LEGAL UPDATE
CLIENT NEWSLETTER OF
CARR, MORRIS & GRAEFF, P.C.

1120 G STREET, N.W., SUITE 930 WASHINGTON, D.C. 20005-3801 (202) 789-1000 APRIL - MAY 2003

WAGE HOUR
SNOW DAYS – MUST THE EMPLOYEE BE PAID?

As we approach Summer, it is hard to think about snow. However, not too long ago, many of us were dealing with more snow than we knew what to do with. Large snowfalls closed many businesses that had not been closed in recent memory for weather related reasons. Businesses were forced to ask, "Do we have to pay employees for days we were closed or on days we were open but the employee did not report to work?"

Hourly employees, those employees who are not exempt from the overtime requirements of the Fair Labor Standards Act ("FLSA"), must only be paid for hours actually worked. Thus, the non-exempt (hourly) employee need not be paid when the business is closed for inclement weather or if the employee elects not to report to work because of inclement weather. The non-exempt (hourly) employee may, however, request to be paid in these circumstances by using accrued leave in accordance with the employer's leave policies.

Salaried employees, those employees who are exempt from the overtime requirements of the FLSA, may not suffer

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DAMAGES
D.C. COURT EXPLORES ISSUE OF LUXURY CAR DAMAGES

A topic that comes to us with remarkable frequency is the calculation and collection of money *damages* for property damage arising from automobile accidents. The issue is not typically the cost of repairs or whether a client's insurer should recognize the car as *totaled*. The issue is whether the client must take back a repaired car without additional compensation, that is, whether there is some recompense for the *diminution of value* of the car. Unquestionably, a car that has "been in an accident" is worth less than one that has not, and cosmetic body repairs do not address that loss.

That issue recently piqued the scholarly interest of D.C. Superior Court Magistrate Judge Ronald Goodbread, who confronted a focused damages issue in the Small Claims case of *American Service Center v. Helton*, D.C.Sup.Ct.Sm. Cl. No. 8200-02 (Jan. 2003). Judge Goodbread completed exhaustive research of D.C. and regional precedent before concluding that the current state of the law in the District of Columbia limited an accident victim to either repair costs or lost value, but not a combination of the two. He determines that D.C. stands alone in this narrow view, and—supporting his decision with a comprehensive review of trends in neighboring states—points the litigants to their appellate options.

The factual backdrop of *American Service Center v. Helton* is simple. Defendant, driving a rental car in Washington, caused an accident with an American Service Center customer test driving a *previously-owned* (*i.e.*, used) Mercedes. The rental car company's insurer paid for the body damage, \$5,900, but the car dealer brought suit nonetheless, seeking \$4,500 more for "lost value" damages. Defendant moved for summary judgment, arguing that under D.C. law Plaintiff's responsibility was satisfied by paying for the body repair.

The trial judge's examination led him to surprisingly little current and applicable appellate precedent. The most compelling D.C. case, *Knox v. Akowskey*, 116 A.2d 406 (D.C. 1955), recognizes alternative standards looking to (1) the difference in value of chattel immediately before and after injury, or (2) the reasonable cost of repair. Nothing in *Knox* or elsewhere suggests the remedies can be combined, so Judge Goodbread ultimately concludes he is bound to grant Defendant's motion for summary judgment.

The judge didn't stop there, though. At length, he explores the numerous issues and sub-issues presented by this seemingly simple problem. For instance, why is the analysis different when dealing with vehicles that are *totaled*? Is it significant that a car is new or used? Is it significant that the car—as in this case—is a *luxury* car? Does it matter whether the loss claimant is a car dealer? How are *market value* and *lost resale value* different? And shouldn't lost use (*i.e.*, the need for a rental replacement car) also be recognized as recoverable damages?

Looking to other courts, particularly Virginia and Maryland, and to the *Restatement Second of Torts*, Judge Goodbread concludes that D.C. precedent, especially *Knox*, is inadequate. He clearly sympathizes with the Plaintiff-dealer's quandary and thoroughly explains his ruling in order to facilitate an appeal. Whether the Plaintiff here will pursue appellate relief is unknown, of course; but, a business litigant might well value the cost of continued litigation over the goal of making "new law" in an interesting area. If there is no appeal, Judge Goodbread's opinion will at least serve as a thoughtful and thorough examination for future litigants.

