

BASIC OHIO BUSINESS LAW



Getaway C.L.E. Ltd.
Presents
Benjamin S. Zacks, Esq.

BASIC OHIO BUSINESS LAW TOPICS

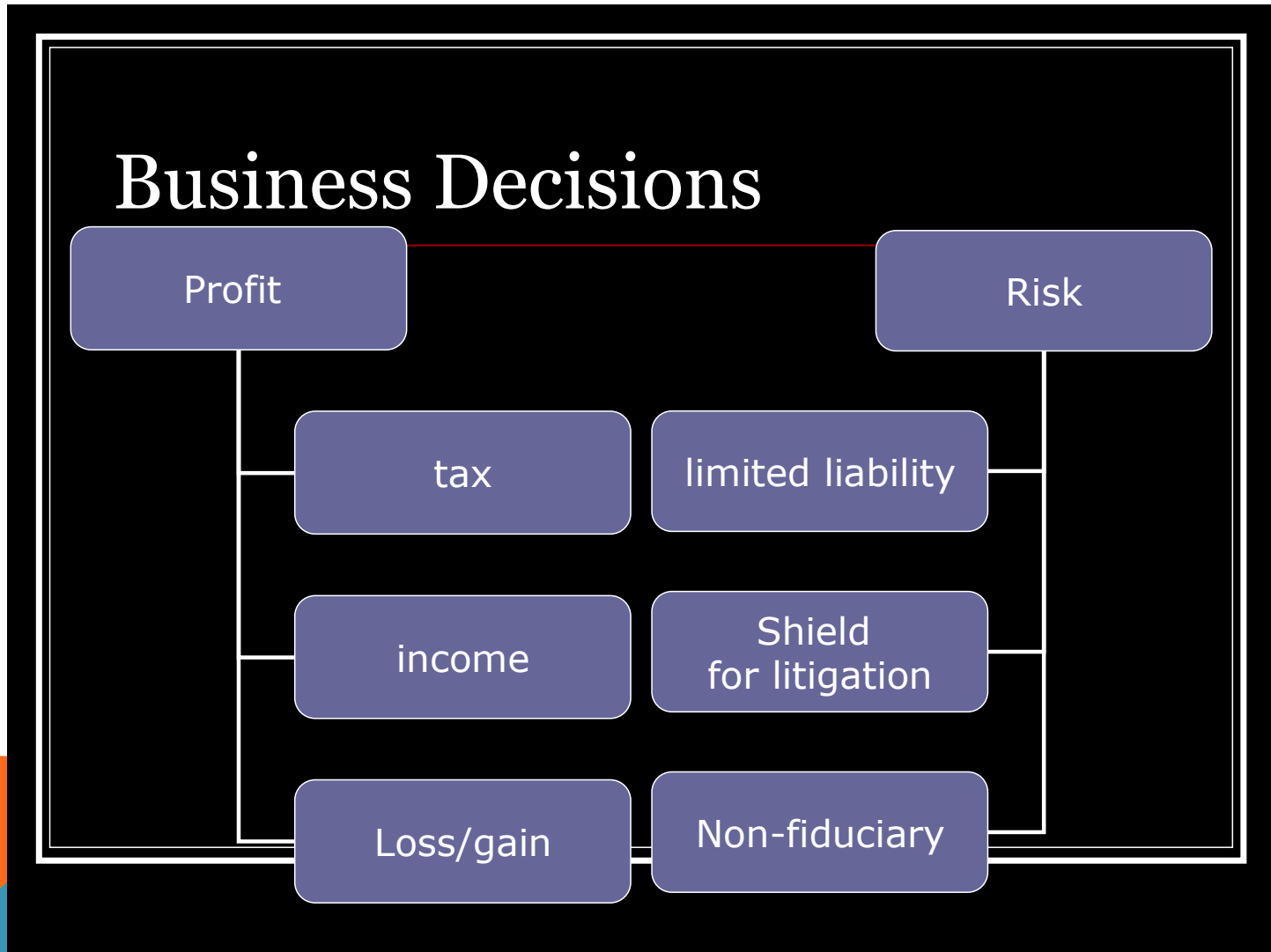
IN A FLASH

- ✧ Ideal & appropriate Ohio Business formation
- ✧ Standard contracts and secured transactions
- ✧ **High yield investment possibilities**
- ✧ Basic securities law
- ✧ Evaluating mergers
- ✧ Negotiating acquisitions
- ✧ Employment matters
- ✧ Basic tax

