

Strategies for Defensive Record Keeping

ANY MANAGER OR DIRECTOR of a corporate entity probably understands that involvement in the occasional litigation is the cost of doing business. Additionally, high-profile cases involving destruction of documents, such as the one that brought down Arthur Anderson in the wake of the Enron scandal, highlight the need for an effective document retention policy. What officers and directors may be less clear on are the array of missteps that can expose them to liability and expense, as well as the full complement of strategies that can protect them.

Statutory requirements

State and federal statutes impose hard-and-fast rules regarding retention periods for certain types of documents; an effective document retention policy will include the statutory requirements for every type of document addressed in these statutes. What is important to note here is that some of these requirements can be remarkably esoteric. For example, in New York, registered investment companies declaring abandoned shares must retain all notices they sent to the interested shareholders for a period of five years after the end of the calendar year in which the shares are declared abandoned. Obviously, destroying these types of documents before the statutory period expires exposes corporate officers to sanctions for spoliation of evidence. However, the simplicity of these statutory requirements may

be deceptive; there are situations where the prudent course is to retain such documents for longer periods than those required by the statutes, so the statutes are best regarded as setting baselines, not deadlines.

Statute of limitations

Another type of statute that should be considered in forming a document retention policy is the statute of limitations. Corporate officers should be aware of the length of time a potential litigant has to bring suit against them for a particular type of grievance, and they must retain documents relating to that grievance for *at least* that period. Extreme care should be taken to consider all the different causes of action that a potential litigant may be able to bring based on his or her grievance, as well as any special exceptions to a particular statute of limitations. For example, in New York, the statute of limitations for a personal injury action is three years, and so it may be tempting to dispose of accident reports after that period has elapsed. However, under certain specified circumstances, the emergence of new scientific knowledge that may help to ascertain the cause of symptoms after the statutory period has elapsed, as well as late-occurring symptoms, can both extend the three-year period. Ignoring these potential extensions of the statute of limitations could leave a corporate defendant with no documents to support its side of the story.

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Destruction in anticipation of litigation

A good document retention policy must take into account the responsibility of the company to retain documents that relate to a reasonably anticipated litigation. This goes beyond the routine retention of litigation-sensitive documents, such as the accident report mentioned above, that may aid a corporate defendant; it is, rather, a positive legal obligation, the neglect of which could expose corporate officers to penalties.

In New York, corporate officers who oversee the destruction of documents that might have been discoverable in a subsequent, reasonably foreseeable litigation may become liable for penalties for spoliation of evidence. It is important to note that this can apply *even in the case of documents that have outlived their statutory retention period.*

When a company destroys documents that may have been discoverable, the court will investigate whether they were destroyed in bad faith. Courts ask two questions in making this determination. First, were they destroyed in the ordinary course of business? In other words, was it the company's routine practice to destroy that type of document within that time frame? Note that destroying documents in accordance with a written retention plan will not necessarily help a company over this hurdle if the retention plan was not consistently followed. Therefore, it is vital that once a sound document retention policy is drawn up, the procedures are consistently and rigorously followed.

The second question courts will ask is, even if the documents were destroyed in the ordinary course of business, should the managers have

been on notice that litigation might be pending? There are at least two situations where the managers should be on notice that they may be subject to a lawsuit involving the relevant documents. First, the adversary, or potential adversary, may send signals. A "deal gone sour" or increasingly hostile letters may put a company's managers on notice that a lawsuit may be looming, and documents relevant to the subject matter of that potential dispute should be preserved. Second, if the documents themselves, or other documents of that class, were already subpoenaed in a prior lawsuit, the managers will generally be deemed to be on notice that such documents might be sought again in the future.

Corporate officers who have experienced the rigors of litigation will know that certain documents are not admissible in court. It is important to note, however, that in the case of anticipated litigation, such documents may not be destroyed just because they are

non-admissible. They still must be retained if they may be discoverable. To be subject to discovery, a document need not be admissible at trial; rather, a document is discoverable if its production could lead to the discovery of relevant information. Moreover, even privileged documents may have to be produced to the court for its inspection. Destroying such documents could lead to penalties in spite of their non-admissibility.

The flipside: the hazard of excess caution

Of course, responding to the dangers posed by premature document destruction by hanging on to too many documents for too long opens up hazards of its own. Obviously, it may be



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prohibitively expensive to store many years' worth of documents of all categories. Apart from the expense of storage, there is an additional potential expense: exhaustive searches to respond to document requests in litigation. If a company has access to many years' worth of all categories of documents, it will be required to search through them all, at a potentially tremendous expense of money and time, to find responsive documents.

