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Intellectual Property And Employment Law Best Practices: Are You Covering Your Bases In Protecting Construction-Related Trade Secrets?

by Colin Holley, Partner

When I joined Watt Tieder as a lateral partner at the beginning of this year, I had already spent a great deal of time considering the ways in which I would be able to expand upon and enrich the scope of legal services the firm brings to client representation. My decision to join the firm was in part based upon my belief that my practice areas and experience, combined with Watt Tieder's already-existing, deep knowledge about its clients' industries and specific needs, creates an opportunity to serve the firm's clients in new and valuable ways. My belief in that regard has only deepened since I joined the firm, with concrete examples stacking up continuously.

I am pleased to have this opportunity, in my first article as a Watt Tieder partner, to discuss issues pertinent to an area of litigation and consulting expertise that I hope will be of interest to those of you involved in ownership, management, or operation of construction-related businesses. Namely, intellectual property and employment law issues and best practices you and those within your company should consider in assessing whether you are doing everything you should to protect your valuable trade secrets.

Brief Overview Of Types Of Intellectual Property

There are four main types of intellectual property (IP) - patents, copyrights, trademarks and trade secrets. Many companies have IP rights of all four types. Very different steps are required to protect different types of IP. Your company should work with an experienced IP attorney to develop and continuously update a comprehensive IP protection plan. And for the reasons discussed below, it is important for your company's IP protection plan to be closely coordinated with employment and contracting practices.

Patents are rights that may be granted to protect uniquely-original and usable inventions for a prescribed period of years, the length of which depends on the patent type. To register a patent, an application must be filed with the United States Patent and Trademark Office (USPTO), which will decide whether the invention is patentable. A registration gives the owner the ability to prevent others from using or selling the invention without permission. Registered patents may be challenged in court on several grounds, but mounting a successful challenge is a very expensive proposition. A patent registration is thus a highly valued asset and is key to preventing others from using or copying your invention, unless you have a foolproof way to keep your invention secret and out of the hands of competitors. On the other hand, if it is possible to keep the invention secret for enough time to gain a commercial advantage over competitors and the enforceability of the patent is questionable, registering a patent may be a mistake because the invention must be publicly disclosed in excruciating detail, for all competitors to see.

Copyrights protect ownership of artistic works. Protected works can be nearly anything creative. Examples run the gamut from songs, paintings, and books, to architectural drawings and computer software. A copyright generally lasts for the entirety of the creator's life, plus an additional 70 years after his or her death. Copyright protection in a work exists automatically from the moment of creation. No registration is needed to protect the work. However, registering a work with the United States Copyright Office is necessary to sue for infringement and to make available certain remedies for post-registration infringement. It also provides proof of the date of creation of the work. Subject to certain exceptions such as "fair use" (for example, use in news reporting), the owner of a copyright controls all rights to use the work in any way.

A trademark (or service mark) is a word, phrase, symbol, or design used in commerce to identify goods or services as originating from a single source. Product brand names and logos are the most common marks. Trademark rights protect against commercial use of a similar

mark in a way that is likely to create customer confusion as to the source of the product or service. "Common law" trademark rights can exist without the need for registration when there has been sufficient use of a mark in commerce. Registration with the USPTO creates additional protections that do not exist under common law, such as "constructive" notice to others of the registrant's ownership of the mark, which can be crucial in an infringement lawsuit. Trademarks can be maintained for an indefinite period so long as use in commerce continues.

A trade secret is information known only to a specific business that gives it an advantage over its competitors. It is unlike a patent, copyright, or trademark in that it cannot be protected by government registration, but rather only by taking steps to protect its secrecy. The remainder of this article addresses issues that should be considered in identifying and protecting trade secrets.

Protecting Construction-Related Trade Secrets

Trade secrets are protected by federal and state statutes. Almost every state in the country has adopted a version of the Uniform Trade Secrets Act (UTSA), and similar statutory law is enforceable under the federal Defend Trade Secrets Act (DTSA). These state and federal statutes provide significant protections against, and penalties for, trade secret misappropriation.

The law generally protects "against the disclosure or unauthorized use of the trade secret by those to whom the secret has been confided under the express or implied restriction of nondisclosure or nonuse." *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974). To qualify as a trade secret, information need not be maintained in absolute secrecy. Protection is afforded to any information that (1) has economic value due to being generally unknown to those outside the business, and (2) is the subject of reasonable efforts to maintain its secrecy.

Companies frequently do not realize that they have information that may qualify for trade secret protection or do not realize the breadth of information that may be protected. For example, companies doing business in the construction space might recognize the need to protect purchasing and sales pricing and requirements information, but might overlook that protecting other types of information might also give the company a competitive advantage, such as:

- Custom design and manufacturing processes;
- Volume or other special discounts negotiated with vendors and customers;
- Unique arrangements with manufacturers, distributors, and licensors/licensees;
- Specially-designed insurance programs;
- Specialized plans for employee or contractor retention;
- Business forecasting;
- Mergers and acquisition plans;
- Joint venture information;
- Real estate purchase or sale plans; and
- Specialized contract terms used in all phases of the business.