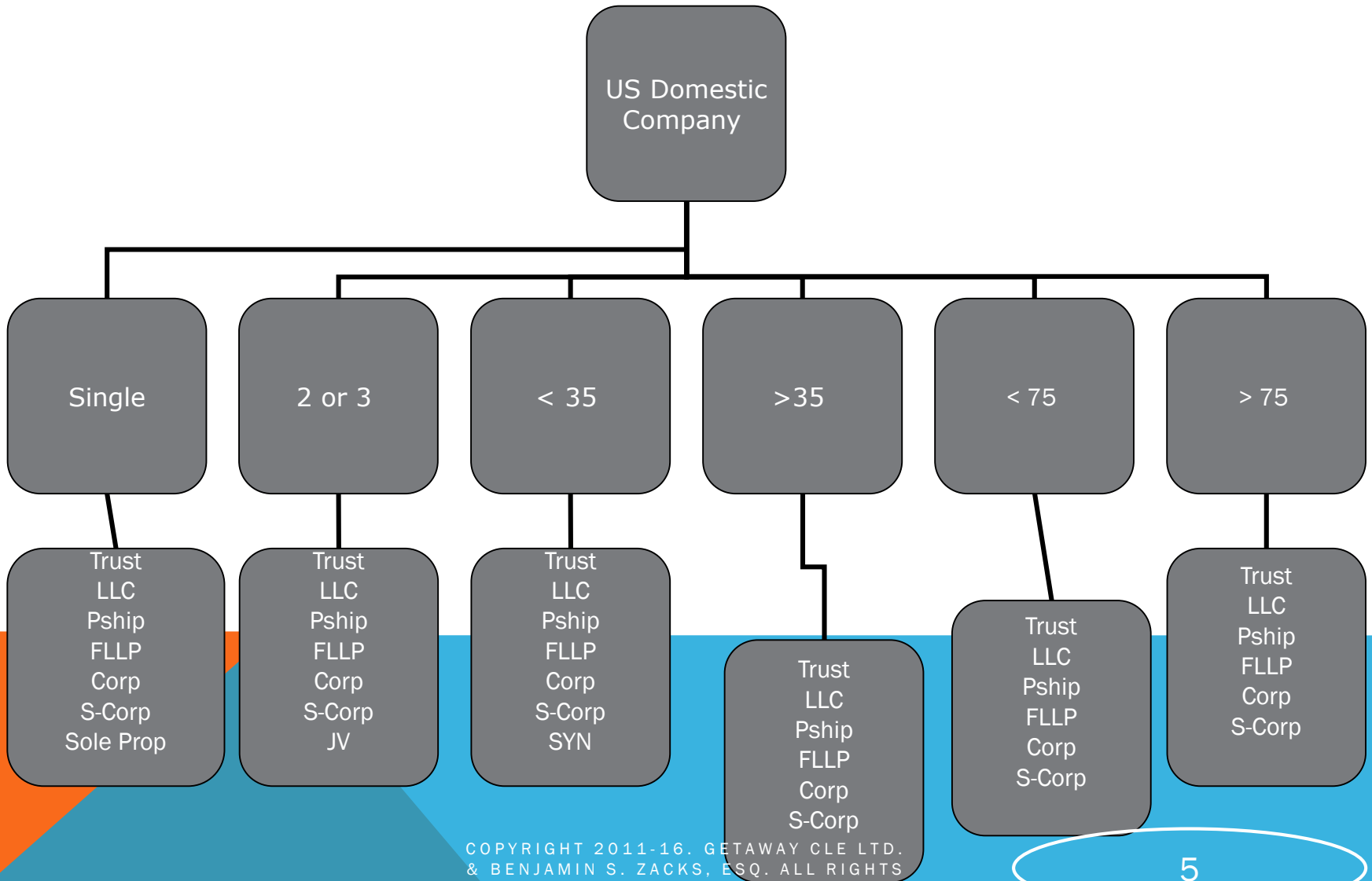
IDEAL & APPROPRIATE OHIO BUSINESS FORMATION



CLIENT PERSPECTIVE

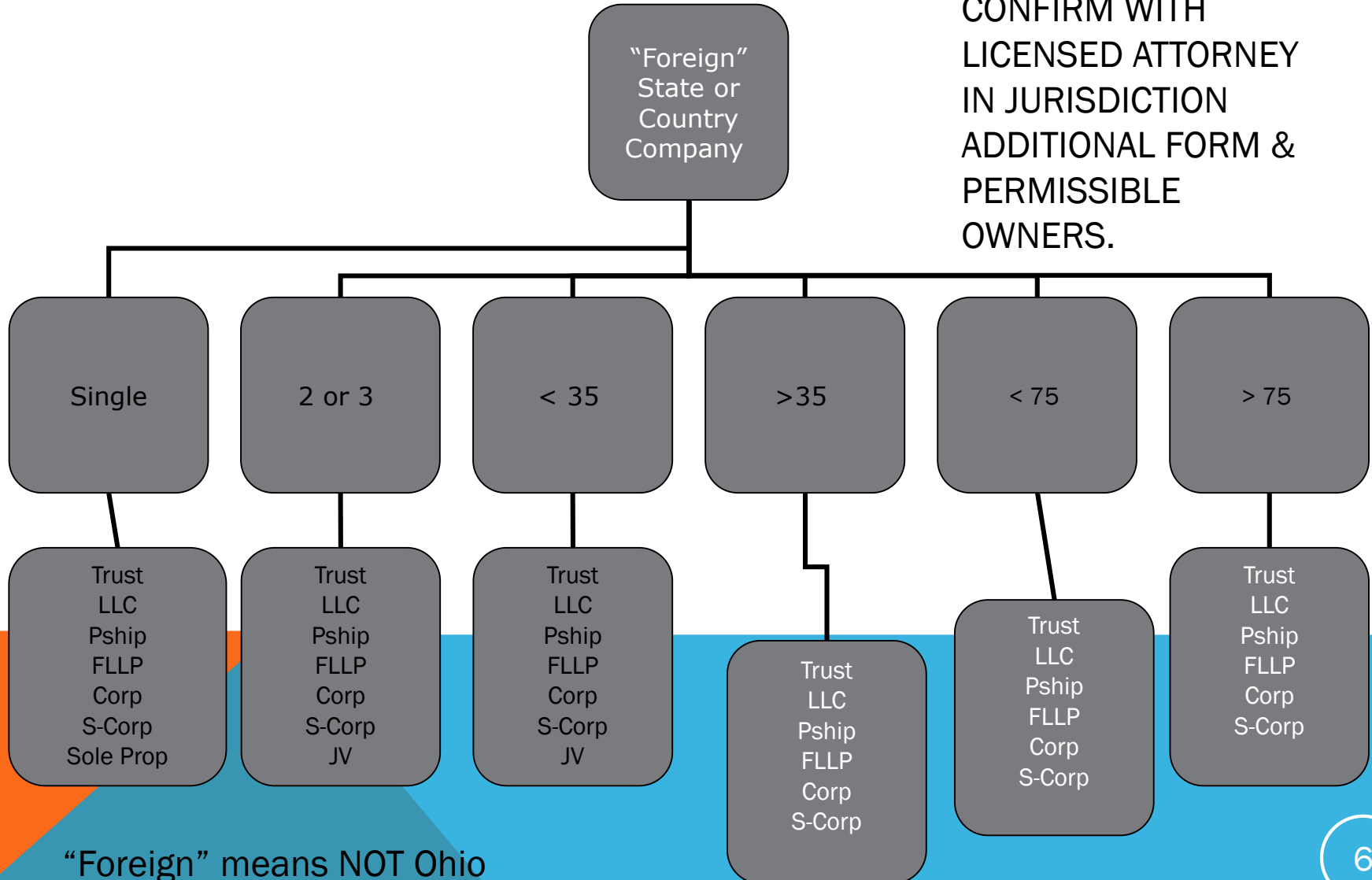


HOW MANY OWNERS? WHO IS YOUR SPECIFIC CLIENT?



MULTI-STATE & GLOBALIZATION REALITY

CAVEAT: CHECK & CONFIRM WITH LICENSED ATTORNEY IN JURISDICTION ADDITIONAL FORM & PERMISSIBLE OWNERS.



"Foreign" means NOT Ohio

C CORPS

- **Double taxation can be avoided depending on profitability below taxable thresholds.**
- **Retained earnings.**
- **Public companies opportunities.**
- **General partner use.**

LIMITED PARTNERSHIPS

A limited partnership's liability shield is close to a corporate shield.

To achieve this control is given up by limited partners as well as capital and a role in management.

Each limited partnership must have at least one general partner who will be personally liable for the limited partnership's debts.

For a limited partnership with a corporate general partner to be taxed as a partnership, the net worth of the corporate general partner (exclusive of the general partner's interest in the limited partnership) had to equal 10 percent of the total contributions of all limited partners. Complying with this requirement diverted capital that could otherwise be engaged in the business. Even after “check-the-box”, using a thinly capitalized corporate general partner raises the possibility of liability through piercing that corporate general partner's corporate veil.

As for the limited partners, their liability shield is safe only if they stay out of management. Limited partners risk personal liability if they are too involved in the business. At the same time, however, limited partners can lose some of the tax benefits of partnership losses if they do *not* materially participate in the business.

S CORPORATIONS

An S corporation provides a full corporate liability shield with some of the benefits of pass-through tax status. Like a partnership, an S corporation generally pays no tax on its earnings, and its profits and losses are passed through and taxed directly to its shareholders. There the similarity to partnerships ends, however.

S corporations face significant constraints that do not apply to partnerships. Subchapter S significantly limits who can own interests in the enterprise, what kind of business the enterprise may conduct, and how the enterprise may structure its finances. Moreover, decisions that make sense for an S corporation's business may have untoward tax consequences for the corporation's shareholders.

