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# THE HOWE & HUTTON REPORT

ANALYZING LEGAL NEWS OF IMPORTANCE TO THE NONPROFIT COMMUNITY

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## THE LAW FIRM FOR ASSOCIATIONS®

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**\$30 MILLION EMBEZZLEMENT BY DIXON, IL CFO – SAME OLD STORY** – The people of Dixon, Illinois, a small town about 100 miles west of Chicago, were stunned to learn that its long-time comptroller and treasurer has allegedly embezzled \$30 million from the city's bank accounts. That's quite a haul considering the town's budget is about \$9 million a year. A professor at nearby Northern Illinois University in its government affairs program commented, "The biggest mistake you can make in any kind of organization that deals with money is to have one person that controls everything, and that's what they have in Dixon." *Yep, and this embezzlement was missed by the town's auditors, its bank, its mayor, the city council, and the state comptroller. Hard to believe no one noticed the equivalent of more than three years' funds was missing. Dixon unfortunately did not pay heed to the words of Ronald Reagan, its most famous native son: "Trust but verify!" How many times do organizations have to hear this message?*

**GSA SAYS IT HAS CANCELLED 35 ALREADY-PLANNED CONFERENCES** – The GSA Acting Commissioner is attempting to put out the firestorm over the GSA "employee training conference" in Las Vegas in 2010 which cost some \$823,000 and reportedly included skits lampooning restrictions on government spending. Heads have rolled in the wake of this conference and other wasteful spending in violation of GSA rules. *You have to ask about the cancellation fees incurred with these cancellations, or do government meeting contracts not have such cancellation fee provisions?*

**HERE IS A USEFUL TRAVEL TIP** – A professional photographer offers the following travel suggestions. In addition to the usual advice about having identification inside and outside your bags and other tips, he suggests using your cell phone camera to take picture of baggage receipts, including the barcode, just in case the receipts are ripped off the baggage during your trip. He also mentioned having bags of some color other than basic black so they are easier to spot, and using colored tape rather than ribbons or straps to differentiate your bags. *It might also work for identification documents so you have a copy while traveling, but make sure you keep track of your cell phone if you use this suggestion.*

GOOD READING ... See you June

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## NOT-FOR-PROFIT LAW DEVELOPMENTS

**UAE SHUTS NONPROFIT, DETAINS STAFF – *H&H Report Update*** – The government of the United Arab Emirates recently shuttered the Dubai offices of the American-financed nonprofit National Democratic Institute, briefly detained its American director as she tried to leave the country, and took its deputy director, a Serbian national, into custody, all just prior to Secretary of State Hillary Clinton’s visiting the country to strengthen security ties. No explanation has been offered for the UAE government’s actions, and there is no word on how long the deputy director will be held. The Institute was one of several nonprofits promoting democracy that were earlier subjected to a government crackdown in Egypt. *The timing of the events in the UAE make them look like a slap in the face for the U.S. Here we go again. Americans serving nonprofits that operate overseas should keep in mind that they can expect only so much support from our government if their activities arouse the ire of local officials.*

**NONPROFITS GET PARTIAL BREAK FROM TRUSTEE “CLAWBACKS”** – In several recent highly publicized cases, criminals have donated millions of dollars to charity and then gone bankrupt, leaving court-appointed trustees to try and “claw back” their contributions from charities in order to repay victims of the criminals’ fraudulent schemes. Now, the Governor of Minnesota has signed a new state law that will give charities some relief from such efforts, making charities liable to repay money unwittingly received from criminals only to the extent a “clawback” demand is made within two years after the charities receive contributions. The new law arose from a case in which several criminals made as much as \$425 million dollars in charitable contributions with “dirty” money. *Statutes of limitations have previously limited the time bankruptcy trustees have for “clawing back” money. But the new law in Minnesota cuts the time allowed for making a clawback demand in that state by two-thirds, provided charities have received donations without any “guilty knowledge” that the contributions were made with ill-gotten gains. Such legislative relief will be welcomed by charities that have been required to disgorge money they unknowingly received from criminal enterprises and then spent for their charitable purposes.*