The types of information that have competitive value, and can be reasonably protected from disclosure, of course vary from business to business. And different departments within a business often have different perspectives on what has competitive value. To most effectively and comprehensively protect your proprietary information, include all departments in brainstorming sessions to identify as broadly as possible the information, systems, programs, methods, and plans that bring value to the company, and consult with experienced IP and employment law counsel regarding the steps you should take to maximize your protection.

It is critical to involve legal counsel experienced in both IP and employment law because you need to know both what can be protected and how you can best protect it. While theft of information from outside the company (such as by computer network hacking) is certainly a concern to be considered, misappropriation by existing or former employees, or trade partners, is a larger concern for many businesses. To protect information with competitive value, and to maximize the likelihood of a legal finding that the information is a trade secret, reasonable steps must be taken to require employees and trade partners to protect secrecy. For example:

- Employees and trade partners should be required to sign non-disclosure, confidentiality, non-compete, and IP ownership and assignment agreements;
- Employees and trade partners should be restricted by contract, to the maximum extent legally allowed, from soliciting your employees to leave and join a competitor;
- Procedures should be implemented to ensure that when employment ends all employees are reminded in writing of continuing non-disclosure obligations, return all confidential information, computers and devices, and ideally sign an acknowledgment;

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- Cease and desist letters and lawsuits when necessary should be used to enforce breaches of confidentiality and non-disclosure agreements;
- Paper copies of sensitive documents should be in locked areas, and electronic files should be password-protected, with access of employees and trade partners to information limited (physically and electronically) to those with a specific need for it;
- Encryption-protected communications should be used to send and receive sensitive electronic documents and data;
- For projects involving public entities, assess steps that can be taken to avoid public access to information with competitive value;
- Implement periodic training for employees regarding trade secret protection; and
- Increase vigilance and implement additional safeguards during mergers, acquisitions or other periods of significant company restructuring.

Many of the issues discussed in this article will undoubtedly have been familiar to many of you. I urge you, however, to consider whether any of these "best practices" are things your company may not be adequately addressing. If you take the lead in plugging those gaps in your company's trade secrets protection protocols, you might be the hero who saves the company from losing a significant competitive advantage.

Colin Holley's practice focuses on the litigation of complex business disputes, including matters involving intellectual property, trade secret misappropriation, labor and employment law, commercial law, real property, unfair competition, and appellate advocacy. His practice involves litigation and resolution of disputes in federal and state courts and arbitration venues nationwide.

Highlight On Commercial Bonds: Is A Probate Bond Ever *Really* Discharged?

by Paula Lee Chambers, Partner

Whether a probate bond is ever *really* discharged is a rhetorical and challenging question. The realistic answer is that it may not be unless the bond is discharged by the probate court at the time the final accounting is approved or the statute of limitations has run. Whether the statute of limitations has run is state specific and subject to additional tolling defenses. Most probate cases, such as conservatorships, guardianships, trust, and estate administrations, work their way through the probate court and are simply closed without a formal discharge of the bond. In some of the New England states, such as Massachusetts and Maine, the court will not discharge the bond without submission of a fillable form requesting discharge of the bond. In Connecticut, New Hampshire, and Vermont, the probate court will issue an order to discharge the bond upon approval of the final accounting and/or final report by the fiduciary. Unfortunately, in many jurisdictions, even where a probate court has discharged the bond, allegations of fraud and self-dealing may reopen a closed estate years later. This can lead to exposure not only to surcharge on the bond or bonds but also to reimbursement of attorneys and expert fees of the challenging party. This article briefly discusses the exposure and the risks.

The Exposure On The Bond

Although probate bond claims are less than 1% of overall surety underwriting claims statistics, the exposure can be significant depending on the circumstances. For example, the penal sum of an individual bond may be in the millions of dollars depending on the assets held by a probate estate. Similarly, a surety may underwrite one principal with multiple bonds for multiple estates, conservatorships or guardianships. Individually, the risk on those bonds may seem to be non-existent or negligible due to the small size of individual

bonds. However, an objection to one bond for alleged breaches of fiduciary duty may lead to a further inquiry by the petitioner or the court and a review of all cases by the principal, including opened and closed cases. This increases the overall risk on the account and potentially exposes the surety to losses, expenses, and in some states, the petitioner's attorney's fees.

To highlight the exposure, in a recent New Hampshire case involving a private guardian, the surety had underwritten over $25M in bonds for multiple guardianships and trusts managed by one principal. The Personal Representative for the ward objected to certain fees charged by the private guardian asserting that the fees were disproportionate in comparison to the fees charged by public guardians- $125.00 hr. v. $60.00.

