Design and Construction Management Professional Reporter

September 2016

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Supreme Court Rules That Grounds for Judicial Review of an Arbitration Award Cannot be Altered by a Contract

By Kristen R. Ragosta, Esq.

ON MARCH 9, 2016, the Supreme Judicial Court of Massachusetts ("Supreme Court") ruled[1] that parties to a commercial arbitration agreement may not alter by contract the scope or grounds for judicial review of an arbitration award that are set out in the Massachusetts Uniform Arbitration Act for Commercial Disputes ("MAA").

The underlying dispute involved shareholders of an accounting firm ("Firm") whose professional relationship was governed by a shareholders' agreement ("Agreement"). In 2011, three members of the Firm ("Plaintiffs") voted to terminate the fourth member ("Defendant") from the Firm purportedly pursuant to the terms of the Agreement based on certain work that Defendant had performed for a Firm client. Soon after his termination, Defendant opened his own accounting Firm ("Defendant Firm"). Defendant did not agree that his termination was in accordance with the Agreement's terms.

Pursuant to the Agreement's arbitration clause, the issue of whether Defendant's termination was required by the terms of the Agreement was submitted to binding arbitration. On December 19, 2012, the arbitrator issued an award that concluded that Defendant had been validly terminated "for cause" pursuant to the Agreement. The arbitrator's award was ultimately confirmed by the Superior Court over Defendant's objection and despite Defendant's various motions seeking to vacate or modify the award or for a new trial, all of which were denied. Plaintiffs were awarded attorneys' fees, and Defendant filed an appeal from both the judgement confirming the arbitration and the court's denial of his post judgment motions.

The Supreme Court granted Defendants' application for direct appellate review as to whether the arbitrator's award should be vacated on the grounds that the arbitrator committed an error of law in interpreting the Agreement. Contrary to the general rule that an arbitrator's error of law or fact, no matter how erroneous, will not be reviewed by a court unless there is "fraud, corruption, or other undue means"[2], Defendant argued that the error of law was subject to review because the Agreement's arbitration clause provided for judicial review to determine whether there was a "material, gross and flagrant error" by the arbitrator.

The Supreme Court affirmed the judgment holding that, although arbitration is a

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Colorado Supreme Court Finds Tort Claims Not Barred by the Economic Loss Rule if Supported by an Independent Duty

By Lauren E. King, Esq.

ON JUNE 27, 2016, THE SUPREME COURT OF COLORADO issued a decision[1] holding that a tort claim alleging pre-contractual misrepresentations creates an independent duty of care under tort law and is, therefore, not barred by the economic loss rule.

Petitioner ("Petitioner") sells metaphysical crystals through his website. In early December 2009, Petitioner entered into a contract with a website developer ("Developer") to perform web-related services. Developer represented itself as a web design, search-engine optimization ("SEO"), webhosting, and media company. Additionally, Developer advertised itself as a certified Gold Partner of a leading e-commerce software ("E-Commerce"). Based on these representations Petitioner contracted with Developer to create a new website using E-Commerce, design three additional websites, and provide ECC Integration (a QuickBooks application), training, and website optimization. The contract between Petitioner and Developer provided that the sites would go live on January 22, 2010.

Rather than furnishing working websites on January 22, 2010, Developer informed Petitioner that the websites would not be ready until March 4. On March 2, the parties entered into a second contract for SEO services. Developer again delayed the date the websites would be operational to April 1. The parties then entered into a third contract in which Developer agreed it would host the website on its own server. Ultimately, SEO services were not performed and the website was hosted on a shared server. When the website went live on April 1, the Petitioner alleged the natural search rankings were destroyed, there were broken website sections, and the website was slow due to placement on a shared server. Petitioner claimed these malfunctions caused "irreparable harm" to his website and brand.

Petitioner sued Developer for negligence, fraud, constructive fraud, fraudulent concealment, negligent misrepresentation, civil theft, violation of the Colorado Consumer Protection Act ("CCPA"), and three breaches of contract. The trial court dismissed all but Petitioner's contract claims, and the court of appeals affirmed the dismissal, finding the economic loss rule barred his tort and civil theft claims, and lack of impact as to his CCPA claim.