Generally, S corporation shareholders must be U.S. citizens or resident aliens. Subchapter S eliminates many potential owners and investors, including all corporations, investment banks, venture capital firms, and most foreign nationals. Moreover, an S corporation may not have more than seventy-five shareholders. Previous law allowed no more than 35 shareholders and only a single class of shareholders.

Subchapter S also rules out a long list of business types and structures. A corporation may not obtain or retain S status if it is a foreign corporation, a bank or savings and loan association, an insurance company, a possessions corporation, a domestic international sales corporation (DISC) or former DISC, or a regulated investment company (RIC), real estate investment trust (REIT), or real estate mortgage investment conduit (REMIC).

S CORP. (CONT.)

- An S corporation may have only one or two class of stock. This requirement precludes flexible allocations of profits, restricts the type of debt the corporation may issue, hampers efforts to gradually shift control of family-owned businesses, and, in general, makes passive investment very difficult to structure.
- An S corporation is not a complete pass-through entity. As a result, S corporations contain a number of traps for the unwary. For example, distributions of appreciated property trigger a gain to the corporation and hence to the shareholders. In addition, the basis of a shareholder's stock is not increased to take into account any corporate debt, thereby limiting the shareholders' ability to take advantage of passed-through losses. Moreover, when a shareholder dies, the basis of the assets of the corporation is not adjusted to reflect the estate's stepped-up basis, thereby putting the estate at risk of realizing unexpected and (in an economic sense) phantom gains.

GENERAL PARTNERSHIPS

β 1775.14. Liability of partners

(A) Subject to section 1339.65 of the Revised Code and except as provided in division (B) of this section, all partners are liable as follows:

- (1) Jointly and severally for everything chargeable to the partnership under sections 1775.12 and 1775.13 of the Revised Code. This joint and several liability is not subject to section 2307.22, 2315.36, or 2315.46 of the Revised Code with respect to a negligence or other tort claim that otherwise is subject to any of those sections.
- (2) Jointly for all other debts and obligations of the partnership, but any partner may enter into a separate obligation to perform a partnership contract.

