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Origins and Characteristics of Navigation and Trading Warranties

by Stephen F. White, Esq.



Trading Warranties (also called Navigation limits) can be found in almost every marine insurance policy. A typical yacht policy Trading Warranty states:

“This policy provides coverage when the ‘insured yacht’ is being used or navigated within navigation limits specified on the Declarations page.

There is no coverage under this policy if the ‘insured yacht’ is being used or navigated outside the navigation limits specified on the Declarations page.”

The Declarations page may then provide certain route restrictions (e.g., remain in inland waterways), may specify areas to be avoided during hurricane season, or may limit how far offshore the vessel may go before “sailing out of coverage.”

Navigation/trading warranties date back to the early days of sailing. Then, as now, insurers carefully examined the risk and set the premium, based upon whether the vessel would remain in known waters between safe ports, during calm weather, or would be facing dangers such as hurricanes or pirates. Coverage would be immediately terminated once the insured deviated from the warranty. English law has always provided for strict interpretation and application of navigational warranties (known as the “literal compliance rule”). A breach of warranty would void the

policy and coverage of a loss would be denied – even if there was no connection between the violation of the warranty and the cause of the loss.

Until 1955, courts in the United States also followed the “literal compliance rule” in maritime cases. However, that year the U.S. Supreme Court decided the case of Wilburn Boat v.

Fireman’s Fund Ins. Co. In Wilburn Boat the Supreme Court held that the breach of a warranty in a policy of marine insurance should be interpreted in accordance with applicable state law, unless it was found that there was already an “entrenched” precedent under federal maritime law. Admiralty law scholar Alex Parks put it another way:

“Under Wilburn, where a state statute requires that the breach of warranty must contribute to the loss, the state statute governs; where the state statute does not so provide, a mere violation of the warranty is sufficient to void the policy even though the loss may not be attributable to the breach.”

In deciding Wilburn, the Supreme Court apparently attempted to avoid the harsh effect of the literal compliance rule by permitting courts to apply certain “anti-technical statutes” that had been adopted by a minority of states. These statutes

Estate Taxes in Maryland

By Mary Alice Smolarek, Esq.

The estate tax laws have undergone significant changes in recent years. Married couples who prepared estate planning documents prior to 2004 should review their documents to make sure that their plan still meets their needs.

In an effort to eliminate the federal estate tax, Congress passed sweeping legislation in 2001. The federal exemption from estate taxes and the federal estate tax rates were revised with incremental increases in the federal estate tax exemption phased in over time. The federal estate tax exemption now stands at \$2,000,000 per individual. It will increase to \$3,500,000 in 2009. In 2010, it is unlimited because there is no federal estate tax for individuals dying in 2010. In 2011, the federal exemption drops back to the \$1,000,000 level.

This creates a tremendous incentive for wealthy individuals to die in 2010. For example, assume you have an estate of ten million dollars. If you die in 2010, your heirs pay no federal estate taxes. If you survive 2010 and die in 2011 or later, your heirs would pay \$4,795,000 in estate taxes. Congress has been struggling with this dilemma (of their own making) without any success. The estate planning community expects a resolution prior to 2010. We anticipate that the federal exemption will be set at some amount in excess of \$1,000,000.

In order to protect tax revenues, the Maryland legislature froze the Maryland estate tax exemption at \$1,000,000 in 2004. This causes a disconnect between the federal estate tax regime and the Maryland estate tax regime. While the federal exemption continues to increase, Maryland's remains at \$1,000,000. An individual dying with assets of \$999,000.00 will pay no Maryland estate tax. An individual dying with assets of \$1,000,000 will pay \$33,200 in Maryland estate taxes.