Colorado recognized the economic loss rule in the seminal case *Town of Alma v. AZCO Constr., Inc.,* 10 P.3d 1256 (Colo. 2000). In *Town of Alma,* the Supreme Court concluded that "a party suffering only economic loss from the breach of an express or implied contractual duty may not assert a tort claim for such a breach absent an independent duty of care under tort law."[2]

The question in Petitioner's case was not whether Petitioner's tort claims were related to the promises forming the basis of the contract, but whether the tort claims flowed from an independent duty under tort law. Petitioner argued that not only had Developer breached its obligations under the contract, but also, that it wrongfully induced the Petitioner into entering into a contractual relationship while knowing that it did not have the capabilities to perform the promised web-related services. Petitioner argued on appeal that the latter allegations constituted a violation of an independent tort duty and, therefore, his tort claims were not barred by the economic loss rule.

Colorado recognizes an independent tort duty where negligent misrepresentations induce the contractual arrangement. Citing this principle, the Colorado Supreme Court found that to survive a motion to dismiss, Petitioner merely had to allege facts, taken in the light most favorable to him, that would amount to a violation of a tort duty that is independent of the contract. The Colorado Supreme Court concluded that Petitioner had met this burden, and reversed the judgment of the court of appeals as to the tort claims.

The Colorado Supreme Court did not reach the question whether the economic loss rule applied to Petitioner's civil theft or CCPA claims, thereby affirming the dismissals of the court of appeals on the grounds that Petitioner failed to allege sufficient facts to support those claims.

1 *Van Rees v. Unleaded Software, Inc.,* 373 P.3d 603 (Colo. 2016).
2 *Town of Alma,* 10 P.3d 1256, 1264 (Colo. 2000).

New York Appellate Court Enforces the Economic Loss Doctrine and Bars Contribution Claim

By Nicholas G. MacInnis, Esq.

IN A DECISION UPHOLDING THE APPLICATION OF THE ECONOMIC LOSS DOCTRINE in New York, the First Department Appellate Division recently affirmed a finding of summary judgment granted in favor of a design professional.[1]

Economic Loss Doctrine

The economic loss doctrine provides that where a party has suffered only economic damages, it may recover only in contract, but not in tort. While tort law provides a basis for recovery in the context of personal injury or property damage, economic loss refers to damages arising from financial harm including, but not limited to, lost profits, reduced value of property or deficient performance. Although the doctrine initially arose in the context of products liability litigation, courts have applied it in many different situations, including construction litigation. In this context, the economic loss doctrine preserves the line between recovery under a theory of tort law and recovery under a contractual claim.

A construction project is generally governed by the written contracts entered into by and between the multiple parties providing work or services (i.e., the owner, architect, engineer and contractor) and these contracts govern the rights and obligations of the respective parties. Since the entities involved may, and often do, sustain losses resulting from the conduct of another party with which it has no contractual privity, New York courts tend to disfavor negligence claims brought by third parties seeking recovery of economic damages in the absence of personal injury or property damage.

New York courts have also precluded contribution claims under CPLR § 1401 when one party seeks contribution from a third party for economic losses sustained as a result of a breach of the first party's contract.[2] Specifically, the New York Court of Appeals held in *Sargent*[3] that "purely economic loss resulting from a breach of contract does not constitute 'injury to property' within the meaning of New York's contribution statute."[4] The *Sargent* Court reasoned that:

> Nothing in the legislative history or the common-law evolution of the statute on which to base a conclusion that CPLR 1401 was intended to apply in respect to a pure breach of contract action such as would permit contribution between two contracting parties whose only potential liability to the plaintiff is for contractual benefit of the bargain.[5]

It was on this basis that the First Department affirmed the trial court's decision in favor of a design professional in *Board of Mgrs. of the A Bldg. Condominium v. 13th & 14th St. Realty, LLC,* 126 A.D.3d 634, 635, 6 N.Y.S.3d 249 (1st Dep't 2015), as discussed herein.

Project Background

This action arose from the construction of the A Building Condominium located in New York City the ("Building"). Pursuant to a contract with the Owner, the contractor ("Contractor") was retained to serve as the construction manager for construction of the Building the ("Project").