LAWRENCE CARR

The articles in this publication are designed to give general information on the matters covered. Space limitations prevent exhaustive treatment or analysis of any topic. The articles are not intended to substitute for advice on specific legal problems.

CORPORATE

SARBANES – OXLEY WATCHDOG BOARD FACES TOUGH ISSUES

The Sarbanes-Oxley Act of 2002 constitutes one of the most sweeping pieces of securities and corporate regulation legislation in some time. The Act is lengthy and complex. We plan to provide our readers highlights of the Act as developments occur. For example, in the October-November 2002 issue of this publication one of our attorneys wrote about the whistleblower provisions of the Act. In this article we discuss the issues likely to be faced in the immediate future by the Public Company Accounting Oversight Board (Board) created by the Act. The Board has a broad mandate to register CPA firms, establish auditing standards, and enforce the securities laws with respect to audit reports on financial statements. A principal objective of the Act is to preclude the sort of accounting fraud that led to the financial scandals of the late twentieth century.

With this new legislation companies, their accountants, and attorneys will, in effect, be responsible to at least three public bodies: the Securities and Exchange Commission (SEC), the Financial Accounting Standards Board (FASB) and the new Board. In order to anticipate on what issues the Board is likely to focus in the months ahead we have compiled a list of the six practices that have been the subject of most SEC enforcement action over the past several years and briefly discussed what is at stake. These are areas where generally accepted accounting principles (GAAP) are not precise and are thus fertile ground for the "creative" accounting that the Board is supposed to rein in. Before we proceed it should be pointed out that the very lack of precision in GAAP has put companies, their accountants and lawyers in a difficult situation. Typically, a company that wants to show a good financial face to the world goes from *creative* accounting to *aggressive* accounting, at some point graduating to fraud. Unfortunately, there are few bright lines. It is hoped that this discussion will raise some red flags for the benefit of Chief Financial Officers.

The Big Bath. Right after new management takes over or at the end of a particularly bad year, management may be tempted to take a "big bath"—wholesale write-down of assets or accrual of liabilities to obtain a conservative balance sheet. The result is lesser expenses to drag down future earnings. During the first few years after taking a *big bath*, management can pat itself on the back to shareholders about spectacular financial results.

Income Smoothing. Some companies always report meeting earnings per share objectives down to the second decimal place. Usually the company is engaging in income "smoothing"—removing the normal fluctuations in profit by creating artificial reserves for bad years during good years. If a company is profitable and growing, there is nothing particularly sinister about income—*smoothing*. The problem is that income smoothing becomes like a drug, and the company might be tempted to try something more potent in the future, especially if profitability suffers.

Booking Bogus Sales or Recognizing Revenue Prematurely. This category generates more enforcement actions than any other. Booking false sales is, of course, *per se* fraudulent; but, there at least four more subtle ways to manipulate sales figures, and, by extension, profit figures: "bill and hold," that is, billing customers for products but holding the goods for later delivery; product shipment and revenue recognition in advance of an expected order; "channel stuffing" or shipment of product to distributors who are pressured to overbuy; and, side letters maintained outside normal reporting circuits which purport to clarify the sales agreement but effectively negate some of the terms. Premature recognition of service revenue is also a serious enforcement problem. Typically, the service provider books sales and profits before determining the full extent of services that will have to be provided in connection with the sale. In this area of financial reporting the only limit is the ingenuity of the person misreporting sales.

Aggressive Capitalization. By capitalizing expenses that should be deducted, expense recognition is postponed, thereby boosting current earnings. Sometimes companies capitalize certain marketing costs on the premise that the costs will be recovered from sales generated directly by the sales costs capitalized. When the sales fail to materialize the company is faced with a large write-down of capitalized marketing costs. The capitalization of software development costs continues to pose problems of definition which have not been resolved satisfactorily. Research and development (R & D) costs should be expensed currently because of the uncertainty in future benefits. Nevertheless, the SEC has a busy enforcement schedule in this area with companies that continue to capitalize rather than expense R & D costs.