The New Hampshire Probate Court has the power to reopen a fiduciary's account for good cause. Good cause may consist of fraud, misrepresentation, self-dealing by the fiduciary, mistake, and/or any combination thereof. *See Massachusetts Bonding & Ins. Co., v. Keefe*, 100 N.H. 361, 363 (1956) (citations omitted). What is sufficient cause is a question of fact depending upon the particular circumstances of each case. *Thompson v. Trustees of Phillips Exeter Acad.*, 105 N.H. 153, 157 (1963). Here, the court agreed with the personal representative and ordered that the principal reimburse the estate the delta between the private versus public guardian fees. Rather than simply pay the ordered amount, the principal actively defended her duties as a guardian and fully accounted for each expenditure to justify both her time entries and value of her services at the private rate of $125.00. The Office of Public Guardian then launched a wholesale review of every case opened and closed involving the private guardian. Once the review began, the court did not limit its investigation to the amount of fees but further investigated other actions taken by the private guardian including the sale of assets of the estate, the valuation and sale of antiques, and purchases made for the care and comfort of the ward. The surety stepped in to defend the claims in concert with the principal when the personal costs of defending the multiple claims drove the public guardian to the brink of bankruptcy. The surety objected, arguing that: (1) the bonds had been previously discharged by the court; (2) the bonds were discharged as a matter of law when the accounts were approved without objection; (3) there was no breach of fiduciary duty on behalf of its principal; and (4) the retro-active application of a decrease in guardianship fees was subjective and arbitrary. The surety was prepared to consolidate the cases and appeal to the State's highest court. The surety incurred significant attorney's fees to investigate and defend its principal including negotiation of several of the bonds to ultimately obtain a discharge and release all the bonds.

Similarly, in a recent Massachusetts case involving a guardianship bond with a penal sum of $950K, the Personal Representative of the Estate filed a petition to reopen the guardianship estate *five years* after the final accountings were approved by the court . The Personal Representative alleged that the guardian committed multiple breaches of fiduciary duty, including but not limited to failing to prudently invest and manage the ward's assets causing losses to the Estate, charging excessive and unnecessary fees for her services, inaccurate accountings, and failing to prepare estate plans for the ward or her heirs-at-law. Under Massachusetts law, accounts which have been previously allowed by the court may be reopened after the final decree if the court finds fraud or manifest error which may be constructive or technical in nature. *Reynolds v. Remick*, 333 Mass. 1,10 (1985).

In this case, the court ordered the reopening of six previously approved accountings finding that the petitioner met what arguably should be a high standard to reopen an account. The court applied the well settled principal in Massachusetts "that if a person makes a representation of a fact, as of his own knowledge, in relation to a subject matter susceptible of knowledge, and such representation is not true; if the party to whom it is made relies and acts upon it, as true, and sustains damage by it, it is fraud and deceit, for which the party making it is responsible." *National Acad. of Sciences. v. Cambridge Trust Co.*, 370 Mass. 303, 308-09 (1976) (*citation omitted*). Here, the principal argued that she meticulously accounted for all the expenses that were for the ward's health and benefit. The court disagreed and allowed the guardianship to be re-opened. Thus, it does not matter whether the guardian intended her accounts to be deceptive - negligent misrepresentations of fact are legally sufficient grounds for reopening accounts in Massachusetts.

In the Massachusetts case, there were multiple legal issues, two of which were issues of first impression for the court including whether the guardian was required under Massachusetts law to prepare an estate plan to include the heirs-at-law and the degree of reliance on outside counsel and other professionals in management of the estate. Of note, the principal was a friend of the petitioner with no business or financial

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background. As such, the principal retained a reputable fund manager to manage the assets of the estate with several layers of oversight. Undaunted, the petitioner continued to allege the guardianship suffered losses as a result of the principal's lack of personal oversight. As in the New Hampshire cases, the surety incurred significant expense in defending the action with significant motion's practice, retaining of multiple experts and legal fees to protect its interest in light of the legal issues in the case. The case ultimately settled after two mediations on the eve of trial.

The Answer To The Question

To answer the question, "is a probate bond ever *really* discharged?" It is until it is not. What should a surety do, if anything, to insure the closure of the estate and discharge of its bond? It may not be any different than the common underwriting standards already in place. Communications between the underwriters and agents to review high exposure bonds should be carefully monitored especially where there is a singular principal on multiple high exposure bonds. This should include a periodic review of the financial condition of the principal; a review of whether the probate application lists an attorney to contact to determine the closure of the estate and whether the bond has been discharged by the court. With the advent of probate courts utilizing ECF, an estate case can be discretely reviewed on-line. If an objection to an account appears in the probate record that may expose the bond, early investigation may reduce the risk of a larger loss on the bond.