The solution, then, is not to retain every document, but rather to craft an effective document retention policy. Such a policy will have the following characteristics:

- **Informed.** Be aware of statutory retention periods, as well as statutes of limitations.

- **Consistent.** Make sure that employees in all affected departments are following the written procedures.
- **Responsive.** Your policy should have contingencies for looming litigation that may affect your retention obligations.
- **In writing.** It will be far easier to argue that documents were destroyed in accordance with your document retention policy if it is on file, in writing and up-to-date.

Remember, the laws occasionally change, and your duties change with them. Work with your attorney to minimize your exposure, as well as your archives. ■

Expense Audits

BUSINESS OWNERS, INCLUDING LANDLORDS and tenants, should consider regular audits of certain expenses. Expenses usually are controlled by budgets and reasonability tests. However, you may be paying expenses that you do not control and which may not be accurate or reasonable.

1. Lease Audits

For tenants, the largest areas to question are operating expenses, electricity and real estate tax pass throughs billed by a landlord under typical leases. A landlord's operating expenses are not supposed to include all of the building's expenses. A tenant should have an expert determine if there were items inappropriately included, inadvertently or not. Capital improvements, with some exceptions, are usually not part of operating expenses. Nor are expenses in connection with leasing or space

promotion of the building. Those expenses for which a landlord is reimbursed by other tenants, an insurance company or other third party are also excluded in typical clauses.

A tenant should consider hiring a certified public accounting firm or other expert to audit the landlord's books.

For small tenants an operating expense audit may appear too expensive to justify the cost. Some companies will work on a contingent fee basis, being paid a percentage of the amount saved. Tenants may also consider acting together, sharing the cost of auditing books and records. In some leases, landlords have prohibited contingent audit fees, in the belief that such a firm would have to claim some errors in order to collect a fee. Confidentiality clauses may also appear in leases to avoid group claims by tenants.

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Leases often limit the scope of an audit and the time within which it must be requested. Typically, if a tenant does not conduct the audit within one year, it loses its rights to do so. The parties should also be careful in determining whether and when a tenant can audit base year expenses. Some tenants seeking an audit midway through a lease may find that the expense item was included in base year expenses and that they can no longer contest its inclusion. Another landlord deterrent is a provision requiring a tenant to pay the landlord's expenses for its employees to be present during the audit, for storage retrieval or for photocopying. A tenant should also be aware of its remedies when the tenant's auditor disagrees with the landlord. Arbitration of issues generally saves time and money for both parties.

Real estate tax statements would appear easy for a tenant's internal staff to review. One has to just check the tenant's percentage against the actual tax bill. But one must also check assessments against the property or abatements that phase in on or out over a period of years. In New York City, a tenant must know if the building participates in a building improvement district fund and whether that fund is part of the definition of real estate taxes. If the landlord regularly seeks to reduce its tax assessments, its expenses may be part of the real estate tax category, whether or not the assessment is reduced. Finally, if there has been a tax reduction resulting in a refund, the issue becomes whether the tenant received its proportionate share. These additional issues may warrant investigation by a tax attorney or an accountant. Property owners should also verify their tax bills and refund status with tax authorities.

2. Utility Audits

Electricity charges to a tenant may be based on meter or submeter readings or a flat rate. Increases may be determined by a consultant who can estimate a tenant's power requirements and usage of equipment. Meters and submeters should be checked periodically for accuracy by tenants as well as landlords. Both should also verify that no other premises are being covered by their meters. Utility companies have often miswired lines to meters. The same questions arise for landlords and tenants paying for water service. In these areas, there are specialized consultants who can verify meters and utility lines and analyze your bills.

Other utilities also require periodic review. One overlooked utility is the telephone company. Overcharges occur in monthly telephone line expenditures, long distance plans and local rate plans. A company that reviews telephone bills may also be able to advise about better plans for the services you use.

3. Insurance Audits

Large companies should consider hiring risk management consultants to review insurance policies and recommend coverage changes. These consultants work on retainer fees and not commissions. They are not insurance brokers and do not replace your brokers or agents, but work with them and you to provide needed coverage at reasonable cost.

In addition to your attorney and accountant, there are experts to guide you in each of the areas discussed. Please feel free to call us if you would like to discuss your lease provisions or need recommendations of experts in any particular field. ■

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Lead Poisoning Prevention Rules Affect Multiple Dwellings in New York City

THE NEW YORK CITY COUNCIL has enacted the New York City Childhood Lead Poisoning Prevention Act of 2003 (the “Act”). The Act has the stated goal of reducing lead poisoning in children and imposes new burdens on owners of multiple dwelling buildings. The Act has the potential of altering the way leases and co-op and condominium operating documents are drafted.