Extended Depreciation and Amortization. This practice is the flip side of aggressive capitalization. A company typically stretches out the period to depreciate or amortize assets well beyond what is reasonable, thus showing higher profits during that extended period. In our fast paced economy when assets become technologically obsolete much before their useful lives are used up, this gimmick can result in large impairment charges in future years.

Miscellaneous. Because of space limitations we cannot discuss in detail each and every potential issue, but here we list some other areas which have caused problems for the SEC in the past: overvaluing assets, undervaluing liabilities, misrepresenting extraordinary items and discontinued operations, misleading pro-forma figures, inconsistent reporting of earnings and cash flows, understating pension costs, special purpose entity non-disclosure, off-balance sheet financing non-disclosure, and misreporting benefits of mergers and acquisitions.

The new Board has a great opportunity, in conjunction with the SEC and the FASB, to clarify standards *via* rule-making. Case-by-case adjudication is usually effective only after the fact. What companies, their accountants and lawyers need more than anything else is more precise guidelines which will save everyone the time and trouble of litigation. If the Board can achieve some degree of clarification of the effect of GAAP on auditing standards, the unfortunate accounting outrages of the past few years will not have been in vain. The Board may look for guidance no further than tax law. Whatever its demerits revenue legislation has the virtue of being relatively precise, not only with respect to other legal fields, but also with respect to GAAP. Please call Roy Morris or the author if you have any questions on this vital topic.

NÉSTOR CRUZ

EVIDENCE
COLLATERAL SOURCE RULE ADDRESSED BY D.C. COURT

Is a plaintiff entitled to recover the reasonable value of medical services rendered rather than the amount actually paid by the health insurance carrier?

Any court relying on or applying the so-called "collateral source rule" answers this question in the affirmative. The collateral source rule provides that if a plaintiff includes medical expenses in a lawsuit, the defendant is not allowed to introduce to a jury evidence of any reimbursements to the plaintiff by health or disability insurers or other source for losses resulting from an injury. The goal of the collateral source rule is to compensate the victim and prevent a tortfeasor from reducing the amount he owes by proving that the victim received benefits from a third party.

The question arises in medical malpractice or other cases where a plaintiff was injured and is seeking compensation for medical services provided to her. Should the amounts that are written-off be included in the damages award? For example, a patient may have actually incurred medical bills totaling $200,000 but the health care provider accepts $120,000 as payment in full from the insurance carrier. Therefore, the health care provider has written-off $80,000 in medical expenses. If applicable, the collateral source rule prevents the jury from hearing evidence of the fact that the insurance carrier paid $120,000 instead of $200,000 to the health care provider. If the plaintiff successfully makes her case, she stands to receive the full $200,000.

Conflicting views of the practicality of the collateral source rule abound. One theory, held by supporters of the rule, is that if courts ignore the rule and deduct the amount received by other sources from the amount of the damage award to be paid by the tortfeasor, some of the deterrence effect of tort liability is removed. In effect, the collateral source rule enables the court to hold a tortfeasor fully responsible for the damages he caused regardless of the fact that the victim has received some compensation from another source. Conversely, many argue that the collateral source rule gives an unfair benefit to the plaintiff or victim by allowing the plaintiff to double-dip or receive a double recovery. Under this theory a plaintiff should only recover the amount actually "incurred."

In a case of first impression, the District of Columbia Court of Appeals recently decided that the collateral source rule does apply in a situation where the plaintiff is seeking to recover medical expenses from a tortfeasor. *Hardi v. Mezzanotte*, 2003 D.C. App. LEXIS 140 (D.C. March 20, 2003). Thus, the plaintiff can recover the full amount of her actual medical bills, including the amount written-off by the health care providers. The D.C. Court of Appeals recognized that "[a] reason for the rule [the collateral source rule] is that a party should receive the benefit of a bargain for which he or she has contracted." In this D.C. case, the victim paid a private insurance carrier, and the court found that the agreement or contract between the victim and her insurance carrier was independent of the relationship between the victim and her doctors or health care providers. The insured should receive the benefit of paying insurance premiums, and the tortfeasor should not be able to deduct the amount paid by the insurance carrier from the amount he or she owes. The court held that the plaintiff was entitled to all the benefits resulting from her contract with her insurance carrier.

