CECB Carnahan, Evans, Cantwell & Brown, P.C.

on the Subject

January 2013

# Meet Our New Shareholders

## Christiaan D. Horton

CECB is pleased to announce that Christiaan D. Horton recently became a Shareholder of the Firm. Christiaan is a member of the Litigation/Dispute Resolution and the Transactional Practice Groups. He concentrates his practice in the areas of business, commercial and civil litigation, mergers and acquisitions, corporate and business law, real estate and construction law, condemnation, environmental and utility law. He also represents select clients in certain areas including employment law and probate.

Christiaan has been a member of the Missouri Association of Trial Attorneys since 2004 and was honored in 2009 and 2010 as a *"Rising Star"* in the Missouri and Kansas *"SuperLawyers"* publication. He was a Partner at The Law Firm of Neale & Newman, LLP for twelve years prior to associating with the Firm.

He has authored a chapter in the *"Missouri Environmental Law Deskbook"* published by the Missouri Bar, and is a current author for the *"Environmental Law and Regulations section of the Court's"* and CLE Bulletin also published by the Missouri Bar. He is a member of Leadership Springfield, Class XVI, and is as an adjunct professor teaching Environmental Law and Regulations at Drury University. He also serves on the School Board of New Covenant Academy, a Christian school offering private education K4-12, and is a member of James River Assembly in Ozark, Missouri.

## Richard B. Maltby

CECB is also excited to announce that Rich Maltby has been named a shareholder of the firm. Rich is a member of the Litigation/Dispute Resolution Group and concentrates his practice in the areas of construction, architectural, engineering and development law, business litigation, real estate litigation, and alternative dispute resolution.

Many of Rich's clients are construction-industry professionals seeking counseling on negotiating and developing contracts for construction; managing risk, increasing profitability and reducing litigation on construction and development projects; and prosecuting and defending claims arising from problems on projects. He has extensive involvement in this industry as a regional and national speaker on pressing construction topics, president-elect of the Southwest Missouri Chapter of the Construction Specifications Institute, and founder of the now 450-member Ozarks Construction Referral Network.

In the business arena, Rich has successfully litigated cases involving employment, franchise/trademark, copyright infringement, banking, shareholder agreements, shipping and transportation, commercial and residential leases, unfair trade practice laws, and insurance. Drawing on his litigation experience, Rich also has advised clients on various transactional matters, including stock buyouts, commercial, residential and agricultural leases, property management, and non-competition and employment agreements. Rich is a member of a variety of non-profit organizations in the community and is proudly married to Stephanie and they have two daughters, Brynn and Carys.

# Estate, Gift and GST Tax Implications of the American Taxpayer Relief Act of 2012

By: Tom Peebles

At 2:00 a.m. on January 1, 2013 (after the nation had technically gone over the "fiscal cliff"), the Senate passed the American Taxpayer Relief Act of 2012 (the "Act"). Just before midnight on that same day the House of Representatives also passed the Act, which was then signed by the President on January 2, 2013. The Act averted many of the tax hikes and exemption reductions which were scheduled to go into effect in 2013. On the estate planning wealth transfer side, this piece of last minute legislation prevented the scheduled reduction of the estate and gift tax exemption to $1 million and the scheduled increase of the top estate, gift and GST tax bracket to 55%.

**Highlights of the estate, gift and GST tax provisions of the Act can be summarized as follows:**

**1. Exemption.** The $5 million exemption (indexed to inflation since 2011) for estate, gift and GST taxes is now made permanent. The inflation-adjusted exemption for 2013 is expected to be $5,250,000, although that number is not yet official. Clients who did not use all of their gift and GST exemption in 2012 still have the opportunity to do so in this or future years. In addition, as a result of the inflation index, clients can expect to acquire additional gift and GST exemptions each year that they may wish to utilize.

**2. Tax Rate.** Effective January 1, 2013, the maximum estate, gift and GST tax rate for transfers in excess of the inflation-adjusted $5 million exemption is 40%. That rate is higher than the 35% rate in effect from 2010-2012, but is lower than the 55% rate which would have applied if no Act had been passed and lower than the 45% rate proposed by the Administration.

**3. Portability.** The Act makes "portability" of exemptions between spouses permanent. Portability is a feature added by the 2010 Tax Act which, in its simplest terms, allows the estate of the first spouse to die to transfer his or her unused estate and gift tax exemption (but not GST tax exemption) to the surviving spouse. The effect of portability (although certain restrictions apply) is to allow a couple to transfer an inflation adjusted total of $10 million in assets free from any estate or gift taxes.