## INTELLECTUAL PROPERTY & COMPUTER LAW DEVELOPMENTS

**CONVICTION FOR STEALING PROPRIETARY CODE REVERSED** – A federal appellate court in New York summarily reversed a defendant’s conviction for stealing proprietary high-frequency trading code protected as a trade secret from Goldman Sachs in New York and taking it to a startup high-frequency competitor in Chicago, moving from a \$400,000 salary to \$1,000,000 per year. The theft was accomplished by downloading the proprietary code to a server in Germany, then to the defendant’s home computers, and thereafter onto a flash drive and laptop computer he took to Chicago. He was arrested by the FBI when he returned home to New Jersey. He was charged and convicted in a jury trial under the National Stolen Property Act (“NSPA”) and the Economic Espionage Act (“EEA”). The appellate court reversed, finding the NSPA required a “stolen” “good” and while the code was stolen intellectual property it was not a tangible good, therefore the NSPA was not violated. Similarly, the trade secret must be related to or included in a product produced for or placed in interstate commerce. The court reasoned the EEA was not violated because the trading code was not intended to be related to or included in a product sold in commerce. *The concern for owners, including associations, with proprietary software is that an employee (or someone else) may successfully avoid prosecution under the NSPA or EEA so long as the theft is not accomplished using a tangible device such as downloading to a thumb drive or photocopies as the first step in the theft process. This should not be the end of this theft story as state criminal theft laws may apply, and the owner may sue for breach of contractual confidentiality, copyright infringement and plain old theft of intellectual property. Many laws have not kept pace with the digital age as this theft demonstrates.*

## EMPLOYMENT LAW DEVELOPMENTS

**FRANCHISE RESTAURANT AND OWNER LIABLE FOR MANAGERS' ACTS** – The federal appellate court in Chicago affirmed a jury verdict and compensatory and punitive damages against a franchise restaurant and its sole shareholder-owner in favor of two young female employees who had been sexually harassed by one of the restaurant's two assistant managers. The teenage servers had both complained about the misconduct to the other assistant manager and then to the general manager of the restaurant. Their complaints were ignored. Months later a district manager higher in the restaurant franchise system investigated, then fired the general manager and assistant manager who had ignored the complaints (the other manager who caused the problem had quit by then). The restaurant and its owner (of 21 franchise restaurants) argued there was a sexual harassment and diversity policy in place, and they had responded as soon as they were aware of the problem. Not good enough responded the court, noting the assistant manager who had failed to respond to complaints was responsible for training employees and had not been trained about harassment; the next level of management had also ignored the complaints; the complaint procedure was not made known to employees; and the delay in responding was simply too long. *It is not enough to have a policy in place. Employees have to be trained regarding the policy, a complaint procedure needs to be made known to employees, and complaints must be promptly and thoroughly investigated. And beware retaliation against those who complain or you have a second and potentially greater liability to deal with.*

## REGULATORY LAW DEVELOPMENTS

**“SUE AND SETTLE” IS THE BACKDOOR TO EXPANDING REGULATIONS** – How many times have we noted in passing that a federal agency has been sued by some group seeking an expansion of regulations by the agency, claiming the agency should have ruled more quickly, ruled more comprehensively, ruled differently? This has been most noticeable in the environmental area but this approach is not exclusive to environmental regulations. The federal agencies sued often settle, caving to the demands of the plaintiffs. The settlements essentially backdoor the regulatory process by excluding nonparties, who may also have a stake in the outcomes, as the lawsuits are between the plaintiffs and the agencies. Frequently targeted agencies include but are by no means limited to the Environmental Protection Agency, Interior Department, Transportation Department, Agriculture Department, Defense Department, and Army Corps of Engineers. And if the agencies do not settle, they still face the injunctive powers of federal judges who are not reluctant to order federal agencies to revise, speed up, delay, or otherwise direct regulatory activities. *Wait and see what comes out of the Dodd-Frank and other financial laws passed last year, and what will come out of the Patient Protection and Affordable Care Act of 2010 regulations and the regulations implementing that 2,500-page legislation. They are litigants' dreams come true. If you can't get it in the law, sue to get it in (or keep it out of) the regulations interpreting the law. It's the American way, don't you know.*

**POSTAL UNION PROPOSES ITS OWN RESCUE PLAN TO USPS – H&H Report Update** – The National Association of Letter Carriers, the postal workers union, hired a high-priced consultant to prepare a rescue plan for the U.S. Postal Service. Without substantial cuts in services, facilities and workers, the USPS warns it will soon simply run out of money. The union acknowledges a need for some limited cutbacks without being specific but says reduction of services, facilities and workers envisioned by the USPS will mostly lead to more revenue losses. The union and Congress say they favor running the USPS on a more businesslike approach. The union calls for an increase in postage rates, opposed by business mailers. *Well, businesses hemorrhaging cash often try to reduce services, facilities and workers, but the union balks at worker layoffs and Congress says don't close facilities in my district, don't cut Saturday deliveries, and continue mail service to every home in America. So exactly how is the USPS supposed to become more businesslike?*