FALSE CLAIMS ACT

Implied Certification Liability Under The False Claims Act – What You Don't Say *Can* Hurt You

by C. William Groscup, Partner

Enacted in 1863, the False Claims Act was the outgrowth of a series of congressional hearings where witnesses painted a sordid picture of how, during the Civil War, "the United States had been billed for nonexistent or worthless goods, charged exorbitant prices for goods delivered, and generally robbed in purchasing the necessities of war." *United States v. McNinch*, 356 U.S. 595, 599 (1958). Congress responded by imposing civil and criminal liability for 10 types of fraud on the government, subjecting violators to double damages, forfeiture, and up to five years' imprisonment. Since then, Congress has repeatedly amended the False Claims Act ("FCA"), with the focus remaining on those who present or directly induce the submission of false or fraudulent claims. *See* 31 U.S.C. § 3729(a).

Viability Of The Implied False Certification Theory Confirmed In *Escobar*

As the FCA evolved over time, so too did the creativity of government counsel and relators seeking to broadly interpret the Act's scope. The implied false certification theory was one such effort to "push the liability envelope." Under the "implied false certification" theory of FCA liability, an entity is considered to have defrauded the government if it submits a claim that is accurate on its face but fails to disclose the entity's violation of a statutory, regulatory, or contractual requirement that is material to the claim. The implied false certification theory is premised on the argument that, simply by virtue of having submitted a claim to the government for payment, the claimant has *implicitly certified* compliance with statutes, regulations and contract terms that govern the parties' contractual relationship. Relying upon this theory, the government and relators have argued that any noncompliance is sufficient to trigger FCA liability, regardless of whether the defendant made an express false statement and irrespective of how trivial the regulatory or statutory noncompliance.

In the landmark decision *Universal Health Services, Inc. v. U.S. ex rel. Escobar*, 136 S. Ct. 1989 (2016), the U.S. Supreme Court held that, under the appropriate circumstances, FCA

liability can indeed be imposed for an implicitly false certification. Although recognizing the viability of such a claim, Justice Thomas, writing for a unanimous Court, cautioned that the FCA is not "an all-purpose antifraud statute." Nor is it a vehicle for imposing treble damages for "garden-variety breaches of contract or regulatory violations." In order to avoid morphing the FCA into a general antifraud super statute (whereby a party certifying a claim is suddenly and automatically subject to treble damages for non-compliance with any applicable regulation or contract requirement), the Court adopted a two-part test for determining liability for implied false certification. Specifically, the Court held that liability may exist under an implied false certification theory where "at least" two conditions are satisfied: (1) the defendant's claim "makes *specific representations about the goods or services provided*," and (2) "the defendant's failure to disclose noncompliance with *material* statutory, regulatory, or contractual requirements makes *those representations* misleading half-truths."

The Court emphasized that only *material* noncompliance with a statutory, regulatory or contractual requirement can trigger FCA liability and the attendant possibility of treble damages. The Court also characterized the materiality requirement as "rigorous" and "demanding," and defined it by applying principles from both the FCA and the common law. The Court eschewed any "one size fits all" test for "materiality," but offered the following guidance on this issue:

- Although not dispositive, the government's express designation of a requirement as a condition of payment is certainly relevant to the materiality inquiry;

- Minor or insignificant noncompliance will not be sufficient to find materiality;

- The fact that the government had the option to refuse to pay a claim if it knew of the noncompliance is insufficient to find materiality; and

- "[I]f the government regularly pays a particular type of claim in full despite actual knowledge that certain requirements were violated and has signaled no change in position, that is strong evidence that the requirements are not material."

Escobar's two-part test (inclusive of its materiality requirement) helps to ensure that relators cannot use the FCA to profiteer from a garden variety regulatory breach where the government itself would not have changed its position on payment even if it had known of the regulatory violation. With the Supreme Court having recognized a claim for implied false certification, and yet having also imposed a somewhat exacting two-part test for its application, a new argument surfaced on the part of relators. Specifically, they argued that *Esbobar's* two-part test was not the *sole criteria* for recognizing liability for a claim of implied false certification but, instead, merely reflected *one example* of a situation in which such liability would attach.

This argument was laid to rest (at least in the Ninth Circuit) in *U.S. ex rel. Rose v. Stephens Institute*, 909 F.3d 1012 (9th Cir. 2018), *cert. denied*, 139 S. Ct. 1464 (April 1, 2019). Specifically, the Ninth Circuit held in *Stephens Institute* that *Escobar* sets forth the exclusive test for establishing FCA liability under the theory of implied false certification. As explained below, however, while confirming that *Escobar's* two-part test must always be met to impose liability under the FCA for implied false certification, the Ninth Circuit's application of that test suggests that the materiality requirement is not quite as "rigorous" and "demanding" as it first seemed.