**4. IRA Charitable Rollover.** The Act reinstates for calendar year 2013 the ability of taxpayers over the age of 70½ to make distributions of up to $100,000 from an IRA directly to qualified public charities and exclude the distribution from their income. The Act also includes two transition rules to allow donors to make 2012 charitable contributions from an IRA: (a) first, if an individual over the age of 70½ took an IRA withdrawal in December 2012, that individual may elect to treat up to $100,000 of that withdrawal as an income tax-free direct payment to charity to the extent he or she makes an equivalent cash contribution to a public charity by January 31, 2013; and (b) second, during the month of January, 2013, an individual over the age of 70½ may make a direct distribution of up to $100,000 from an IRA to a qualified public charity and elect to have that distribution treated as a 2012 qualified

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# Contract Unconscionability: Brewer Opens the Door

**By: Jay Preston**

The language of a contract is the essence of the agreement between parties. Absent an ambiguity in the contract, parties are bound by its express language and generally may not offer evidence of other oral agreements to vary or contradict its terms. Given these fairly strict rules, the negotiation stage when the contract is drafted becomes that much more important. Each party wants the contract to be as favorable as possible with every scenario addressed. The problem is what happens when the contract goes too far. This concept is referred to as unconscionability and gives a judge or jury discretion to invalidate contracts when a party is subject to the absence of a meaningful choice and the terms of the contract are unfairly oppressive.

In the past, rendering a contract unconscionable required the showing of both procedural and substantive unconscionability. Substantive unconscionability refers to the terms of the contract. Terms are unconscionable when they are unreasonably oppressive or one-sided. Procedural unconscionability refers to the formalities of making the contract. In practice, this generally refers to issues of fairness in the formation process such as high pressure sales tactics, unreadable fine print, misrepresentations, and unequal bargaining positions.

The Missouri Supreme Court in a recent decision eliminated this dual requirement. In *Brewer v. Missouri Title Loans*, the court invalidated an arbitration agreement executed as part of a title loan. The agreement provided that all disputes were to be decided in individual arbitration, referred to as a class action waiver. It also provided that each party would be responsible for its own expenses and judicial action was only available to the title company to aid in repossession of the vehicle. *Brewer* is actually the rehearing of a previously decided Missouri Supreme Court decision from 2010. The 2010 decision struck down the entire arbitration agreement as unconscionable because of the class arbitration waiver; combined with the alleged unavailability of counsel to take an individual arbitration, the small amount of damages, and small fees for the attorney; all of which could be considered substantive unconscionability. Subsequent to the 2010 decision the U.S. Supreme Court in *A.T. & T. v. Concepion* held that states could not declare arbitration agreements to be unconscionable on the basis of a class action waiver alone. In light of *Concepion* the U.S. Supreme Court vacated the 2010 decision and sent the case back to the Missouri Supreme Court.

In *Brewer*, the Missouri Supreme Court once again invalidated the entire arbitration agreement, but on the basis that the agreement as a whole, not just the class action waiver, was unconscionable. While the court did not delineate which facts it thought related to procedural versus substantive unconscionability, the separation is apparent from the organization of the opinion. In reference to procedural unconscionability the court noted that the arbitration clause was non-negotiable, it was difficult for the average customer to understand, and the title company had the superior bargaining position. As to the substantive terms several provisions were identified as greatly favoring the title company; that each party would bear their own costs placing a higher burden on the customer, Brewer waived her ability to sue in court but the title company did not, and the title company maintained its ability to seek attorney's fees if victorious in arbitration. These facts coupled with the fact that no customer had ever arbitrated a claim against the title company led the Court to conclude that the arbitration agreement as a whole was unconscionable.

As compared to other decisions the amount of procedural unconscionability found in *Brewer* is relatively small. In *Whitney v. Alltel Communications, Inc.*, an arbitration agreement printed on the back of a cell phone bill that stated the customer agreed to the provision by mailing in his payment was declared unconscionable. In *Woods v. QC Financial Services, Inc.*, an agreement that compressed a 1,300-word arbitration clause onto one page was likewise invalidated. The class action waiver in *Brewer* was in bold capital letters and above the signature line was the bolded phrase "contains a binding arbitration provision." Several other factors were that Brewer did not attempt to negotiate the agreement, Brewer listed twenty other title companies she could have gone to, and Brewer did not even read the agreement before signing. Nevertheless the court found that the arbitration agreement, in the context of contract formation, was unconscionable.

The importance of *Brewer* lies in the freedom that it gives the lower courts. While some courts may still require a party to show both procedural and substantive unconscionability, the elimination of the dual requirement opens the door for more contracts to be found unconscionable. Situations may arise, as in *Brewer*, where the court wishes to invalidate a contract but the plaintiff fails to provide sufficient evidence of procedural unconscionability. Under this new paradigm a court could simply state that the contract was unconscionable in reference to issues relating to contract formation, whereas under the old law the court would have been forced to uphold the contract as the plaintiff failed to prove both of the required elements of unconscionability.

How this change plays out in the courts is something that will evolve over the following years. One certainty is that by eliminating the requirement of both procedural and substantive unconscionability, the door is open for judges to find more contracts unconscionable. Careful drafting and contract execution are now that much more important. Contracts should be written in plain language that can be easily understood, important provisions should be bolded or capitalized, and maybe most importantly one should ensure that the other party reads and understands the contract. Everyone wants contracts that they enter into to favor them, but in light of *Brewer* one must be cautious as to how far the contract goes, or face the possibility that they are left with no contract at all.