Prior to commencement of construction, the geotechnical engineering firm ("Engineer") entered into an agreement with the Owner to perform certain geotechnical engineering services as part of a subsurface investigation ("Engineering Contract"). While the Engineer ultimately issued a report, which included certain recommendations concerning waterproofing, it is unclear whether those recommendations were ever adopted. In any event, the submission of that report ended the Engineer's involvement on the Project — it performed no services during construction.

At some point in March 2006, a second geotechnical engineering firm ("Engineer 2") was retained to monitor the movement of two structures adjacent to the Building during the excavation phase of the Project ("Engineering Contract 2"). Engineer 2 provided services as agreed and finished its work on the Project in May 2006. Indeed, Engineering Contract 2 did not require Engineer 2 to provide any additional work or services beyond this supervisory function during the excavation phase of the Project.

Underlying Action

On or about July 23, 2012, the plaintiffs in the underlying action filed an Amended Complaint against the Contractor and other parties involved in the Project seeking damages allegedly resulting from deficient work during construction of the Project. The plaintiffs asserted two causes of action, one in negligence and the other in contract, against the Contractor. The plaintiffs

sought to recover the cost to repair the allegedly deficient work, and for the corresponding diminution of value to the Property allegedly caused by design and construction defects.

The Contractor subsequently moved to dismiss the claims asserted against it, arguing that where the claimed damages involved only economic losses there can be no finding of liability in tort against it absent a finding of an independent duty outside of the boundaries of its contract. The trial court agreed, and dismissed the claims on the grounds that they were barred by the economic loss doctrine. More specifically, the trial court concluded that the plaintiffs could not recover economic losses resulting from negligent construction from parties with which it had no contractual relationship.

Contractor v. Engineers 1 and 2

Following the foregoing decision, the Contractor asserted third-party claims against Engineers 1 and 2, among others, seeking contribution. These claims were based on allegations that Engineers 1 and 2 improperly performed their respective services thereby giving rise to a dangerous condition. While acknowledging that it had not contracted with either engineer, the Contractor nevertheless sought to recover damages from these parties even in the absence of such contractual privity. The engineers then moved to dismiss the Contractor's claims.

The court found that, where "[Contractor] had successfully argued on its prior summary judgment motion that plaintiffs are seeking only economic losses arising from a breach of contract, it may not now take the inconsistent position that plaintiffs are seeking other damages as well." The First Department then held that the trial court had properly dismissed the Contractor's contribution claim against the engineers. Indeed, the court concluded that "[t]hose claims are barred, because plaintiffs' complaint seeks to recover only economic losses resulting breach of contract." (citations omitted). Since only economic losses were sought in the underlying claim in chief, and were barred, there was no basis for a third party claim seeking the same, barred damages.

The decision reached by the First Department Appellate Division endorses the long-standing rule in New York that the economic loss doctrine prohibits contribution under the state's contribution statute, CPLR § 1401.[6] Indeed, the "determining factor as to the availability of contribution is not the theory behind the underlying claim but the measure of damages sought."[7] Thus, contribution is unavailable in situations in which an underlying plaintiff seeks to recover economic damages which were otherwise barred.[8]

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1 *Board of Mgrs. of the A Bldg. Condominium v. 13th & 14th St. Realty, LLC,* 126 A.D.3d 634, 6 N.Y.S.3d 249 (1st Dep't 2015).

2 *See e.g. Board of Ed. of the Hudson City School District v. Sargent, Webster, Crenshaw & Folley,* 71 N.Y.2d 21, 517 N.E.2d 1360 (1987) (holding that damages resulting from a breach of contract is economic loss and not injury to property).

3 *Id.*

4 *Id.*

5 *Id.* at 28.

6 *See Sound Refrig. & A.C., Inc. v. All City Testing & Balancing Corp.,* 84 A.D.3d 1349, 924 N.Y.S.2d 172 (2d Dep't 2011).

7 *Rockefeller Univ. v. Tishman Constr. Corp.,* 240 A.D.2d 341, 343 659 N.Y.S.2d 460 (1st Dep't 1997).

8 *Trump Village Section 3, Inc. v. New York State Housing Finance Agency,* 307 A.D.2d 891, 897, 764 N.Y.S.2d 17 (1st Dep't 2003).

Resentful Homeowner Lacks Reliance and Proper Timing

By Gregory S. Paonessa, Esq.