A basic estate planning technique for married couples with a taxable estate is to create a trust at the death of the first spouse to protect the exemption of that spouse. Remember, each individual currently has a \$2,000,000 exemption from federal



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estate taxes. With appropriate planning a married couple can take advantage of two exemptions (\$4,000,000). If the couple leaves everything to the surviving spouse, the first spouse's exemption is wasted. A trust can capture the first spouse's exemption, provide support to the surviving spouse and avoid all estate taxes at the second spouse's death. If the pre-2009 trust is funded with the entire \$2,000,000 allowable federal exemption, the estate will pay Maryland \$99,600 in Maryland estate taxes. If the 2009 trust is funded with the entire \$3,500,000 federal exemption, Maryland will receive \$229,200 in estate taxes at the first spouse's death. **IF THIS IS YOUR ESTATE PLAN AND YOU WANT TO AVOID ALL ESTATE TAXES AT THE DEATH OF THE FIRST SPOUSE YOU MUST REVISE YOUR WILL.**

For some large estates, paying a Maryland estate tax at the death of the first spouse makes sense because it is better to avoid a 45% federal estate tax by pre-paying a 7.2% Maryland estate tax. Remember, the \$2,000,000 trust and all the appreciation between the first spouse's death and the surviving spouse's death, avoids estate tax. Once sheltered in the trust it is not subject to estate taxes.

For moderate estates, such as married couples with a combined estate of \$4,000,000 or less, avoiding paying estate taxes at the first spouse's death may make more sense. The trust created

at the first spouse's death can be funded with an amount less than \$1,000,000 to avoid Maryland estate tax and save federal estate tax. At the surviving spouse's death, any assets owned by the surviving spouse which have not been spent will be subject to Maryland estate tax if the total exceeds \$1,000,000, and will be subject to federal estate tax only if the total exceeds \$2,000,000 (or \$3,500,000 in 2009). By placing the \$1,000,000 in trust and sheltering it from estate tax at the first spouse's death, federal estate taxes may be completely avoided at the surviving spouse's death if the federal exemption is large enough. Maryland estate taxes have been avoided on the amount in the trust, and deferred on the amount outside of the trust.

Another option allowable in Maryland is to bifurcate the trust created at the first spouse's death into two trusts: one that is exempt for Maryland and federal purposes, and one that is exempt for federal purposes but deferred for Maryland purposes. This is called the Maryland only QTIP trust. The \$2,000,000 trust would be divided into one \$1,000,000 trust that is exempt from federal and state estate tax at the death of the second spouse. A second trust also funded with \$1,000,000 would be exempt from federal estate tax but would be included in the taxable estate of the surviving spouse for Maryland purposes at that spouse's subsequent death. The Maryland estate tax is only deferred, and any appreciation on the second trust is also subject to Maryland estate tax inclusion at the death of the second spouse.

Most documents drafted prior to the change in Maryland law provided for full funding of the federal exemption into the trust at the death of the first spouse. As noted above this will trigger a Maryland estate tax at the death of the first spouse. The increasing exemption levels may also result in more assets passing in trust than you intended. If you have any questions about how these changes affect your planning, now may be a good time to call us for a review. [WCS](#)

Ferries on the Chesapeake

By David W. Skeen, Esq.



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The EMMA GILES, for nearly half a century until 1936, carried weekend tourists from Baltimore's Inner Harbor across the bay to Tolchester Beach and passengers to Port Deposit, West River, and the Little Choptank. The CITY OF NORFOLK or "the Night Boat," as she was called, made her final sailing from Norfolk to Baltimore on April 13, 1962. George W. Hilton in his 1968 book The Night Boat, describes the experience as follows: "A leisurely dinner at prices comparable to restaurants on shore, a relaxed evening on deck, or in the grand salon, and a night of sleep in the creaking comfort of a berth afloat." In the past centuries the EMMA GILES, The CITY OF NORFOLK and other ferries, including paddlewheel steamers, were part of Maryland's transportation system, providing passenger and freight service linking cities a few hundred miles apart. (Baltimore Harbor: A Pictorial History by Robert C. Keith).

With the 1950's came a massive investment in highway and automotive transportation, including the building of the Bay Bridge, and the ferries disappeared. However, today's increase in vehicular congestion, rising oil and gas prices, infrastructure deterioration, and increasing environmental concerns, may herald a return of ferries to the Chesapeake.