DANA THERIOT

WAGE HOUR
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reductions in pay if their employer is closed for inclement weather or if they fail to report to work because of inclement weather. Under most circumstances, the FLSA requires that all exempt (salaried) employees be paid a regular wage each pay period that is not subject to variation based on the quality or quantity of work (number of hours worked) during the pay period.

The United States District Court for the Central District of Illinois recently ruled in *Kennedy v. Commonwealth Edison Co.* that an employer may not require an exempt (salaried) employee to take leave without pay or take a deduction against accrued vacation leave for failing to report to work due to inclement weather. In *Kennedy*, the employer argued that it should be free to dock the employee's pay or require a leave deduction as the employee did not report to work for "personal reasons." The Court disagreed, relying on the U.S. Supreme Court's decision in *Auer v. Robbins*. In *Auer*, the Supreme Court held that an exempt (salaried) employee may not suffer a reduction in pay for absences due to sickness, which the Court characterized as an event "essentially out of the employee's control." Likening the employee's failure to report to work during inclement weather to being an absence due to sickness – an event beyond the control of the employee–– the Court in *Kennedy* ruled that a pay deduction or a reduction to the employee's vacation leave balances was not permissible as the inclement weather was also an event beyond the employee's control.

The employer's inability to deduct from the exempt (salaried) employee's pay or charge the leave to the employee's vacation accrual balance for absences due to inclement weather can be contrasted to the employer's options when the same exempt (salaried) employee elects to play golf on a spring day instead of reporting to work. While some golfers may claim that the urge to play golf on a spring day is *an event beyond the employee's control*, in fact, this day off is a day off for *personal reasons* and can result in a deduction in the employee's vacation leave accrual balance or a reduction in pay.

PHILIP SCHWARTZ

CARR, MORRIS & GRAEFF, P.C.

Carr, Morris & Graeff, P.C., was established in 1982 by the named principals–Lawrence Carr, Roy Morris and Stephen Graeff. It is a diversified firm structured primarily to meet the legal needs of businesses and their principals.

The firm strives to provide full service representation to its corporate and individual clients. It is designed to provide such service by organization and presentation of an array of attorneys with diverse backgrounds in specialized areas of the law as well as a generalized background which enables them to look beyond a narrow specialty or need. The academic and cultural backgrounds of the attorneys of the firm are as diverse as their experience and specializations.

Carr, Morris & Graeff, P.C., specializes in the following areas: Corporate/General Business; Taxation/Estate Planning; Civil/Commercial Litigation; Alternative Dispute Resolution; Employment/Labor; Discrimination; and Wage-Hour.

The firm maintains its office in the Metro Center region of downtown Washington. It has attorneys admitted to all of the local judicial jurisdictions–the District of Columbia, Maryland and Virginia.

STAFF NOTES

Congratulations. Very early in the morning of May 1, Tim Feely's wife, Terri, gave birth to the couple's third child—Andrew Robert Feely. Sisters Hannah and Caroline are pleased. Labrador Retriever (and previous favorite son) Reagan is perplexed but looks forward to diverse chow opportunities. *Proud father Tim insists his life won't change...sad but true.*

* * *

Margarita and Néstor Cruz spent spring vacation in and around London. Néstor ended our local drought by bringing the London weather back with him.

* * *

Easy Rider. Roy Morris returned safely from his motorcycle tour of the Southwest. Roy, as many know, has been an avid bicyclist since his college days. In the past few years, though, he has rapidly progressed through scuba diving, sport (BMW) motoring and into motorcycling. History would suggest that there should be a bigger, faster motorcycle on the near horizon...but what then? Office prognostication has identified several possibilities: bungee jumping, parachuting, big game hunting and soaring. A betting pool is forming.

* * *

Effective June 1, 2003, Col. Lawrence E. Carr III, U.S. Marine Corps Reserve, joins the ranks of the retired. Upon graduation from college in 1973, Larry was commissioned a 2d Lieutenant. After an initial active duty tour in Quantico, Virginia and Camp Pendleton, California, Larry continued a varied career in the reserve component. Primarily in combat service support billets, Larry served in units in Indiana, Virginia and the District of Columbia. Highlights included two-year command tours as a company commander, staff group Officer-In-Charge and Battalion Commander.

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