IN A PECULIAR ACTION, A SURVEY ENGINEER ("SURVEY ENGINEER") was retained by a Homeowner in March 2009 prior to Homeowner purchasing a foreclosed residence ("Property"), located in Marblehead, Massachusetts, which it planned to demolish in order to construct a new home on the Property. Survey Engineer surveyed the Property ("Survey") in April 2009, relying heavily on a prior survey performed by a different survey engineer. The resulting survey showed that the Property was not of sufficient size to enable Homeowner to construct the home it had planned on the Property, and that a strip of land Homeowner believed it owned was, in fact, owned by its abutting neighbors ("Abutters"). After performing the work, Survey Engineer realized that it had performed survey work for one of the Abutters in the past, and Survey Engineer did not disclose this past relationship to Homeowner.

Within a few weeks after receiving Survey Engineer's Survey, Homeowner rejected its conclusions and retained a new Survey Engineer ("Survey Engineer 2") to re-survey ("Survey 2") the Property. Survey 2 deviated sufficiently from Survey to enable Homeowner to obtain the necessary permits to perform the work it intended on the Property. Survey 2 also showed that Homeowner was the rightful owner of the contested strip of land identified in Survey. However, the Abutters objected to the proposed work, claiming that Homeowner did not have sufficient setbacks for the work and that they owned the contested strip.

Homeowner constructed the residence and then set out to install a fence on the Property claiming the disputed strip as its own. This led to hostility among Homeowner and the Abutters until the matter was resolved by the parties through a settlement agreement by which Homeowner paid the Abutters a settlement amount in exchange for the disputed strip of land.

In the summer of 2010, after constructing the home but before the Homeowner-Abutter settlement, Homeowner claimed that it could no longer live at the Property due to the ongoing dispute with the Abutters. As a result, Homeowner moved out of the newly constructed home and listed the Property for sale. Homeowner had difficulty selling the Property, allegedly due to the Property boundary dispute. After leaving the Property vacant for almost two years and incurring expenses related to moving, rent and travel, Homeowner moved back into the Property. Homeowner remained in the Property for two more years, ultimately selling the Property in October 2014 for a price of $825,000, realizing a gain of $95,000 given the Homeowner's original purchase price of $230,000 and construction costs of $500,000.

On May 8, 2014, Homeowner filed an action against Survey Engineer in the Massachusetts Superior Court seeking damages for a multitude of costs unrelated to the Property, such as moving expenses, interest on college loans for its children, travel costs to and from work and other unusual damages that it alleged resulted from its inability to sell the Property due to the ongoing dispute between Homeowner and the Abutters. Homeowner asserted causes of action against Survey Engineer for: (1) Breach of Contract and Fiduciary Duty; (2) Fraud and Intentional Misrepresentation; and (3) Negligence.

Counsel for Survey Engineer prepared a detailed and thoughtful Memorandum of Law in Support of Summary Judgment, seeking dismissal of all claims asserted by Homeowner against Survey Engineer on the basis of the statute of limitations.[1] After the hearing, the Court allowed Survey Engineer's Motion for Summary Judgment for the following reasons:

I. Breach of Contract and Fiduciary Duty

The Court found that, although the Complaint mentioned a breach of contract and breach of fiduciary duty, the allegations recite only an alleged breach of fiduciary duty. The Court agreed with Survey Engineer that there was no fiduciary relationship reasoning that the law does not establish an automatic fiduciary duty between a surveyor and client. In the absence of a legally established fiduciary duty, one can be created by circumstances.[2] To create a fiduciary duty, a plaintiff must prove that he or she relied upon a defendant's expert knowledge and the defendant knew that the plaintiff intended to rely on such knowledge.[3] Here, it was evident that the Homeowner did not rely on Survey Engineer's Survey because Homeowner almost immediately retained Survey Engineer 2 after receiving Survey Engineer's results. The Court found that, without reliance, there was no fiduciary relationship to breach and dismissed the claim for breach of contract and fiduciary duty.