On December 19, 2007 the President signed into law the Energy Independence and Security Act of 2007, which contains a section on "short sea transportation initiative" §1121. "Short Sea" Transportation is another name for movement of goods and passengers by coastal shipping. The new law's purpose: "to establish a short sea transportation program and designate short sea transportation projects to be conducted under the program to mitigate landside congestion." §§(a). The goal is to "provide transportation services for passengers or freight (or both) that may reduce congestion on landside infrastructure using documented vessels." §§(d)(2) The Act directs the Secretary of Transportation to establish designated

short sea transportation projects through coordination with state departments of transportation and the private sector to include marine transportation solutions in their transportation planning to include ferries. The law funds research in consultation with the EPA to study the environmental and transportation benefits to be derived from short sea alternatives as well as the technology and vessel design necessary to reduce emissions, increase fuel economy, and lower the cost of short sea transportation. The bill also qualifies vessels engaged in the short sea transportation trade for capital construction funding under MARAD (U.S. Maritime Administration). Finally, the law provides for a short sea transportation report no later than one year after its date of enactment to describe the activities conducted under the program and any recommendations for further legislative or administrative action.

Studies already exist on the potential impact of short sea transportation among these coastal ports currently serviced by truck traffic along I-95 on the East Coast. See "High Speed Ferries and Coastwise Vessels: Evaluation of Perimeters and Markets for Application" by National Ports and Waterways Institute, Louisiana State University, June 2000. While some barge services already exist in Maryland and elsewhere, the study considers

other potential vessel systems for cargo, including RoRo ships (roll on/roll off freight ferries), which can operate at speeds of 18-22 knots; high speed RoRo Monohulls which can operate at speeds above 28 knots ("fast ships"), high speed RoRo Catamarans at service speeds of 40 knots. Passenger vessels such as Hovercraft and Hydrofoils, are useful for short distance routes and can reach speeds of 50 knots.

Another 2005 study considered the specific ferry route between the Northern neck of Virginia, focusing on the Reedville area in Northumberland County, and the Eastern Shore of Maryland, focusing on Crisfield area in Somerset County. See Maryland-Virginia Ferry Feasibility Study, Step 2 Report February 2008, PD Consult, Inc., PBQ&D, Inc., Baltimore, Maryland. Such a mid-bay ferry (south of the Bay Bridge and North of Virginia's Chesapeake Bay Bridge Tunnel) would relieve transportation congestion by offering a shorter route for automobile travelers and freight originating on the upper Eastern Shore of Virginia to ports north along the Delmarva Peninsula in Maryland, Delaware and New Jersey, including Eastern Pennsylvania, New York and New England.

Other projects in the planning stages including Mid-Atlantic Hovercraft Operations, a planned high-speed Hovercraft passenger ferry servicing multiple routes in New Jersey and Pennsylvania through the C&D Canal to Baltimore, cross Bay landings, Annapolis, Southern Maryland, Washington, D.C. and Virginia. Hovercraft ride on a cushion of air above the waves and generate only a small wake, but can reach cruising speeds of 50 knots. The noise or decibel level is minimal and they have little adverse impact on the environment. Hovercraft can ride up on boat launch ramps at various convenient locations and do not require elaborate terminals. Projections

see **Ferries page 4**

required insurers to prove that a breach of warranty caused or contributed to the loss, before they could deny coverage based upon a breach of warranty. However, despite the Supreme Court's good intentions, since 1955, the lower courts have either ignored Wilburn, or found ways to circumvent it, thereby effectively reinstating the literal compliance rule. Today, an insured's breach of a navigational warranty, provides the marine insurer with one its most potent grounds upon which to void the insurance policy and to deny coverage of losses occurring after the navigational limits have been violated - regardless of whether the violation has any causal connection with the claimed loss.