GENERAL PARTNERSHIPS

1775.24. Co-ownership of specific partnership property; incidents of tenancy

- (A) A partner is co-owner with his partners of specific partnership property holding as a tenant in partnership.
- (B) The incidents of this tenancy are such that:
- (1) A partner, subject to this chapter, and to any agreement between the partners, has an equal right with his partners to possess specific partnership property for partnership purposes; but he has no right to possess the property for any other purpose without the consent of his partners.
 - (2) A partner's right in specific partnership property is not assignable except in connection with the assignment of rights of all the partners in the same property.
 - (3) A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership. When partnership property is attached for a partnership debt, the partners, or any of them, or the representatives of a deceased partner, cannot claim any right under exemption laws.
 - (4) On the death of a partner, his right in specific partnership property vests in the surviving partners, unless he was the last surviving partner, in which case his right in the property vests in his legal representative. The surviving partners have, or the legal representative of the last surviving partner has, no right to possess the partnership property for any but a partnership purpose. This division is subject to the procedures set forth in Chapter 1779. of the Revised Code.
 - (5) A partner's right in specific partnership property is not subject to dower, any statutory interest of a surviving spouse, heirs, or next of kin, or any allowance to a surviving spouse, minor children, or both a surviving spouse and minor children, including, but not limited to, the allowance for support under section 2106.13 of the Revised Code.

TRUSTS

The law of trusts traces its origins back to the Middle Ages. Maitland has said that the trust is the greatest achievement of Equity.

The genius of trusts is found in their flexibility and versatility and, not surprisingly, such a flexible, versatile instrument is difficult to define.

Underhill sums it up thus: “A trust is an equitable obligation binding a person (who is called a trustee) to deal with property over which he has control (which is called the trust property), for the benefit of persons (who are called the beneficiaries or cestuis que trust), of whom he may himself be one, and any one of whom may enforce the obligation.”

Keeton puts in slightly different words: “All that can be said of a trust, therefore, is that it is the relationship which arises whenever a person called the trustee is compelled in Equity to hold property, whether real or personal, and whether by legal or equitable title, for the benefit of some persons (of whom he may be one, and who are termed cestuis que trust) or for some object permitted by law, in such a way that the real benefit of the property accrues, not to the trustee, but to the beneficiaries or other objects of the trust.”

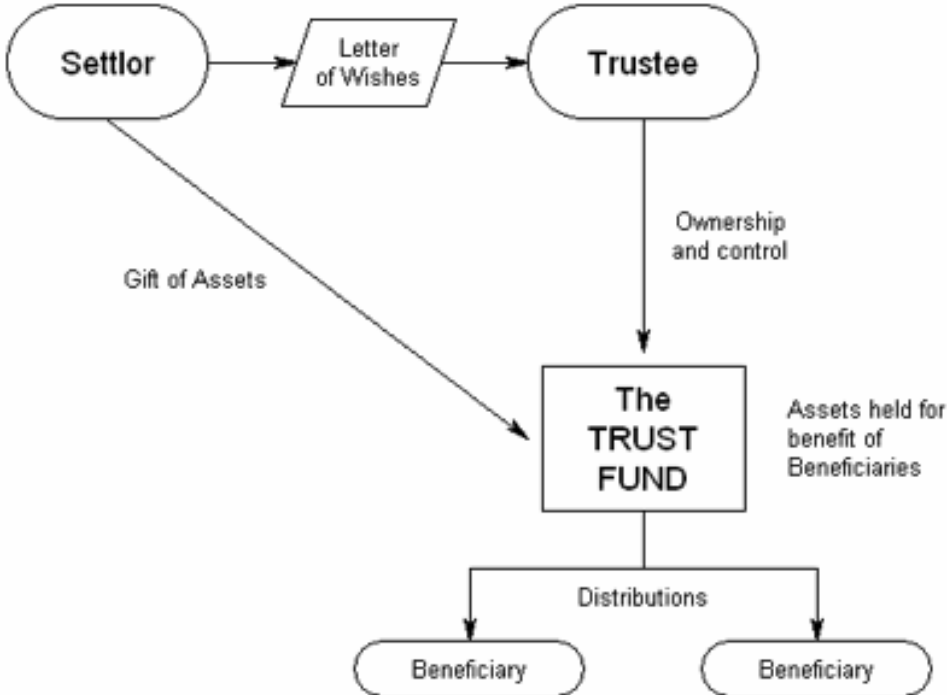
TRUSTS

Trusts can be crafted to provide for all manner of future benefits to all manner of beneficiaries– provided that the objects are otherwise lawful, the only limitation is the creativity of the drafter. Trusts can save tax, trusts can prevent spendthrift young wastrels from “blowing the wad”, trusts can provide for adult children with disabilities.... there is little that trusts cannot be crafted to do.

But trusts can be created by actions as well as by documents. When an individual deals with property in such a fashion that the court will find it unjust that he keep the benefit, one of the tools the court can use to rectify the matter is to find that the first individual actually holds the property in whole or in part for the benefit of some other who should more justly enjoy it. It is particularly on this basis that the law of trusts continues to evolve at a vigorous pace, the courts eagerly using this flexible instrument to find ways to ensure that fairness is enforced where there may not be an adequate contractual arrangement between the parties.