## **LIGHTSQUARED VS. GPS REGULATORY BATTLE OVER FOR NOW – *H&H Report Update*** –

The Federal Communications Commission (“FCC”) had previously greased the wheels to facilitate the adoption of communications technology of a company called LightSquared which promised lower-priced and more comprehensive telephone service utilizing a slice of the airwaves frequencies sold by the government. The technology was based on signals routed via satellites to phones, opening up service to unserved and underserved rural and low population areas throughout the country, and offering competition to AT&T and Verizon. Regulatory approval of the technology appeared certain as the FCC gave early and vocal support to the company’s permit applications. The company founded by billionaire Philip Falcone appeared to have all its ducks in a row for a major success until questions were raised regarding its impact on GPS technology used for navigation, air control, by farmers, in cars and phones, and a myriad of other applications, including military applications. The problem was GPS signals are very weak and the LightSquared signals were much stronger, and they use very close frequencies on the airwaves spectrum. After two years of testing, the FCC has reluctantly concluded that the incompatibility of signals is too great a hurdle for now. *Mr. Falcone is understandably outraged as his \$4 billion investment is for naught, at least for now, and LightSquared appears headed for bankruptcy court but the GPS user community will sigh with relief. Too many depend on GPS to take a chance on assurances the incompatibility problems can be solved. Come back when they are, Phil.*

## **TAX LAW DEVELOPMENTS**

### **LATEST FROM IRS ON DEDUCTIBILITY OF EXPENSES FOR LOCAL LODGING** –

The Internal Revenue service has proposed regulations relating to the deductibility of local lodging expenses when not traveling away from home. In general, employees’ expenses incurred for local lodging and meals are regarded as personal expenses by the IRS. Thus if the employer reimburses the employee for such expenses and claims them as a deductible business expense, they are additional taxable income to the employee. If the employee pays such expenses and they are not reimbursed by the employer, they are regarded as nondeductible personal expenses by the IRS. But the proposed regulations clarify this is not always the case. The IRS distinguishes between reimbursement for or direct payment of local lodging as additional compensation to avoid a long commute or because the employee has to work overtime compared to paying or reimbursing for local lodging on a temporary basis to enable an employee to attend a business meeting, or training, or similar activities directly tied to the employer’s business. *The IRS says the proposed regulations are intended to clarify the deductibility of local lodging expenses, and supersede IRS Notice 2007-47. They are basically in line with what associations already do so this should not require changes in expense procedures. The proposed regulations are open to public comment for 90 days, and Notice 2007-47 is “obsoleted” [IRS terminology] now. Anticipate the clarified regulations will be effective at the end of July.*

### **FOLLOWING TAX FORM INSTRUCTIONS IS “OPTIONAL”** –

The Internal Revenue Service has announced that following certain instructions on Form 990 and Form 990-EZ is “optional” for the tax year 2011 when exempt organizations are reporting their interests in joint ventures and other partnerships to the IRS. The instructions tell such organizations to value their interests by using the information on the Form 1065, Schedule K-1, that is supposed to be provided to the nonprofits by the partnerships. But comments received by the IRS have convinced the IRS that organizations might be able to value partnership interests more accurately and with less of a burden if they use their own books and records in the valuation process instead of the data provided on Form 1065, Schedule K-1. *So, for tax year 2011 anyway, the IRS says it will let tax-exempts report partnership interests valued on the basis of their own books and records or the information provided on Form 1065, except for those organizations required to complete Form 990 Schedule H and Schedule R, which must use information from Form 1065, Schedule*

*K-1 in filling out those two schedules of the Form 990. We hope readers have all of this straight in their minds, especially since May 15 is the deadline for organizations with December-end fiscal years to file their Form 990s and Form 990-EZs or utilize an extension for filing. It's good that the IRS recognized that it may have made a mistake with the original tax form instructions. Confessing misjudgments is not a common attribute in D.C.*

## MEETINGS & TRAVEL LAW DEVELOPMENTS

**THERE'S GOOD NEWS AND BAD NEWS** – The Chicago Visitors and Tourism Bureau reported good and bad news regarding tradeshows and meetings at McCormick Place in Chicago for 2011. Business was up in the number of conventions and tradeshows there but down in overall attendance, revenues and number of meetings. *Overall it is a mixed report with reasons for smiles and frowns. After too long a period of uncertainty regarding union work rules and costs that finally led to a labor agreement in late 2011, McCormick representatives may find it easier to promote McCormick's features and central location but also face a lot more competition from other venues large and small around the country. High costs and onerous work rules drove a lot of business away and recapturing it is a much tougher sell now.*