United States ex rel. Rose v. Stephens Institute

Less than a month before the Supreme Court's decision in *Escobar*, the United States District Court for the North District of California was grappling with a claim for false implied certification in *United States ex rel. Rose v. Stephens Institute*. The defendant was an art school in the San Francisco area that had entered into a Program Participation Agreement ("PPA") with the Department of Education that required the school to comply with certain regulations, including an incentive compensation ban, to receive federal funding. The relators (former admissions officers of an art university), alleged that the school violated the incentive compensation ban by giving admissions officers salary increases of up to $30,000 in exchange for meeting quantitative enrollment goals.

In denying the school's summary judgment motion, the district court found that the relators had raised a triable issue of fact as to whether the school in fact compensated admissions officers solely on the basis of their enrollment numbers. The district court allowed the case to proceed because "each of [the school's] requests for [federal] funds contained an 'implied certification of continued compliance with the incentive ban'" contained in the PPA, thus satisfying the pre-*Escobar* test that had previously been applied in

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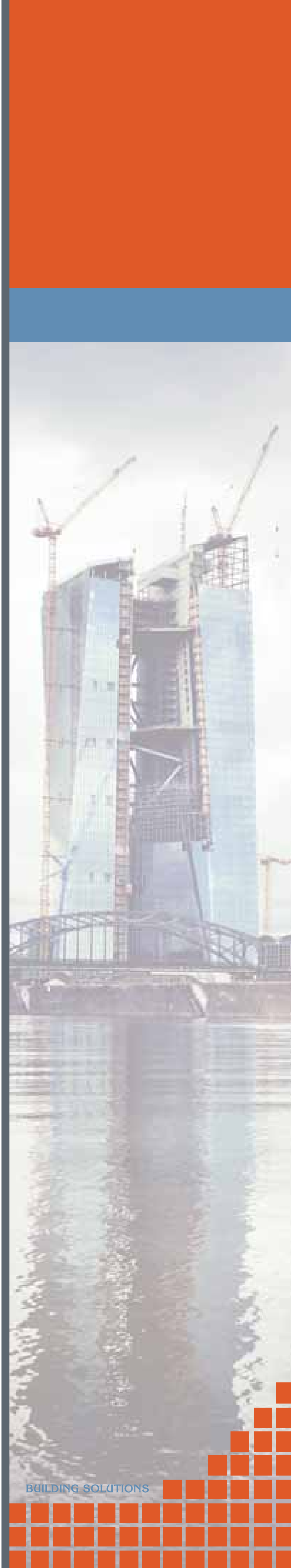

the Ninth Circuit. *Rose v. Stephens Inst.*, No. 09-CV-5966-PJH, 2016 WL 2344225, at *9 (N.D. Cal. May 4, 2016).

With the Supreme Court deciding *Escobar* just a month later, the school moved for reconsideration to have the case decided pursuant to *Escobar's* two-prong test for implied false certification under the FCA. In denying the school's motion, the district court expressly held that *Escobar* did not establish "a rigid 'two-part test' for falsity that applies to every single implied false certification claim," but nonetheless found that the relators' allegations raised a triable issue of fact under that standard, as well. The district court thereafter granted interlocutory appeal of its denial order and certified the following question to the Ninth Circuit: "Must the 'two conditions' identified by the Supreme Court in *Escobar* always be satisfied for implied false certification liability under the FCA?"

The Ninth Circuit answered this question in the affirmative, with the three-judge panel unanimously holding that relators must satisfy both of the conditions set forth in *Escobar* in order to prove a claim for implied false certification under the FCA. Although the panel was unanimous as to the relevant test, the judges split 2-1 as to whether the relators had established a genuine issue of material fact as to falsity under the *Escobar* standard.

According to the majority, the test had been satisfied because the school had represented on its loan form that the student-borrowers were "eligible" and "enrolled in an eligible program," whereas the school's failure to disclose its non-compliance with the incentive compensation ban rendered those representations, in the words of *Escobar*, "misleading half-truths." Delving deeper into the "materiality" prong of the test, the majority found that materiality was a triable issue based on the fact that: (i) compliance with the incentive compensation ban was a "condition of payment;" (ii) the government "did care about violations" as it took at least some form of corrective action in 25 of 32 cases in which other schools violated the incentive compensation ban, including requiring schools to cease providing incentives; and (iii) the bonuses at issue were as much as $23,000, as opposed to "cups of coffee or $10 gift cards."

Balanced against these facts, the evidence showed that – out of the 32 reported instances of known violations of the incentive compensation ban – the government had only pursued recoupment of its payment in one case. Relying on this evidence, together with the Supreme Court's admonition that the materiality requirement should be viewed as both "rigorous" and "demanding," the dissent argued that "caring is not enough" under Esbobar's materiality standard.