*American Taxpayer Relief Act of 2012 Continued form Page 1*

charitable distribution. This later provision is of particular benefit to donors who want to take advantage of the IRA Charitable Rollover in both 2012 and 2013.

**5. Annual Exclusion Gifts.** Although it was not a part of the Act, the gift tax annual exclusion has increased from $13,000 to $14,000 in 2013 under the normal indexing provisions of the Internal Revenue Code. Clients are encouraged to take advantage of annual exclusion gifts early in calendar year 2013.

The Act directs that the tax provisions outlined above are "permanent". Obviously, that is welcome news for clients (and their advisors) who have endured "temporary" tax measures for the last 12 years. However, tax laws are only permanent until Congress decides to change them.

While the issues of exemptions, tax rates and portability appear to be settled for the time being, there are other estate, gift and GST tax issues that have been proposed by the Administration and/or considered by Congress and may be debated in the near future. Included among those issues are proposals for minimum terms for GRATs, limitations (or elimination) of entity-based valuation discounts for intra-family transfers, restrictions on the duration of GST-exempt trusts, and new rules for Grantor trusts. In other words, although we now have greater certainty in estate, gift and GST tax planning than we have enjoyed for many years, it is still important to be sensitive to additional changes that Congress may take under consideration.

If you have any questions regarding these issues, please feel free to contact any member of the CECB Estate Planning Practice Group. We would be pleased to assist you in meeting your estate planning and wealth transfer goals.

# ESTATE PLANNING - A Potpourri of Mistakes & Misconceptions

By: Jennifer K. Huckfeldt

### ALL OF MY ASSETS WILL BE DISTRIBUTED PURSUANT TO THE PROVISIONS OF MY LAST WILL & TESTAMENT:

**MAYBE NOT!**

The Last Will and Testament only controls the distribution of assets that become part of your Probate Estate. If there is a beneficiary designation, payable on death (POD), or transferable on death (TOD) designation, a contractual provision regarding the passage of the asset at your death, or the asset is titled in joint tenancy with rights of survivorship, and a joint tenant survives, then such designation or form of ownership controls the distribution or passage of ownership of such assets. The provisions of your Will are irrelevant with respect to those assets. For example, if your Last Will & Testament provides that all of your assets are to be distributed to your church, but the beneficiary on your life insurance policy is your children, your bank accounts are POD to your children, and you own your home with your sister as joint tenants with rights of survivorship, and your sister survives you, then none of these assets would pass to your Church.

### I HAVE A REVOCABLE LIVING TRUST, SO MY ASSETS WILL NOT BE SUBJECT TO PROBATE AT MY DEATH:

**NOT NECESSARILY!**

Establishing a Revocable Living Trust is only the first step in the Estate Planning Process to avoid probate (and possibly plan for estate taxes). Similar to a Will, which only governs the distribution of assets of the Probate Estate, the Revocable Trust only controls property owned by the trust or made payable to the trust. Thus, title to any of your assets in your sole name must be transferred to the trust, made POD/TOD to the trust, or the trust must be the designated beneficiary for the trust to control the distribution of the asset at your death. If an asset is owned in your name without a designated beneficiary or other designation or ownership, then the asset may end up being governed by your trust via Probate. In other words, such assets owned in your sole name without a beneficiary would become a part of your probate estate, and your Last Will and Testament will likely direct the residue of your estate to your Revocable Living Trust. *[Caution: Assets should <u>not</u> be transferred to your trust and your trust should <u>not</u> be designated as the beneficiary of your assets without the advice of your attorney, as there may be income tax or other tax and legal ramifications of doing so for certain types of assets including retirement benefits and annuities].*

### MY LIFE INSURANCE WILL NOT BE SUBJECT TO ESTATE TAX OR PROBATE TAX AT MY DEATH IF I HAVE NAMED A BENEFICIARY OF THE POLICY AT MY DEATH:

**IT DEPENDS!**

Avoiding Probate does not mean the asset is not subject to estate taxes. These are two separate issues, which are often confused and misunderstood. The "Gross Estate" for Estate Tax purposes is NOT the same as the "Probate Estate." In general (and over simplified!), all assets that the decedent owned or controlled at death are part of the Gross Estate for Estate Tax Purposes. The fact that assets have been titled to pass in a manner to avoid probate at your death does not have any bearing on whether the asset is part of the Gross Estate for Estate Tax Purposes. In other words, all assets of the Probate Estate and all other assets the decedent controlled or owned at death are part of the Gross Estate for Estate Tax Purposes.

Part of this misconception (especially with life insurance) is that life insurance on a decedent's life is excluded from the Gross Estate for Estate Tax Purposes if the decedent did not own any incidence of ownership in the policy at death (among other rules). If set up correctly, and an Irrevocable Life Insurance Trust (ILIT) owns the policy insuring your life, then the proceeds may not be included in the Gross Estate (but again, there are many details that must be carefully followed for the life insurance proceeds paid to the ILIT to be excluded from the decedent's Gross Estate for Estate Tax purposes).

