system; and
- Thirdparty media liability, aimed at the full range of potential liability from matter published in interactive online communications.