**HOTELS FACE FREE BREAKFAST-BUFFET CRASHERS** – It is not just a rumor or urban myth. Hotels do have to contend with persons posing as registered guests and taking advantage of free breakfast buffets offered to guests. The problem is said to be worse if the breakfast buffet is at street level and visible to passersby. Hotel managers have learned to spot the breakfast buffet crashers and have devised various means to deal with them, including politely asking them to leave or pay a fee for their meal. *Hotel staffers tread carefully because as one GM put it, "We are in the hospitality business." The things people do....*

## OTHER ISSUES, TRENDS & DEVELOPMENTS

**PUNITIVE DAMAGES DENIED IN TWO TRAFFIC ACCIDENT LAWSUITS** – What distinguishes the two court decisions from Pennsylvania is that both involved the defendant using or allegedly looking at a cellphone when the accidents occurred. Despite laws prohibiting handheld cellphone use while driving, including texting, the two judges denied punitive damages, ruling the defendants' conduct was not egregious enough to warrant punitive damages. *That conclusion is certainly open to debate. Here we have the defendants knowingly violating a state law intended to deter the very conduct alleged to have been the primary cause of the accidents, but this does not seem serious enough misconduct to warrant punitive damages to two judges. With punitive damages being routinely granted in cases where the underlying cause is negligence, not statutory misconduct, you have to wonder.*

**ARIZONA IMMIGRATION LAW AT THE U.S. SUPREME COURT** – While the U.S. Supreme Court hears arguments from the U.S. Solicitor General to overturn Arizona's law authorizing local law enforcement authorities to essentially enforce federal immigration law by asking detainees about their immigration status and notifying federal immigration officials if a detainee is in the U.S. illegally, Senator Charles Schumer (D.-NY) is conducting a hearing asking the Arizona state senator who authored Arizona's law the basis for taking on the immigration issue, and declaring if the Supreme Court upholds Arizona's law Congress will preempt it. *Arizona's responded it is enforcing federal immigration law, not superseding it. Five other states have laws similar to the Arizona law. Federal immigration enforcement is "nuanced," i.e., sometimes enforced, sometimes not, but Arizona and a number of other states are heavily*

*impacted by such nuanced enforcement which is not provided for by current federal law. Perhaps Senator Schumer's time would be better spent on a federal immigration law rewrite. Meanwhile, our advice to employers is check those job applicants' I-9 forms and supporting documentation carefully to avoid potential problems from federal and state regulators.*

**FACTOR THESE TRENDS INTO YOUR HEALTH COST PLANNING** – Two recent polls indicate the number of Americans getting their health insurance through their employers continues to decline, most recently down to just over 44% in 2011. Another trend is that those without health insurance continues to rise, over 17% now. Several factors are at play here. Even as the U.S. economy slowly improves, the number of employed is rising more slowly, and we are still several million fewer workers than in 2008 before the current downturn began. Laid off workers, especially the long-time unemployed, are finding health insurance whether through COBRA continuation or other coverage to be unaffordable. State and local governments continue to shed employees as their budgets tank even as the private sector slowly improves. Many employers are relying more on temporary workers, most of whom do not receive full benefits such as health coverage, and some employers looking to cut costs are trimming or eliminating health care benefits. *All these factors are at play as the U.S. Supreme Court works through its decision-making process on upholding or rejecting the 2010 health care overhaul enacted in bitterly partisan fashion and fought over ever since. Employer uncertainty over what the Court will decide and what comes after are other deterrents to hiring and providing health care benefits. No matter how the Court decides in the next three months, health costs will continue to increase and employers and employees will struggle with affordability and availability issues.*

## H & H DEVELOPMENTS

In May ...

Nathan Breen presented “Event Contracts and Negotiation Strategies” in Las Vegas at an appointment-only trade show designed specifically with a corporate meeting planner’s needs in mind.

Barbara Dunn presents “Surviving Social Media” for a major association’s 2012 Annual Association Law Symposium in Chicago Illinois.

Naomi Angel presented “Managing Risk in the World of Social Media” to an international association meeting in Las Vegas, Nevada.. She also presented “Legal Issues Affecting Emerging Technologies” to a joint Gulf States meeting of two associations in Baton Rouge, Louisiana.

Gerard (Jerry) Panaro presented “Continuing Education Series in Nonprofit Financial Management: Avoiding Pitfalls with FLSA Compliance and Employee Timekeeping” in Washington, D.C. for a group of certified public accountants and consultants.

Jonathan Howe presents “Lions and Tigers and Bears – Oh My – Surviving in Tough Economic Times” for the local chapter of a major association meeting in Rhode Island.

**Contributors to this issue...**

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