### PROBATE TAXES ARE VERY HIGH!

**FALSE - IN PART**

There is not a "probate tax" on the probate estate. There are (i) court costs (ii) personal representative or executor fees, and (iii) attorney fees charged to the probate estate. Again, the concept of Probate fees is commonly confused and interchanged with the Estate Tax (which is now taxed at a marginal rate of 40% once assets of the decedent's gross estate (which includes probate and non-probate assets) exceed the exemption amount for the year of death ($5,250,000 in 2013). In other words, probate does not have any bearing on the estate tax and vice versa, these are two separate issues.

### IF I DO NOT HAVE A WILL THEN ALL OF MY ASSETS WILL PASS TO MY SPOUSE, OR IF MY SPOUSE DOES NOT SURVIVE THEY WILL PASS TO MY CHILDREN.

**IT DEPENDS ON WHERE YOU LIVE!**

If you die without a Will, then any assets without a beneficiary designation or other ownership or contractual designation controlling the transfer or disposition at death, will be distributed pursuant to the state's (usually the state of domicile) "Substitute Will." The state's Will statute (in Missouri RSMo Section 474.010) may not match your desired division and distribution. For example, *if a decedent died domiciled in Missouri without a Will, leaving behind a spouse and two children who were issue of both the decedent and the surviving spouse, the probate assets would be distributed as follows: (i) $20,000 would be distributed to the surviving spouse (ii) ½ of the balance of the probate estate would be distributed to the surviving spouse, and (iii) ½ of the balance would be distributed to the decedent's children.* This is probably <u>not</u> the method of distribution many people would expect or desire.

### IF I NAME MY CHILDREN AS BENEFICIARIES OF MY ROTH IRAS, THEY WON'T BE REQUIRED TO TAKE MINIMUM DISTRIBUTIONS FROM THE ROTH IRA ACCOUNTS DURING THEIR LIFETIME.

**SORRY - THIS IS FALSE AS WELL**

Roth IRAs are a relatively new provision in the tax code. While the owner of the Roth IRA is not required to take distributions during the owner's lifetime, after the Roth IRA owner's death, the beneficiaries are required to start taking distributions from the accounts. The amount that is required to be distributed each year is called the "minimum required distribution" or MRD. There is an exception if the spouse is named as the beneficiary, as the surviving spouse has the option to treat the Roth IRA as their own IRA and delay the MRD until after their subsequent death.

## *In the News*

The Firm is pleased to announce that Jennifer K. Huckfeldt was recently appointed to The Board of Law Examiners for a nine year term.

Jennifer is one of six members, appointed by the Supreme Court of Missouri, that make up the board. The duties of the board include determining the eligibility for admission to the bar, providing for and conducting the bar examinations and determining the character and fitness of applicants for admission to the bar.

Jennifer replaces Clifford S. Brown, on the Board. Cliff recently completed his ninth year on the board. Jennifer is a Shareholder of the Firm and concentrates her practice primarily in the areas of Estate, Gift and Income Taxation.

# Seven CECB Attorneys Selected for Inclusion on the 2012 Missouri-Kansas Super Lawyers and Missouri Kansas Rising Stars Lists

Each year, Law & Politics Magazine invites lawyers in each state to nominate top Missouri and Kansas lawyers they've personally observed in action. Research is then conducted on each candidate dividing them into practice areas. A panel of preeminent peers in each practice area then evaluates each candidate. From the original pool of candidates, only 5 percent of Missouri and Kansas attorneys are selected for inclusion in Super Lawyers and no more than 2.5% are named to the Rising Stars list. Meet the Seven CECB Attorneys that were included on the lists.

## SUPER LAWYERS LIST

John M. Carnahan III is a shareholder in the Transactional and Estate Planning Practice Groups of Carnahan, Evans, Cantwell & Brown, P.C. He concentrates his practice in the areas of tax planning, corporate transactions, estate planning, and business succession planning for family-owned businesses. John has been awarded an AV Rating by Martindale-Hubbell.

John is a member of the American College of Tax Counsel. The College is made up of approximately 700 fellows who have been chosen by their peers in recognition of their outstanding reputations and contributions in the field of tax law. John is also a fellow of the American and the Missouri bar foundations.

John is also a member of the Springfield Metropolitan and American (Member, Sections on: Taxation, Business Law, and Real Property, Probate and Trust Law) Bar Associations, as well as The Missouri Bar (Chairman, Taxation Committee, 1984-1985). John has also served as an author and editor for the *Missouri Law Review, The Journal of S Corporations and The Tax Lawyer*.

John recently completed service as a member of the Board of Curators of the University of Missouri System (2005-2011).

John as been included on the *Missouri Kansas Super Lawyers*® list since 2006.