The majority's reasoning begs the question as to whether materiality can be established based simply on evidence that the government "cares about" a violation (at least at some level). Although by no means the only factor to the materiality equation, Justice Thomas opined that evidence of materiality includes that "the Government consistently refuses to pay claims in the mine run of cases based on noncompliance." He further emphasized that "materiality looks to the effect on the likely or actual behavior of" the government. The evidence before the court in *Stephens Institute* was that the government failed to pursue recoupment in 31 of the 32 instances where there was a known violation of the incentive compensation ban. With the regulatory professionals charged with enforcing the incentive compensation ban having opted not to pursue recoupment in the "mine run" of incentive ban violations, it is worth asking whether relators should be permitted to tread where the government itself had so rarely gone.

Thus, although *Stephens Institute* reaffirms the applicability of *Escobar's* two-part test, the Ninth Circuit's application of that test may actually embolden relators who seek to recover (and thus impose) penalties that are far more draconian than deemed appropriate by the government professionals charged with the enforcement of the applicable statutory and regulatory requirements. Going forward, the extent to which relators are able to alter the regulatory framework through recoupment of payments that the government would have never sought to recoup merits careful scrutiny.

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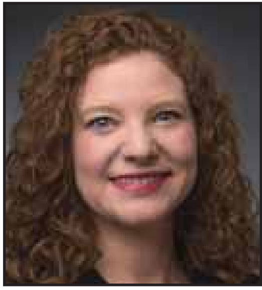

When It Comes To Receipt Of A Discharge In Bankruptcy, There Is No Such Thing As An Innocent Spouse

by Jennifer L. Kneeland, Senior Partner

In *Travelers Casualty and Surety Company of America v. Steven Brice and Erin Michele Wibracht*, (Case No. 18-05203), Watt Tieder attorneys obtained a significant decision in favor of Travelers Casualty and Surety Company of America ("Travelers"), in the U.S. Bankruptcy Court for the Western District of Texas (San Antonio Division). The court revoked the discharge of a debtor whom had filed jointly with her spouse rejecting the debtor's defense that she was an innocent spouse in the numerous false statements and fraudulent transfers made before and during the bankruptcy case.

It is commonplace for two spouses to jointly file a bankruptcy petition. By the joint filing, each spouse expects to receive a discharge, allowing both members of the couple to exit bankruptcy with debt forgiveness and a clean slate. Although the joint bankruptcy filing is given one case number, in actuality, the filing is two bankruptcy cases, one for each spouse. Travelers argued, correctly, that each spouse has independent duties to meet all of his or her obligations under the Bankruptcy Code that are required in order to be eligible to receive a discharge. Those independent duties include, among other things, ensuring that all the information contained in the debtor's bankruptcy schedules is accurate and complete.

The Wibrachts filed a joint chapter 7 case as husband and wife with the chief purpose of skirting their obligations under a general agreement of indemnity and discharging approximately $18,500,000 million in debt, inclusive of approximately $12,500,000 owed to Travelers. Travelers moved to revoke the Wibrachts discharge under several grounds set forth in section 727 of the Bankruptcy Code, including among other things, failure to produce records, false statements on their bankruptcy schedules relating to their personal and business affairs, and pre- and post-petition fraudulent transfers.

In ruling in Travelers's favor and denying discharge, the court noted:

> Discharge obligations are some of the most difficult cases we have because the stakes are high, and there's a lot of emotion. The Debtors in this case, obviously, filed Chapter 7 in order to obtain a discharge. And it's a very important thing to people that are filing Chapter 7.
>
> But there's no constitutional right to a discharge. It's a privilege, not a right. And in order to receive a discharge, a debtor must abide by the rules set out in the bankruptcy code and the bankruptcy rules, must be completely truthful, and be completely cooperative with the trustee and the creditors in the bankruptcy case.

(April 5, 2019 Decision at 4).

The day before the trial, Mr. Wibracht, in the face of substantial evidence that his discharge should be denied, waived his discharge. In doing so, Mr. Wibracht left his wife to face trial alone. Successful denial of Mrs. Wibracht's discharge, however, was necessary to prevent her and her husband from using her discharge to shield the Wibrachts' future assets from Travelers's collection of the approximately $12.5 million owed to it by shifting the assets to her name.

As Chief Judge King framed the issue, "[i]f I had to sum it up, I would say that Mrs. Wibracht is claiming innocent spouse as a defense. And this is a doctrine that sometimes can be used as a defense to IRS tax claims against a spouse, where one spouse owns and controls a business, and the other spouse, the so-called innocent spouse, has no knowledge of or involvement in the business. But in a Chapter 7 joint bankruptcy case, that doctrine doesn't fit." *Id.* at 5. In short, Mrs. Wibracht's defense was that she knew nothing about her husband's business, their family expenses, their family debts, and other basic financial information.