II. Fraud and Negligent Misrepresentation

The Homeowner's fraud and intentional misrepresentation claim was based on Survey Engineer's alleged intentional failure to disclose its long-standing relationship with one of

the Abutters that had retained Survey Engineer to perform survey work on an unrelated property. A claim for fraudulent misrepresentation requires a plaintiff to establish the following five elements: the defendant intentionally made "a false representation of material fact, with knowledge of its falsity, for the purpose of inducing the plaintiffs to act on this representation, that the plaintiffs reasonably relied on the representation as true, and that they acted upon it to their damages."[4] Fraudulent intention can be found due to willful blindness or material omission.[5]

The Court found that a jury could conclude that Survey Engineer committed a fraud by omission by failing to disclose its long-time relationship with one of the Abutters. However, once again, the Court found that the Homeowner could not establish reasonable reliance because Homeowner could have relied only until it retained Survey Engineer 2. The Court also found that Homeowner failed to provide any evidence that it suffered harm due to the alleged fraudulent omission made by Survey Engineer between March 2009, when Survey Engineer completed its survey, and April 2009, when Homeowner received Survey 2. Since Homeowner failed to provide any evidence from which a jury could find the final two elements of fraud (reasonable reliance and damages), the Court granted the summary judgment motion on this cause of action.

III. Negligence

Homeowner alleged that Survey Engineer's survey was negligently performed because of the differences between Survey and Survey 2. Homeowner testified that it immediately thought Survey Engineer's Survey was incorrect, so it hired Survey Engineer 2 to re-survey the Property. Homeowner received Survey 2 on May 19, 2009. Therefore, the last day upon which Homeowner could have filed its Complaint for negligence against Survey Engineer was May 18, 2012. Homeowner filed suit on May 8, 2014, almost two years beyond the expiration of the applicable three-year statute of limitations. As such, the Court granted Survey Engineer's summary judgment motion on the negligence count. Having determined that none of the three counts were supported by evidence or, in the alternative, were time barred, the Court dismissed the action against Survey Engineer in its entirety.

In the end, claims for breach of fiduciary duty and for negligent misrepresentation cannot survive in the absence of reliance. Furthermore, and most importantly with respect to this decision, although the statute of limitations may be extended through an exception for the design, planning or construction of real property, that exception is not applicable to surveying. In light of that, the statute of limitations is subject only to the discovery rule which provides that the statute begins to run from the date of discovery of the issue.

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1 G.L. c. 260, § 2A provides that: ". . . actions in tort . . . shall be commenced only within three years next after the cause of action accrues." While G.L. 260, § 2B provides for a longer limitations period for tort actions arising from the design, plan or construction of real property, land surveys do not fall within this exception. *Raffel v. Perley, 14 Mass. App. Ct. 242 (1982).* Under the discovery rule, the limitation period begins running when Plaintiffs knew, or should have known, of the negligent act. *Bowen v. Eli Lilly & Co.,* 408 Mass. 204 (1990).

2 *Davidson v. Gen. Motors Corp.,* 57 Mass. App. Ct. 637,642 (2003).

3 *Broomfield v. Kosow,* 349 Mass. 749, 755 (1965).

4 *Cumis Ins. Soc'y, Inc. v. BJ's Wholesale Club, Inc.,* 455 Mass. 458, 471 (2009).

5 *Commonwealth v. Mimless,* 52 Mass. App. Ct. 534, 2002.

Defense Verdict Highlights Importance of Defining Beneficiaries in Contracts

By Brian C. Newberry, Esq.

DONOVAN HATEM RECENTLY OBTAINED a complete defense verdict in a jury trial in Worcester Superior Court on behalf of a surveyor. The claim had been brought by some homeowners who did not have a direct contractual relationship with the surveyor. Rather, the homeowners had reached a separate agreement with their neighbor to transfer some property, and the neighbor was charged with procuring and paying for all professional services in connection with the transfer. The surveyor had a written contract with the neighbor that did not specifically reference the plaintiffs or their property. Further, the contract did not specify the exact nature of the survey services to be performed. Nonetheless, the conditions surrounding the agreement made it clear that the survey would have some effect on the plaintiffs' property.

The surveyor acknowledged an error in connection with the zoning restrictions on the parcel. Although the boundaries were correct, the act of conveying the property destroyed the grandfathering of both properties in connection with their respective septic systems resulting in the need for a variance. Plaintiffs claimed that the surveyor had a duty to identify this issue and alert the two adjoining parcel owners of the problem, and further alleged that preparation of the plan with the incorrect zoning designation was a negligent misrepresentation.