William E. Evans is a shareholder in the Transactional Practice Group of Carnahan, Evans, Cantwell & Brown, P.C. He concentrates his practice in the areas of taxation, corporations, real estate, business, and employer/employee law. He has been awarded an AV Rating by Martindale-Hubbell [highest rating possible].

Bill has significant experience in mergers and acquisitions, tax free like-kind exchanges of real estate, and the formation and planning of limited partnerships, limited liability companies, and corporations.

From July of 2003 to July of 2006, Mr. Evans was Legal Advisor to the International Brotherhood of Magicians, a not-for-profit organization consisting of over 12,000 amateur and professional magicians worldwide. Mr. Evans currently is a Member of the Board of Trustees and Chairman of the Grievance Committee.

Bill is a fellow in the American College of Tax Counsel, an elite group of only 700 tax lawyers in private practice, in law school teaching positions and in government, who are recognized for their excellence in tax practice and for their substantial contributions and commitment to the profession. Bill has also been named to the "Best Lawyers in America" list by the publication of the same name.

Mr. Evans has been included on the *Missouri Kansas Super Lawyers*® list in 2006, and 2010-2012.

Joseph (Chip) Dow Sheppard, III is a shareholder and Chairman of the Litigation/Dispute Resolution Practice Group of Carnahan, Evans, Cantwell & Brown, P.C. He concentrates his practice in the areas of real estate, business, securities and intellectual property litigation, dispute resolution and transactions.

A substantial portion of Chip's practice includes securities and other fraud and fiduciary duty related claims, both as an arbitrator and as counsel for the parties. He has tried a combined total of more than 50 arbitrations, state and federal trials, both jury and non-jury, in his areas of concentration. Other areas of concentration are various business transactions, acquisitions, real estate development and related litigation and probate litigation.

Chip is a board member and currently the President of the Springfield Metropolitan Bar Association, Chairman of the Non-Partisan Court Plan Committee, member of the American Bar Association, the Missouri Bar and the Public Investors Arbitration Bar Association. In 2005 he was elected as a Fellow of the American Bar Association, an honor bestowed upon less than .5 percent of the Bar. In 2008, he Co-Chaired the Greene Countians for Fair and Impartial Judges Committee which was responsible for bringing the Missouri Court Plan to Greene County, was a finalist for Missouri Lawyer of the Year and received the Missouri Bar Association and Springfield Metropolitan Bar Association President's Awards in recognition of extraordinary service to those Associations and the legal profession. Chip has also been named to the "Best Lawyers in America" list by the publication of the same name.

Chip was selected to the Missouri Kansas Super Lawyers® list in 2005 and 2006 and again for 2010-2012.

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*Super Lawyers List - Continued from Page 4*

Clifford S. Brown practices in the Estate Planning Practice Group of Carnahan, Evans, Cantwell & Brown, P.C. He concentrates his practice in the areas of estate planning, probate, and trust litigation, and related tax matters.

Cliff has served as an educator and speaker on behalf of the Supreme Court of the State of Missouri, the Missouri Bar Association, the University of Missouri - Columbia School of Law, and other organizations in providing continuing legal education to members of the legal profession.

Cliff is listed in Who's Who in American Law, as well as The Best Lawyers in America. He served as the 84th President of the Springfield Metropolitan Bar Association in 2006. In September 2003, he was appointed to the Board of Law Examiners by the Supreme Court. In 1991, Cliff was elected as a Fellow of the American College of Trust and Estate Counsel. Cliff's community involvement includes serving on the Board of Directors of the Burrell Center and the Community Foundation of the Ozarks.

Cliff has been selected to the Missouri Kansas Super Lawyers® list since 2005.

Thomas D. Peebles, Jr. is a shareholder and member of the Estate Planning Practice Group of Carnahan, Evans, Cantwell & Brown, P.C. Mr. Peebles has concentrated his practice in estate planning and estate and trust administration matters since 1980.

Tom has significant experience in the preparation of basic and sophisticated estate planning documents, and in wealth transfer planning for high net worth clients, closely held business owners and their families. He has been awarded an AV Rating from Martindale-Hubbell in recognition of his preeminent work in assisting his clients in achieving their estate planning goals and objectives. In 2004, Mr. Peebles was elected a Fellow of The American College of Trust and Estate Counsel in recognition of distinguished service in the practice of estate planning, probate and trust law.

Tom has been honored since 2010 with being named to the "Best Lawyers in America" list. Tom was also elected by his peers as a Fellow in the American Bar Foundation. Membership as a Fellow in the American Bar Foundation is limited to one-third of one percent of the lawyers in America.

Tom has, over the years, devoted a substantial amount of his time towards civic and charitable activities including the Community Foundation of the Ozarks, the Foundation for the Springfield Public Schools and the Springfield-Greene County Library Foundation. Mr. Peebles was recognized as one of ten "Volunteers of the Year" as part of the 2004 Gift of Time Awards sponsored by the Council of Churches of the Ozarks.

Tom was selected to the Missouri Kansas Super Lawyers® list in 2005 and 2006 and again for 2010-2012.