Some courts have achieved this end by simply following the Wilburn rule. After looking to state law, they find that the state would enforce the literal compliance rule. Other courts have simply ignored Wilburn, and held that there is an entrenched federal maritime law precedent that requires strict compliance with navigational warranties, regardless of causal connection with the loss. Other courts have held that strict compliance is required by both state and federal law. The only courts following Wilburn and applying state laws that require there to be a causal connection between the breach of warranty and the claimed loss appear to be in Texas and Oregon.

On the East Coast of the United States, the following quotation from the Eleventh Circuit's 1988 decision of Lexington Ins. Co. v. Cooke's Seafood appears to summarize the general rule in this geographic region:

"[A]dmiralty law requires the strict construction of express warranties in marine insurance contracts; breach of the express warranty by the insured releases that insurance company from liability even if compliance with the warranty would not have avoided the loss."

Due to the harsh results of a breach of warranty, insurance agents and brokers must be particularly careful when

responding to requests from insureds for a modification of their navigation/trading limits. In several cases, courts have held that agents have spoken with apparent authority for the insurer by notifying insureds that their navigation limits had been modified, when, in fact, the insurer had not approved the change. In such cases, the agents face potential liability to the carrier for conveying unapproved modifications of navigational limits to the insured. In one case the court even held that there was an issue of fact as to whether a broker (usually acting on behalf of the insured) could act for the insurer. On the other hand, courts have held that notice of navigation limits, given by the insurer to the broker, is considered notice to the insured, even though the broker never conveyed the limits to the insured. One insurer attempted to negate the apparent authority of its agent to modify navigation limits without its consent, by relying on the policy language that allows changes to the policy only when made by "us." However, the court held that without express language stating that agents could not bind the insurer to changes, the "us" clause did not relieve the insurer of complying with an extended navigation limit granted by the agent without the insurer's consent.

In several cases, insurance claims for vessels lost beyond their navigational limits have been denied and policies voided by insurers, only to have coverage reinstated by the courts after holding that the real cause of the loss was barratry which is the fraudulent use of a vessel for the Captains own purposes (such as a drug run) without the knowledge or consent of the owners. Where the barratry was initiated before the vessels crossed the navigational limit, such claims were held covered.

Other courts have refused to enforce navigational limits that were not sufficiently described in the policy. Such clauses are still strictly construed against the insurer. Navigational limits must be drafted with great specificity in order to avoid being found ambiguous and unenforceable. In one case, the navigational limit included northern and southern boundaries

of latitude, but failed to specify the distance that could be traveled out to sea. Therefore, the court held that the insured vessel could sail around the world without violating the navigational limits. Of course, as with all warranty clauses, the insurer may waive its right to enforce the navigational limit in the event it does not raise the violation as grounds for the initial declination of coverage.

Navigational limits are fundamentally the result of risk analysis in the formation of the insurance contract. If the insurer is not willing to accept the risk of insuring the vessel beyond a certain point, or after a certain date, it will set navigational limits that it is not required to alter or amend unless it agrees to do so. Any insured that violates navigational limits (except in an emergency) does so at its own peril, with the likely result that its policy will be voided and coverage of any claim made following the breach will be denied, regardless of whether the violation of the navigational limit caused or contributed to the loss. [WCS](#)

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are that with speeds of 48 knots transit times could be competitive with land travel. (Philadelphia and Baltimore 1.50 hours); Philadelphia to Ocean City (2.78 hours) (Philadelphia to Wilmington (.50 hours and a \$10 fare).

Whatever the future of ferry traffic on the Chesapeake, it is unlikely to resurrect the leisurely pace of the CITY OF NORFOLK. But who is to say that the modern traveler might not want to spend a leisurely evening in the salon, experiencing fine dining and avoiding the congestion of I-95 or the Bay Bridge. It sounds like a great way to travel to me. Still as transit times on land continue to lengthen, those of us who have to get there may find that ferries will once again provide an attractive and economical alternative. [WCS](#)

Business Law Updates

By Paul F. Evelius



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MARYLAND NEWS

Business Acquisition Agreements

– Arbitration

In *Essex Corp. v. Susan Katharine Tate Burrowbridge, LLC*, the sellers of a business sued the buyer to resolve a dispute regarding the proper interpretation of an earn-out clause in the parties' acquisition agreement. The Court of Special Appeals held (i) that the purchaser was entitled to appeal from a lower court's denial of its motion to compel arbitration of the dispute and (ii) that the acquisition agreement required the dispute to be resolved in arbitration rather than in court.