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TRUSTS



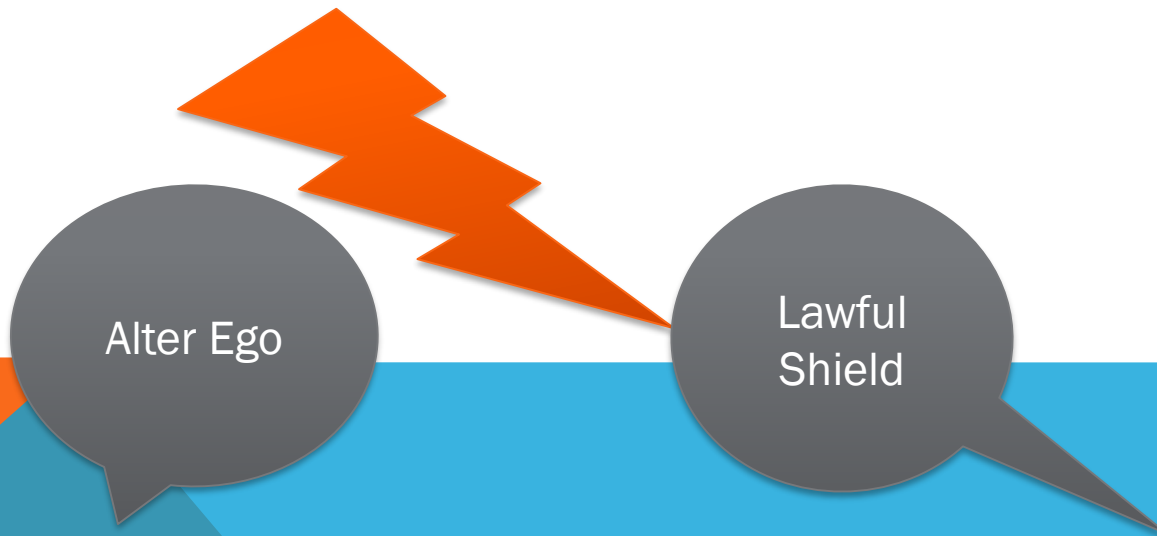
CHOOSING THE CORRECT STRUCTURE

- ◆ Helps client to distribute cash flow & assets
- ◆ Builds equity and paper wealth
- ◆ Allows building intellectual capital which fosters value
- ◆ Avoids disputes and methods for resolving conflicts
- ◆ Provides mechanism for work and reward
- ◆ Defines individual relationships to the entity, to co-owners, non-owners, employees, the general public, vendors/other businesses, government bodies and society.
- ◆ Requires understanding the business, now and as it matures
- ◆ Anticipates a time frame for growth, exit, succession and disposition
- ◆ Positions the business for growth, economic cycles, handling distress, cutting off liability and manages risk

Choose for liability protection, risk control and asset transfer

WHEN ARE COURTS MORE LIKELY TO “PIERCE”?

- Business is closely held
- Plaintiff is tort creditor = involuntary
- Defendant is corporate (not individual) shareholders
- Failed to follow corporate formalities
- Insiders co-mingled business assets with individual ones
- Business is inadequately capitalized



CONT.- PIERCING FACTORS

Insiders deceived creditors

- Grossly inadequate capital (very important!)

Enterprise liability

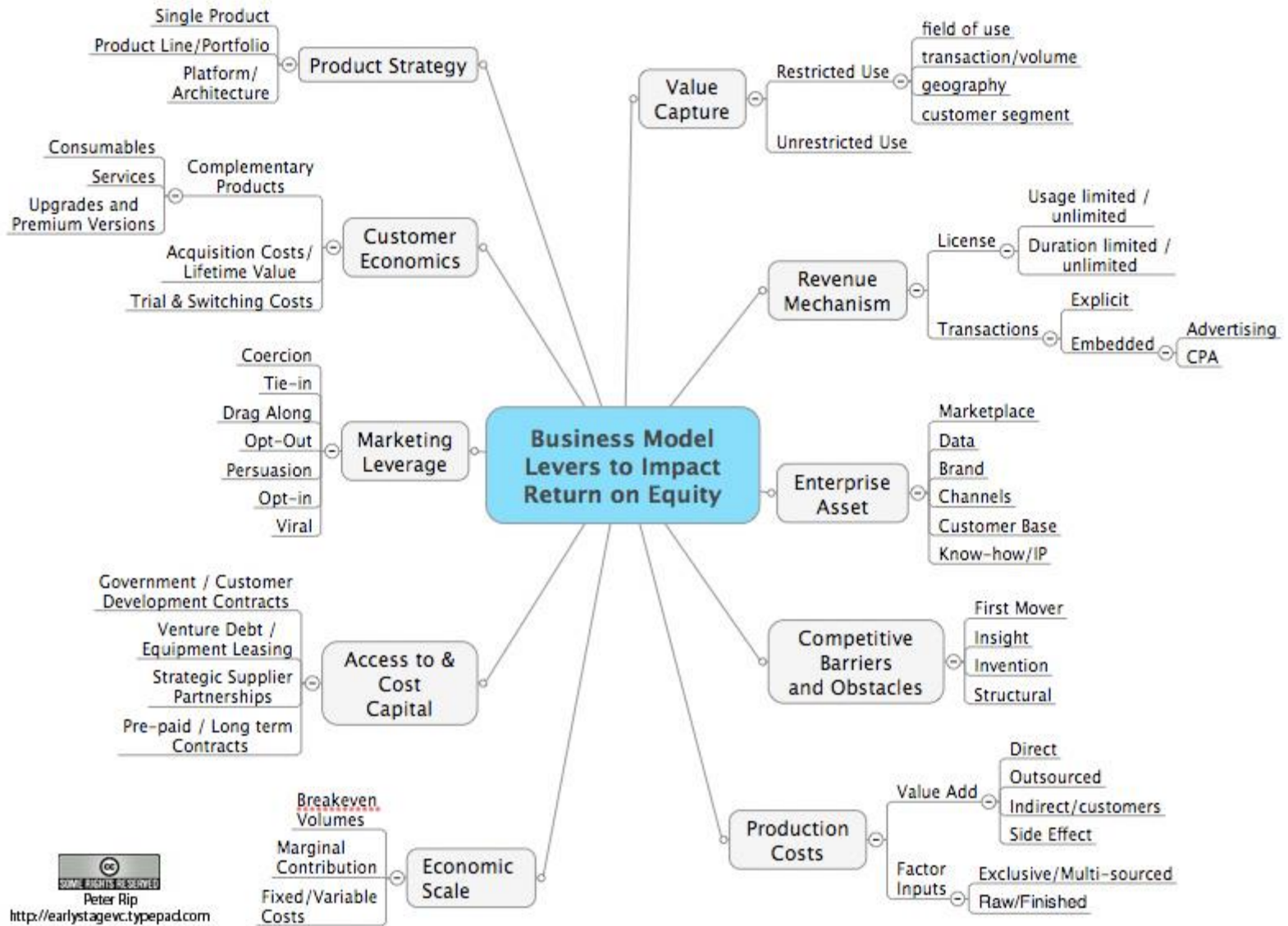
- When there are multiple incorporations of the same business under common ownership