John E. Price is a shareholder in the Litigation Practice Group of Carnahan, Evans, Cantwell & Brown, P.C., concentrating in civil and business litigation, environmental law, corporate and real estate law and appellate practice. Mr. Price has wide experience in environmental law over the last 30 years. He has handled litigation under the Clean Air Act, Clean Water Act, Superfund and toxic torts. He regularly advises clients on environmental regulation, permitting and real estate transactions. John has an AV Rating by Martindale-Hubbell.

John also has much experience with large, complex real estate and business transactions, and with commercial litigation involving leases, contracts and insurance disputes. He has argued over 75 appeals in federal and state appellate courts.

Mr. Price has served as a board member for eight years and was the 2010-2012 President of the Springfield Sister Cities Association, and is currently on the board and entering a term as the 2012-2013 Chairperson of the Springfield-Greene County Park Board. In the past he has served on the board and as President of the Wilsons Creek National Battlefield Foundation, as a board member and President of the Visiting Nurses Association of Springfield, as a member of the Springfield Environmental Advisory Board, as a member and volunteer for Project Parkway. John was recently honored with a 2012 Gift of Time Award from The City of Springfield and the Council of Churches of the Ozarks.

John has been selected to the Missouri Kansas Super Lawyers® list since 2007.

## RISING STARS LIST

Rich Maltby, a shareholder in the Litigation/Dispute Resolution Practice Group of Carnahan, Evans, Cantwell & Brown, P.C., has been named to the Rising Stars list. This follows his recognition by the Missouri Lawyers Weekly as a Missouri Up and Coming Lawyer in 2011. Rich concentrates his practice in the areas of construction, architectural, engineering and development law, business litigation, real estate litigation, and alternative dispute resolution.

Rich has substantial experience handling all aspects of the construction process, including bidding, contract negotiation, project management, and claims resolution. His representation has included many widely recognized owners, developers, contractors, subcontractors, suppliers, design professionals, and lenders throughout Missouri, the Midwest, and the United States. Rich has counseled clients on diverse multi-million dollar projects, both public and private, including affordable housing, airports, assisted living facilities, biofuels and other industrial and manufacturing plants, casinos, historic rehabilitation and preservation, hotel and resort developments, medical facilities, mixed use developments, office, parking structures, power plants, shopping centers/retail, single and multi-family residential developments including houses, lofts, apartments, and luxury high-rise developments, utility and infrastructure systems, and water distribution facilities.

# An Update on Construction Law in Missouri: Property Owners, Contractors and Lenders Take Heed

By: Rich Maltby

In the last four months of 2012, Missouri's appellate courts have been very busy deciding cases that will impact those in the areas of construction and real estate. Regardless of whether you are a property owner, contractor, or lender, it is important to understand these recent developments. The following is a summary of three notable recent decisions in Missouri:

**1. Supreme Court Sharpens Missouri's First Spade Rule.**

On September 11, 2012, the Missouri Supreme Court issued an opinion in Bob DeGeorge Associates, Inc. v. KD Christian Construction Co., 377 S.W.3d 592 (2012), concerning whether a mechanic's lien was superior to a purchase-money deed of trust that had not been recorded until after the contractor had commenced work. The case overruled several prior decisions in Missouri suggesting that the lender's purchase-money deed of trust encumbering land is prior and superior to a mechanic's lien even if the deed of trust was never recorded.

The contractor brought suit against both the property owner and the bank seeking to foreclose on its lien. The Supreme Court harmonized Missouri's recording statutes, RSMo. §§ 442.380 and 442.400, which require the lender to record its deed of trust with the Recorder of Deeds in order to claim priority over third parties, with Missouri's First Spade Rule, RSMo. § 429.060, which provides that all mechanic's liens commence at the date of the first stroke of the axe or spade regardless of the time of filing the lien, performing the work, or furnishing the materials.

The Supreme Court explained that the recording statutes postpone the effectiveness of an unrecorded deed of trust against a third party who does not have actual knowledge of the instrument. The recording statutes protect persons who acquire an interest in real property without notice of prior encumbrances. The First Spade Rule operates as a "relation-back" priority rule in that a mechanic's lien takes priority over all other encumbrances subsequent to the commencement of the contractor's work regardless of the timing of the filing of the mechanic's lien. Since the bank had not recorded its deed of trust until after the contractor began work, the Court found in favor of the contractor even though its lien was filed after the bank recorded its deed of trust. This is a departure from the trend in the past 40 years to find the bank's interest superior to the contractor under these circumstances.

**2. Appellate Court Places Heavier Burden on Contractors Trying to Enforce Mechanic's Liens.**

The Missouri Western District Court of Appeals was not quite as protective of contractors in R.K. Matthews Investment, Inc. v Beulah Mae Housing, LLC, 2012 WL 4344190, which was decided on September 25, 2012. In that case, a contractor brought an action against a project owner for breach of contract, enforcement of mechanic's lien, and relief under Missouri's Prompt Pay Act. The owner defeated the contractor's claims by successfully arguing that the contractor had failed to follow the requirements of the mechanic's lien statutes.