Under the Act, owners have a duty to investigate both the units and common areas of a multiple dwelling for lead-based paint hazards and to remediate any hazards.

Owners of all multiple dwellings constructed prior to 1960 and those built subsequent to 1960, but prior to 1978, if known to contain lead-based paint, must investigate lead-based paint hazards and notify tenants about any hazards. An owner must investigate all units where children under 7 reside and the common areas of such buildings. The investigations must occur at least annually and with greater frequency if the owner knows of a reasonably foreseeable condition that could cause a lead-based paint hazard, an occupant complains to the owner, or the Department of Health and Mental Hygiene issues a notice of violation or order to correct a violation. For all multiple dwellings constructed prior to 1960, it is presumed that the paint is lead-based, and an owner must act with due diligence to conduct an investigation.

An owner must ascertain whether a child of protected age resides in a unit at lease signing

or renewal or at the beginning of occupancy if there is no lease. An owner must also conduct an annual inquiry by giving notice, with an approved form, to each unit inquiring as to whether a child of protected age resides in the unit.

Once a lead-based paint hazard is identified, or if an existing hazard is known to the owner, he or she must take steps to remediate the condition by the use of approved methodology. All work on multiple dwellings which may disturb lead-based paint requires the performance of a dust clearance test at the

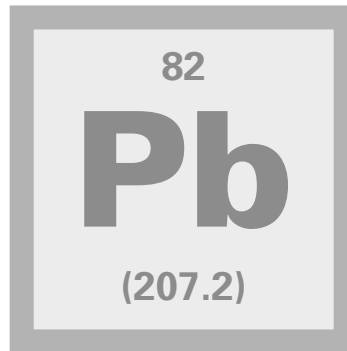
completion of the work. The work must be performed by a person who has successfully completed an approved course on lead-safe work practices.

The Act requires that multiple dwelling leases contain a conspicuous notice in English and Spanish to educate tenants about the

new rules and to allow owners to ascertain whether a child of protected age resides in the unit. Owners also must distribute pamphlets to tenants and prospective tenants containing similar language.

Co-ops and Condominiums

Two important limitations of the Act’s application exist for co-op and condominium multiple dwellings. First, responsibilities imposed on owners with regard to lead-based paint hazards, including the duty to detect and to remediate, may be shifted to a tenant shareholder or an owner of a condominium unit by virtue of an existing or future agreement between the parties. Second, units in



“Owners have a duty to investigate... for lead-based paint hazards at least annually.”

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multiple dwellings are exempt from application of the Act where “(i) title to the multiple dwelling is held by a cooperative housing corporation, or such dwelling unit is owned as a condominium unit, and (ii) such dwelling unit is occupied by the shareholder of record on the proprietary lease for such dwelling unit, or the owner of record of such condominium unit.” However, this exemption for record owners does not extend to tenants or subtenants occupying the unit, and any such tenancy brings the unit back within the requirements of the Act. ■

News from HG&G

- The Firm has been named as one of New York’s top real estate firms in the February 2005 issue of *Development New York*.
- Our partner Jules E. Levy has been elected President of the Alzheimer’s Association Long Island.
- Our partner Edward S. Schlesinger has been listed in *The Best Lawyers in America*, 2005-2006 edition. Mr. Schlesinger has been listed in every edition since the first edition appeared in 1983. His specialty is trusts and estates.

Thanks to Thomas N. Cassino, Joseph R. Geoghegan, and Gerald H. Morganstern, our managing partner, for their contributions to this issue. –David L. Birch, *Editor*.

Health Care Proxies/ Living Wills

AS PART OF OUR ESTATE PLANNING SERVICES, we prepare health care proxies with living will provisions customized to your needs and wishes. Its importance is obvious today.

If you do not have a health care proxy or if it does not authorize your health care agent to see your medical records as now required by the Health Insurance Portability and Accountability Act of 1996 (“HIPAA”) we recommend that you immediately contact one of our partners. ■

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- financial institutions (loan transactions, leasing, acquisitions, credit restructuring, workouts, foreclosures)
- estate planning
- trust and estate administration
- general litigation and alternate dispute resolution
- matrimonial and family law
- taxation
- bankruptcy and creditors’ rights

Clients of the firm range from major financial institutions and public corporations to closely-held businesses, individuals and families.

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