When there is a parent and subsidiary entity look for:

- Commonality in:
 - directors and officers (this is common)
 - business departments – mixing business operations (advertising, insurance, research)
 - File consolidated tax returns (but this is a requirement at the 80% point)
 - Parent finances the subsidiary; better if subsidiary can get debt financing; bank financing not guaranteed by parent.
 - Parent organized the subsidiary
 - Lack of independence in financial setting
 - All subsidiary business given from parent
 - Parent uses subsidiaries property as its own property
 - subsidiary does not keep separate books, doesn't observe basic corporate formalities

BUSINESS MODEL DYNAMICS

People
TRUST&VISION



Peter Rip

<http://earlystagevc.typepad.com>

ADVANTAGEOUS LEGAL STRUCTURE OPTIONS?

- Venture capitalist gets pass-through taxation with exercising control without risking personal liability. PSHIP & LLC.

Alternatives?

- Present interest in exchange for future performance. LLC.

What about stock options?

- Latitude in structuring the control aspects of the deal.

Voting, creditor position, influence, leverage, Return on Investment, Preferred interests?

- In Leverage Buy Out, debt versus equity characterization is moot. LLC

Why? What is debt vs. equity?

- Goodwill may be deducted when redeem ownership interests and deduction passes through to benefit the remaining members. PSHIP, LLC, JV

Is tax benefit worth it?

- When a professional LLC/partnership breaks up, goodwill is not taxable.

What is effect on net?

- Retaining of Earnings. CCORP & “LLC” **What is the benefit of retaining earnings?**

ADVANTAGEOUS LEGAL STRUCTURE ISSUES

- **Allow a owner's estate to obtain a basis step-up in assets and will generally permit a post-death nontaxable liquidation. PSHIP?, JV & LLC**
- **Not-for-profit's share of profits will escape the tax imposed on unrelated business income. ? JV, L3C, LLC, PSHIP.**
- **No need for one class of owners to refrain from participating in management.**
- **Manage strategically ahead and behind.**

ADVANTAGEOUS LEGAL STRUCTURE

Easier to use equity interests to reward or attract key employees.
LLC & CCORP

Easier to use equity interests to reward or attract investors or
companies. LLC & CCORP

No restrictions as to separate classes of ownership interests. LLC,
PSHIP [Note 500/syndications]

Easier for transfers of control and ownership.