This case arguably complicates a contractor's ability to enforce lien rights in at least three ways. First, in a contractor's claim for non-payment, the contractor must prove that the work was performed in a good and workmanlike manner. The burden to disprove the quality of work shifts to the owner only if the owner has raised a claim for damages against the contractor. If the owner simply denies the contractor quality of work (rather than asserting a claim), then the burden remains with the contractor to prove it. Second, even though the mechanic's lien statutes do not expressly require a general contractor to include an itemized statement along with the mechanic's lien, failure to do so increases the risk that the general contractor did not meet the "just and true account" threshold which requires a lien statement to provide an owner with sufficient information to investigate whether the labor and materials described in the lien actually improved the property and whether the charges were reasonable. Third, while the existence of errors in a lien statement does not necessarily mean the contractor deliberately intended to defraud the owner (which invalidates the lien), a judge or jury is free to conclude that fraud occurred based on the frequency of errors in the lien and other evidence regarding the lien claimant's lack of credibility.

**3. Appellate Court Smoothes the Road for an Owner to Recover for Overbilling and Defective Work.**

On October 25, 2012, the Missouri Southern District Court of Appeals (which is the district in which we are located) in Matt Miller Company, Inc. v Taylor-Martin Holdings, LLC, 2012 WL 5258713, addressed a number of disputes between an owner and contractor regarding a cost plus contract. The owner was the landlord of a historical building that was the subject of a rehabilitation commercial project involving tax incentives. The owner terminated the contract contending that the contractor failed to perform. The contractor filed a mechanic's lien and the owners filed claims for improper billing and defective work. While the court addressed a number of issues on appeal, perhaps the most noteworthy findings, which largely favored the owner, were as follows:

a. Even though the owner had entered into a lease with its tenants preventing it from repairing or maintaining the building during the term of the lease, the court found that the owner had an interest beyond merely a right to collect rent in that it could sell or mortgage the building at any time and terminate the leases early by paying a penalty. Thus, the owner, as landlord, was a proper party to pursue claims against the contractor for damages.

b. On a cost plus contract where the contractor is to be paid cost of the work plus a fee, the contractor must be able to link percentages in invoices to actual amounts attributable to specific work on the project. Charges structured as percentages for items such as insurance, offsite work, social security, and payroll taxes are unrecoverable unless the contractor can demonstrate the specific percentage pertains to actual work on the project.

c. While it remains the law that an owner's measure of damages is either the cost of repair or the diminution of value of the property, the contractor has the burden to prove diminution of value and a court need only consider diminution of value when that measure of damage is substantially less than the owner's evidence of cost of repair.

d. When a contract contains a consequential damages waiver, the court will narrow that language to allow the owner to recover full repair costs. Thus, in this case, where the repair of defective tuckpointing was necessary, the court found that the damages include an amount for repainting the building after performance of the tuckpointing corrective work.

There are lessons to be learned from each of these recent cases. For instance, lenders should polish up their protocols and checklists as it concerns the filing of deeds of trust in the financing process. In addition, if a contractor hopes to be successful on a lien claim, the contractor should tighten up its record-keeping and err on the side of including greater specificity in its lien statement as to the labor and materials furnished on the project for which payment is due. Moreover, parties to a construction contract can further define terms and conditions to remove ambiguities as to rights and remedies of the parties in the event of default, including the types of damages that are recoverable, which will eliminate the need for litigating many of the issues that surfaced in the Southern District case.

The above construction law update is not intended to be a complete legal analysis as to the facts and circumstances in each of these above cases. For further information as to how these developments may impact your business, please contact CECB at 417-447-4400.

# Arbitration vs. Litigation – Draw your Battle Plan

By: Christiaan D. Horton

With the growing pace of business, and the standardization of transaction documents and contracts, many business owners and individuals are called upon to make quick decisions about their election for dispute resolution. Most do not appreciate the distinction between arbitration and litigation and are not fully informed when making their election on this issue. Because both of these methods of dispute resolution have risks and benefits, every business owner and individual should understand this distinction. There is a great advantage to drawing a battle plan before the war begins.