Plaintiffs brought claims for breach of contract under an intended third-party beneficiary theory as well as for negligent misrepresentation. Although Plaintiffs attempted to argue a negligence claim, the lack of privity of contract barred such a claim under the economic loss doctrine. Plaintiffs claimed damages were wholly economic, consisting of the difference in value of a lost sale opportunity. The purchaser allegedly backed out when the mortgage bank discovered the title defect. The home was later sold for a lower purchase price to another buyer once the variance was obtained.

The most important claim involved the third-party beneficiary theory and turned on the question of whether the Plaintiffs were intended or incidental beneficiaries of the contract to which they were not direct parties. The jury ultimately concluded that the Plaintiffs were, in fact, intended beneficiaries, though they found there had been no breach of the contract. All design professionals should keep in mind this important distinction because contract claims by non-parties to contracts can be brought only if the claimants are intended third-party beneficiaries. The distinction, as in this case, often turns on the specific facts of each instance, but in drafting contracts, design professionals should make it clear that the contract is for the benefit of the other contracting party or parties, and should include disclaimer language clearly stating that the contract is not intended to benefit any party not specifically a party to the contract. Had such language been included in this instance, the breach of contract claim would have been susceptible to resolution on summary judgment.

Supreme Court Rules *continued from page 1…*

matter of contract,[4] parties to a contract may not modify the scope of judicial review that is contained in the MAA. The Supreme Court found that the MAA directs that a court "shall confirm" an award unless grounds for vacating it pursuant to the MAA are shown; this statutory language "carries no hint of flexibility."[5] The Supreme Court's ruling mirrored a similar decision[6] rendered by the United States Supreme Court which determined that the grounds stated in the Federal Arbitration Act (FAA[7]) for vacating or modifying an arbitration award were exclusive grounds, and that parties could not expand the grounds, thereby expanding the scope of judicial review, by the terms of their agreements.[8]

In affirming the judgment, the Supreme Court explained that, in addition to the MAA language, there are strong policy considerations that support limiting the scope of judicial review of an arbitration award. For example, allowing parties to expand the grounds for judicial review would "undermine the predictability, certainty, and effectiveness of the arbitral forum that has been voluntarily chosen by the parties."[9] In addition, "if parties were able to redefine by contract language the scope of what a court was to review with respect to every arbitration award, it would spawn potentially complex and lengthy case-within-a-case litigation devoted to determining what the parties intended by the contractual language they chose. This contradicts the intent and purpose of the MAA. The policy of limited judicial review preserves arbitration as an expeditious and reliable alternative to litigation for commercial disputes."[10]

Based on the Supreme Court's ruling, parties to an arbitration agreement will no longer be able to alter by contract the grounds for judicial review of an arbitration award that are set out in the MAA.

1 *Katz, Nannis, Solomon, PC. V. Levine,* 473 Mass. 784 (2016).
2 Mass. Gen. Law., c. 251, §§ 1, and 11-13; *Lynn v. Thompson,* 435 Mass. 54, (2001), cert. denied, 534 U.S. 1131, 122 S. Ct. 1071, 151 L. Ed. 2d 973 (2002); *Trustees of Boston & Me. Corp. v. Massachusetts Bay Transp. Auth.,* 363 Mass. 386, 390, (1973).
3 The language in the Agreement that Defendant points to is the following: "The decision of the arbitrator shall be final; provided, however, solely in the event of a material, gross and flagrant error by the arbitrator, such decision shall be subject to review in court."
4 *Commw. v. Philip Morris Inc.,* 448 Mass. 836, 843, (2007).
5 *Hall St. Assocs., L.L.C v. Matell, Inc.,* 552 U.S. 576, 587, 128 S. Ct. 1396, 170 L. Ed. 2d 254 (2008).
6 *Id.*
7 9 U.S.C §§ 1 *et seq.* (2012).
8 522 U.S. at 578, 586.
9 *Plymouth-Carver,* 407 Mass. at 1007, *Hall St., supra* at 588 (purpose of arbitration is to provide efficient alternative to parties seeking finality, not "a prelude to a more cumbersome and time-consuming judicial review process" [citation omitted]).
10 *Katz, supra* at 794.

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