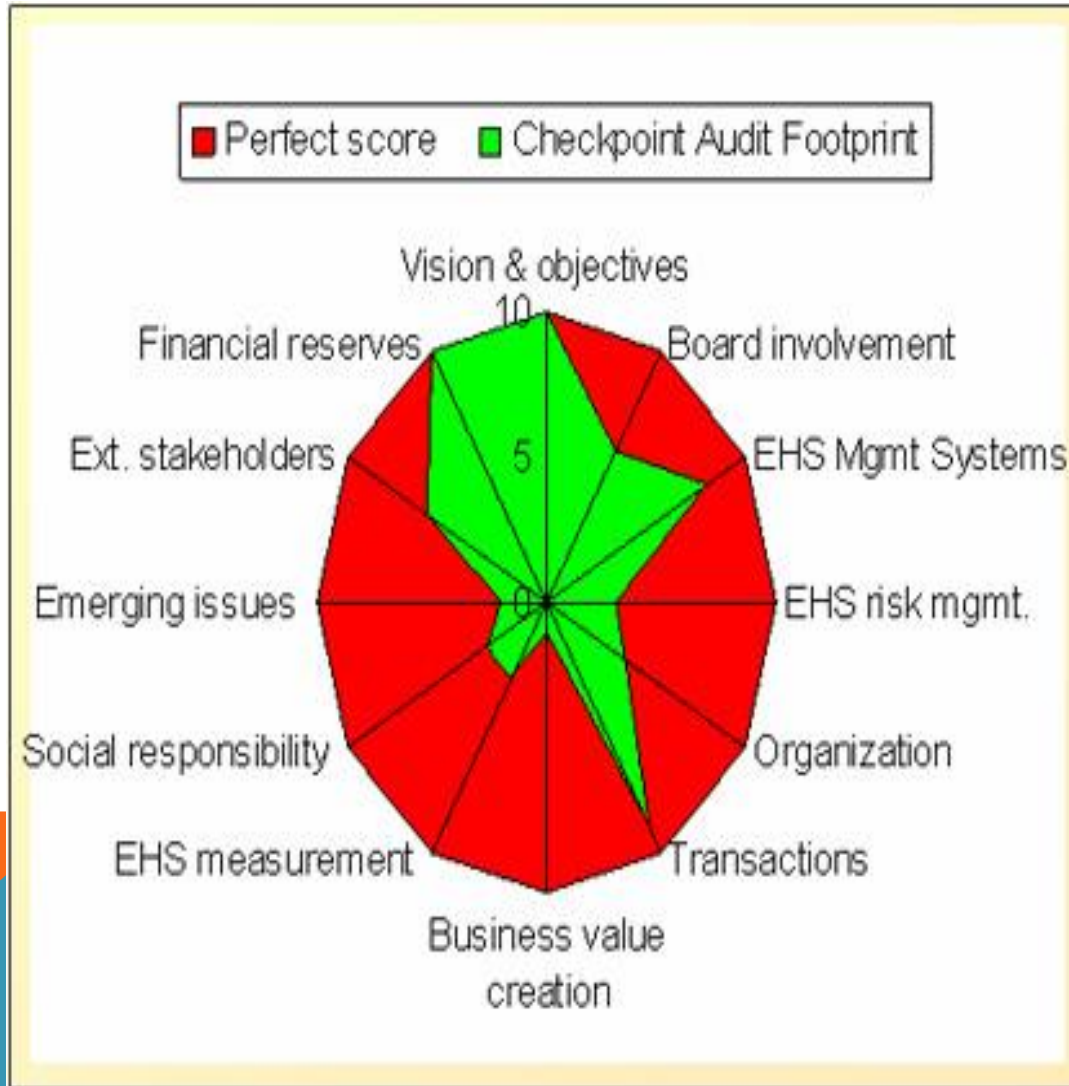
Stock, Partnership Interest, Membership Interests

Effective method for consolidating the venture's profit or loss for tax
purposes. LLC, PSHIP, JV, SCORP

Easier to take money out and place funds in individual portfolio?

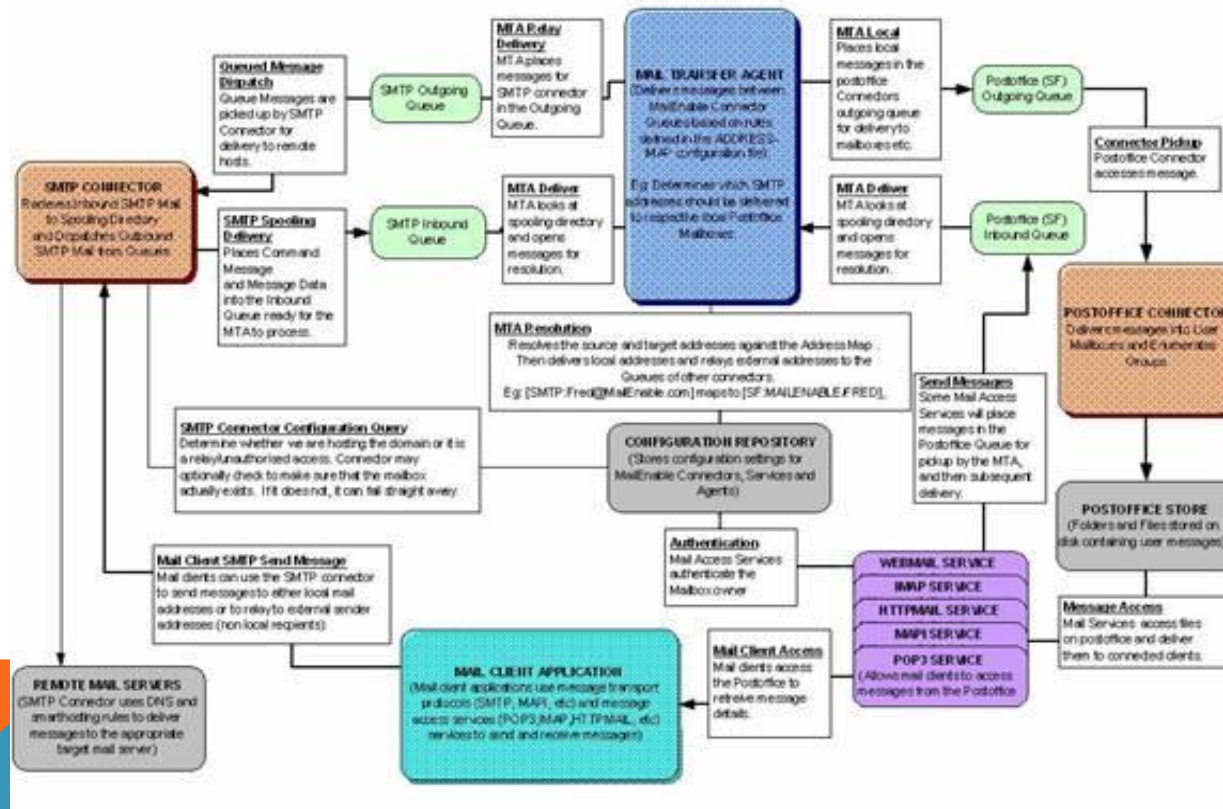
PRACTICUM: STEP 1

FOOTPRINT ISSUES IS STEP 'UNO' TO FORMATION OF BUSINESS



STEP 2

FORMAL BUSINESS PLAN WITH CONSERVATIVE PRO-FORMA PROJECTIONS AND TAX PLANNING SCENARIOS



STEP 3

FORMAL JOB TASKS AND EXPECTATION SETTING.