**Synopsis of Arbitration**. Arbitration is often characterized as a fast-track process to resolve commercial law disputes. In fact, arbitration provisions in contract documents find great support within the merchant community which often seeks a faster method to resolve legal disputes than our traditional judicial system allows. Missouri has adopted special provisions governing arbitrations, and that body of law can be found in Section 435.350 of our Revised Statutes. State law prohibits a "sneak attack" by arbitration and mandates that such clauses be boldly and prominently contained within agreements. Thus, insertion of arbitration provisions in contract documents requires careful attention to insure that proper notice is given under state law due to the significance of the waiver of constitutional rights like the right to trial by jury. Because arbitrations accelerate the pace at which disputes are resolved, this often requires the parties to quickly gather documents, secure witness participation, and comply with a host of procedural requirements including those relating to the selection of the arbitrator or panel that will hear the dispute. It is also important to follow the particular arbitration rules and procedures of the governing body administering the arbitration. For example, the Missouri Association of Realtors has a particular set of arbitration rules and procedures that must be followed in disputes between realtors. The American Arbitration Association has its own set of rules and procedures that guide arbitrations before that tribunal. It is very common for these rules and procedures to be contained in lengthy manuals desired to guide the process and establish the "rules of the game." Although some argue that arbitration is a less costly alternative to our traditional judicial model for dispute resolution, significant costs can be triggered in arbitration including filing fees, arbitrator compensation, tribunal management expenses, and costs to mobilize witnesses to attend arbitration hearings in person.

**Considerations on Finality of Awards.** Many people proceed to arbitration not realizing the potential finality of the decisions that can result from that process. They presume that the arbitration will allow them to "state their case" informally and do not consider the potential for redress in the event of an adverse "award". Often the ability to challenge the award substantively is waived or severely limited, and in some cases, only procedural irregularities in the process may be challenged. Results of this nature are especially dangerous when the arbitrator is not trained in the law but must decide legal issues that affect the rights of the parties. Although most arbitrations will have a hearing transcript of the proceedings and allow the relaxing of evidentiary standards for proof and admissibility of documents and testimony, these safeguards are not applied uniformly and can create pitfalls for unsuspecting participants. Overturning an arbitration award is very difficult, and if competent legal counsel is not involved in the actual arbitration to make a proper legal record, due process rights in the hearing process can be significantly jeopardized.

**Traditional Justice by Civil Action.** Our Court system supplies trained Judges, funded by tax-payer dollars, to hear legal disputes. The Missouri Supreme Court promulgates civil rules that govern judicial proceedings across the State. Although civil rules may vary slightly county-by-county, they are essentially uniform in most respects. Licensed attorneys who litigate in our court system are very familiar with these civil rules which are designed to allow the parties an opportunity to engage in formal discovery so evidence can be fully developed by each side prior to a trial in the case. It is true that the "wheels of justice" turn more slowly in our court system, but there is ammunition within the body of civil rules that allow the parties to seek judicial relief on an expedited basis. Typically, the party filing the action will pay a nominal filing fee and service fees relating to the formal service of the petition and summons on defending parties, but no additional amounts are required to be paid to secure a position on the Court's docket. Furthermore, Judges are required to follow the law that controls the case and are held accountable through the right of each litigant to appeal the judicial decisions made, even on substantive issues in the case. There certainly are more due process safeguards available in our traditional judicial model for dispute resolution, and many attorneys prefer the ability to carefully develop the evidence for their case before trial which takes time. However this model of dispute resolution can be very costly and attorney fees can escalate quickly, especially through the discovery process.

**Which Battle Plan is Best?** With these distinctions in mind, solid arguments can be made that arbitration is a better model for certain disputes while our traditional judicial model is better for others. Individuals who are presented with binding arbitration clauses should at least be fully informed on the arbitration process and procedures that will be invoked if a future dispute arises. Arbitration participants are strongly cautioned from proceeding in arbitration without legal counsel. Knowing the specific procedural rules of the arbitration tribunal is vital for the protection of legal rights and assurance of due process guarantees. Appreciating the risks involved in the finality of an award is also very important because redress from an adverse decision may be significantly limited. Except in exceptional circumstances, Courts rarely disturb an arbitration award once arbitration procedures have been followed and exhausted. Those submitting to arbitration need to be prepared to accept the arbitration award, good or bad, and move away from the battlefield in most cases. Those who elect the judicial path have a greater opportunity to appeal adverse decisions, but the potential for protracted litigation and the cost and expenses associated with "funding the war" carry consequences of their own. Before executing a contract or agreement that contains a standard arbitration clause, pause to consider the above distinctions and what may best serve your strategy in the event of a future dispute. If you are uncertain, obtaining a swift legal opinion on that topic is wise "intelligence" in the event war breaks out.

## *In the News*

We are very pleased to announce that Joseph D. "Chip" Sheppard, III has been elected the 2013 President of the Springfield Metropolitan Bar Association. The SMBA is an association of more than 900 local attorneys. The mission of the SMBA is to maintain the honor and dignity of the profession of law, to cultivate social intercourse among its members and for the promotion of legal science and the administration of justice. Congratulations to Chip! Clifford S. Brown was also President of the SMBA in 2006.

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Founded in 1979, Carnahan, Evans, Cantwell & Brown, P.C. is a locally owned and operated law firm noted for its commitment to providing superior client service to a diverse client base, including national and regional businesses, financial institutions, not-for-profit organizations and individual clients. The Firm currently has 18 attorneys, including seven who have their Master of Laws in Taxation. An "A-V rated" preeminent law firm by Martindale-Hubbell, our attorneys are engaged in the general business practice of law with an emphasis in the following areas:

- Business Organization and Planning
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