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In rejecting the defense, Chief Judge King explained that "[a] debtor in Chapter 7 or any other chapter of the bankruptcy code is not allowed to claim ignorance of her assets and debts. She must disclose and diligently investigate her assets, liabilities, transfers, and other relevant transactions both pre- and post-petition. Merely relying blindly on the other spouse does not satisfy the requirement of disclosure under penalty of perjury." *Id.* at 6.

There appear to be very few bankruptcy cases addressing the innocent spouse defense in the context of the spouse's behavior during bankruptcy. Accordingly, the *Wibracht* decision is useful for future cases in which two spouses jointly file a bankruptcy case in the hopes of discharging their liabilities. The bankruptcy court's rejection of the innocent spouse defense can be used in the scenario in which one spouse has day-to-day knowledge and responsibility for control over the bonded principal and the other spouse has little to no involvement in the business. In such cases, the spouse with little to no involvement in the business and glib knowledge of his or her duties as an indemnitor argues ignorance (or innocence as Chief Judge King describes it) in the hope of holding on to a bankruptcy discharge. Chief Judge King recognized that such cases are emotional. However, a bankruptcy discharge is a privilege, not a right, for the honest, but unfortunate debtor. Thus, to receive a discharge, each debtor has an independent obligation – separate and apart from their spouse – to abide by the requirements of the Bankruptcy Code and the Bankruptcy Rules, to be completely truthful, and to cooperate with the trustee and the debtor's creditors. In this case, the bankruptcy court reaffirmed these fundamental bankruptcy principles and rejected the "innocent spouse" defense based on Ms. Wibracht's own, independent failures to satisfy her obligations as a debtor.

CONTRACT LICENSING

D.C. Court Of Appeals Serves Up Big Bowl Of Nothing To Unlicensed Subcontractor

by Edward J. Parrott, Senior Partner and Noah Meissner, Associate

Edward J. Parrott

Noah Meissner

In the strictest enforcement of regulatory requirements since Seinfeld's "Soup Nazi" declared "no soup for you!" the District of Columbia's Court of Appeals recently issued fair warning to contractors operating in D.C.—if you want to get paid, get licensed. And for unlicensed contractors already working in D.C., it may be too late.

In *HVAC Specialist, Inc. v. Dominion Mech. Contractors*, 201 A.3d 1205 (D.C. 2019), an HVAC sub-subcontractor brought a multi-million dollar action for indemnification or contribution and breach of contract against a mechanical subcontractor, Dominion Mechanical Contractors ("Dominion"). Upon finding that the sub-subcontractor was not properly licensed in D.C., Dominion filed a motion to dismiss the lawsuit. The D.C. Superior Court granted the motion to dismiss, holding that it was "constrained to grant" the motion "inasmuch as the statutes and regulations requiring licenses for businesses operating in the District of Columbia are very clear that businesses performing refrigeration or air conditioning work must have a license to do so *and there are no exceptions*." (Emphasis added). The District of Columbia Court of Appeals affirmed the trial court's ruling, issuing a no-nonsense interpretation of the D.C. licensure statute.

In its opinion, the court made clear that it was opting for a "clear-cut, unmistakable requirement, with equally clear consequences for noncompliance." Contracts in violation of licensing requirements directed at protecting the public are void and unenforceable, regardless of effects that "may appear to be harsh and disproportionate in some cases." Licensure requirements, such as those for

HVAC contractors and other trades, exist "to protect public health, safety or welfare, or to assure the public that persons engaged in such occupations or professions have the specialized skills or training required to perform the services offered." The ruling leaves any contractor subject to licensure requirements in D.C. with little or no room for error.

Not only did the court find that the subcontract was void and unenforceable, but also that any quasi-contractual agreement related to the business activity requiring licensure was as unenforceable as the written subcontract—including tasks such as ordering equipment and materials. Even a contracting party's knowledge of the other's unlicensed status, which was disputed in the case, did not provide a basis for recovery on an illegal contract. Nor could the contractor's license be held to cover the subcontractor's employees. As noted by the court, D.C. Code § 47-2851.02(c) prohibits any "person issued a license under this subchapter" from "willfully allow[ing] any other person required to obtain a separate license to operate under his or her license."