Americans with Disabilities Act

– Punitive Damages

In *EEOC v. Federal Express Corp.*, the United States Court of Appeals for the Fourth Circuit, whose jurisdiction includes Maryland, has upheld a jury verdict that imposed a \$100,000 punitive damage award upon FedEx for its failure to reasonably accommodate a deaf employee who needed assistance from an American Sign Language interpreter to perform his job duties.

Powers of Attorney; Confidential Relationships

In *Figgins v. Cochrane*, the Court of Appeals has deemed ineffective a deed by which Figgins, acting as her father's attorney-in-fact pursuant to a durable power of attorney, transferred her father's residence to herself. It thus upheld a trial court's determination that there existed between Figgins and her father a "confidential relationship" which created a presumption that the conveyance was not fair and that Figgins had failed to produce evidence rebutting that presumption. It also affirmed the trial court's finding that the conveyance was not legitimized by a provision in the power of attorney which authorized Figgins to make gifts to herself so long as she considered certain identified factors, such as the nature and extent of her father's assets, tax issues, and the costs of any long-term care that

her father might need. The Court agreed with the trial court that, before making the purported gift, Figgins had not considered those factors.

NATIONAL NEWS

Noncompetition Agreements – Clauses Extending Duration for Violations

In *H&R Block Eastern Enterprises, Inc. v. Swenson*, a Wisconsin appellate court has deemed unenforceable a tax service's noncompetition agreement which stated that the two year period during which a departing employee was prohibited from serving the firm's clients would be "extended by any period(s) of violation." The court reasoned (i) that given the difficulty of determining how long a particular violation lasted, this language made it difficult for the departing employee to "tell from the terms of his or her contract how long the extension will be for particular conduct in violation" and (ii) that because legitimate disputes might occur relative to whether a violation had occurred, the employee would not know until after a court resolved a dispute whether the length of the covenant would be extended, thus making the duration of the covenant a "time period that is contingent upon outcomes the employee cannot predict."

Family and Medical Leave Act

– Proposed Revisions to Regulations; New Forms of Leave

The U.S. Department of Labor has published proposed revisions to the regulations which enforce the Family and Medical Leave Act of 1993. Also, on January 28, President Bush signed into law the National Defense Authorization Act, which, effective immediately, creates two new forms of FMLA leave: (i) 12 weeks of leave for "immediate family members" of military service members who suffer a "qualifying exigency" as a result of being on active duty or having been notified of an impending call to active duty, and (ii) up to 26 weeks of leave for an individual that is caring for a member of the Armed Forces who is undergoing medical treatment for, or recuperating from, a serious injury or illness incurred during military service. For more information see the Department of Labor web site at <http://www.dol.gov/esa/whd/FMLANPRM.htm>.

Workplace Privacy – Non-Business Communications

In *Scott v. Beth Israel Medical Centers Inc.*, a New York court has ruled that a hospital was legally entitled to review e-mail communications in which one of its physician employees engaged with his personal attorney on the hospital's computer system, since a written hospital policy stated that all computer, voice, and electronic systems were to be used for business purposes only and that no employee had any personal privacy right in anything on those systems.

Noncompetition Agreements – Physicians

In *Awwad v. Capital Region Otolaryngology Head & Neck Group, LLP*, a New York court has upheld a restrictive covenant which stated that during the three (3) years following his resignation from his employment with a practice which focused on ear, nose, and throat medicine, a physician would not practice that specialty within thirty (30) miles of any of that group's offices. [WCS](#)



2006 CENTENNIAL YEAR

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