The District of Columbia Court of Appeal's holding and its ramifications for contractors is particularly noteworthy given the more lenient approaches taken in neighboring jurisdictions. Both Maryland and Virginia offer contractors pathways to redemption if they run afoul of those jurisdictions' licensing statutes. For example, in *Alcoa Concrete & Masonry v. Stalker Bros.*, 191 Md. App. 596 (Md. Ct. Spec. App. 2010), the court interpreted Maryland's Home Improvement Law such that "if a subcontractor is not licensed at the time of subcontracting, but is licensed at the time any payment is due under the contract, the subcontractor's right to payment is protected" because the law only explicitly requires licensure at the time of payment. Under Virginia law, contracts entered by unlicensed persons are unenforceable, but a relatively broad exception exists for contractors who 1) substantially perform within the terms of the contract in good faith, and (2) do not have actual knowledge that a license or certificate was required to perform the work for which payment is sought. Va. Code Ann. § 54.1-1115(c); *see, e.g., Crawford Constr. v. Kemp*, No. CL11-153, 2012 WL 5930483 (Va. Cir. Ct. November 7, 2012).

The upshot of this ruling from the District of Columbia Court of Appeals for contractors is straightforward: be certain to strictly comply with all licensing requirements before contracting to perform work in the District of Columbia. A contract for business activities requiring licensure entered by an unlicensed contractor is likely not worth the paper on which it is written.

Watt Tieder represented Dominion Mechanical Contractors in this action. If you have a similar dispute or any questions regarding proper licensing in any state, please feel free to contact Edward J. Parrot (eparrott@watttieder.com) or Noah Meissner (nmeissner@watttieder.com).

FIRM NEWS

Recent and Upcoming Events

Construction Financial Management Association's Annual Conference & Exhibition, June 1-5, 2019; Las Vegas, Nevada. **John E. Sebastian** was a co-presenter on "Construction Documentation: Successfully Managing Risk and Preserving Claims."

Wentworth Institute of Technology, June 5, 2019; Boston, Massachusetts. **Jonathan C. Burwood** guest lectured on "From the Drawing Board to the Field: Lessons Learned When Design Meets Construction."

Surety Association of Massachusetts, June 27, 2019; Boston, Massachusetts. **Jonathan C. Burwood** will speak on "Managing Contractor and Surety Risks in the Face of Opportunity."

30th Annual Northeast Surety & Fidelity Claims Conference, September 18-20, 2019; Atlantic City, New Jersey. **Christopher J. Brasco, Christopher M. Harris, Noah Meissner** to speak on "Stemming the Flow of Liquidated Damages."

30th Annual Northeast Surety & Fidelity Claims Conference, September 18-20, 2019; Atlantic City, New Jersey. **Vivian Katsantonis** and **Adam M. Tuckman** will speak on "The Psychology of Risk Management and Claims Resolution."

CMAA 2019 National Conference, September 22-24, 2019; Orlando, Florida. **Christopher J. Brasco** and **Kathleen O. Barnes** will speak on "Proven Risk Management Strategies for Collaboratively Addressing Project Changes."

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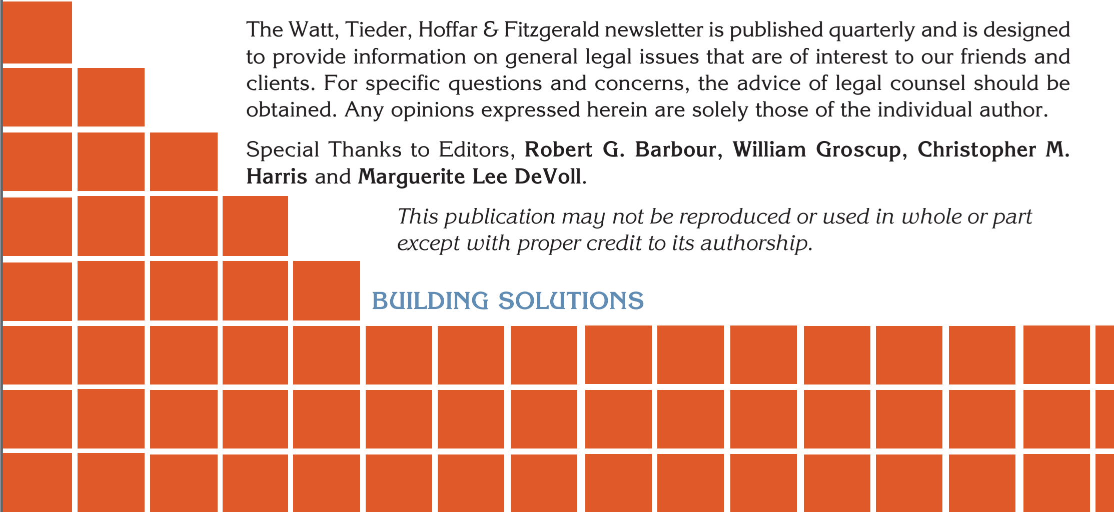

The Watt, Tieder, Hoffar & Fitzgerald newsletter is published quarterly and is designed to provide information on general legal issues that are of interest to our friends and clients. For specific questions and concerns, the advice of legal counsel should be obtained. Any opinions expressed herein are solely those of the individual author.

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