Identify the key positions and responsibilities in writing to set minimum levels of expectations e.g.


- President- General Partner - Manager
- CEO
- CFO
- Operations Manager
- Money locator
- Sales VP

STEP 4

FOLLOW THE MECHANICS OF ORGANIZING A COMPANY.

Any one or more persons may form an entity.

- Under Ohio law the term "person" includes;
 - any natural person,
 - any partnership,
 - limited partnership,
 - trust,
 - estate,
 - association,
 - LLC,
 - corporation,
 - any custodian, nominee, trustee, executor, administrator, or other fiduciary,
 - or any other individual or entity in its own or any representative capacity.



A thing is
a person
too!

The forming parties need not be residents or domiciliaries of the state, or in the case of a business entity, need not be organized under Ohio law.

STEP 5

CHOOSE A GOOD LEGAL, USEABLE, NAME.

- The name of an entity must include legally identifiable status or be registered to an owner.
- The name should be distinguishable from the name of other business entities licensed or registered with the Secretary of State and for other jurisdictions and applications for its use in business including its website, domain and cognizant of how it is translated if doing business in a global economy.
- As a general rule, the Secretary will not file the articles of organization if the name is not distinguishable on the records from the name of others who are registered, either domestic or foreign. But this is far from foolproof.

“A GOOD NAME ENDURES FOREVER.”

- A person may reserve a name for a proposed new entity or for an entity that intends to change its name by submitting to the Secretary of State an application for the exclusive right to use a specified name.
- If the name is available for use, the Secretary will approve, endorse, and file the application. The applicant then has the exclusive right to use the approved name for “X” number of days after the date of endorsement. The date of endorsement is counted as the first of the “X” days. This makes reservation a judgment call to preserve it only for this window.
- Consider the name for image, printing, marketing and internet purposes and how the name will be perceived in domestic and international markets.
- Check the internet domain name registry.
- Look ahead to consider the use the name in multiple ways like branding, trademarks, service marks, advertising, business cards, etc.

IRS EIN FORM SS-4 CHECK THE BOX OR E-FILE

8a Is this application for a limited liability company (LLC) (or a foreign equivalent)? <input type="checkbox"/> Yes <input type="checkbox"/> No	8b If 8a is "Yes," enter the number of LLC members ▶
8c If 8a is "Yes," was the LLC organized in the United States? <input type="checkbox"/> Yes <input type="checkbox"/> No	
9a Type of entity (check only one box). Caution. If 8a is "Yes," see the instructions for the correct box to check.	
<input type="checkbox"/> Sole proprietor (SSN) _____	<input type="checkbox"/> Estate (SSN of decedent) _____
<input type="checkbox"/> Partnership	<input type="checkbox"/> Plan administrator (TIN) _____
<input type="checkbox"/> Corporation (enter form number to be filed) ▶ _____	<input type="checkbox"/> Trust (TIN of grantor) _____
<input type="checkbox"/> Personal service corporation	<input type="checkbox"/> National Guard <input type="checkbox"/> State/local government
<input type="checkbox"/> Church or church-controlled organization	<input type="checkbox"/> Farmers' cooperative <input type="checkbox"/> Federal government/military
<input type="checkbox"/> Other nonprofit organization (specify) ▶ _____	<input type="checkbox"/> REMIC <input type="checkbox"/> Indian tribal governments/enterprises
<input type="checkbox"/> Other (specify) ▶ _____	Group Exemption Number (GEN) if any ▶ _____

ARTICLES OF ORGANIZATION

In Ohio, paying the filing fee and filing Articles of Organization Form 533, and the Original Appointment of the Statutory Agent are all that are required to have official existence.

Filing or obtaining a Federal Employer Identification Number (EIN) is not required by the state LLC statutes. The Filing of the SS-4 Form with the IRS, is the manner to fulfill the “check-the box” rules and to establish the intended tax treatment the company will have.

However, the box checked, while setting in motion the IRS computer to expect a tax return tagged to the EIN is not dispositive of the tax treatment a given company will have in its first year of operation as the filing of the initial year tax return actually will determine the tax implications for a given company.

STEP 6

ARTICLES OF ORGANIZATION, INCORPORATION OR OTHER.

LLCs = Articles of ORGANIZATION (OHIO)

- An LLC's articles of organization must state the name of the LLC.
- The articles also must state the LLC's period of duration if it is to be other than perpetual.
 - The articles may state that the duration is perpetual, and, if the articles do not state a period of duration, the duration of the LLC is deemed to be perpetual. However, an LLC must be dissolved 30 years from the date of its formation if no expiration period is fixed by the operating agreement. Finally, the articles must set forth the address to which interested persons may direct requests for copies of any operating agreement and any bylaws of the LLC.

Filing FORMALLY CREATES the entity,
otherwise it is *defacto*.

STEP 6

ARTICLES OF ORGANIZATION, INCORPORATION OR OTHER.

- If the members wish to place restrictions on the LLC's authority to take property by gift, devise, or bequest, or to make certain donations, these restrictions must be stated in the articles of organization. Unless otherwise provided in the articles, an LLC may take property by gift, devise, or bequest and may make donations for the public welfare or for charitable, scientific, or educational purposes.
- Other restrictions on the powers and authority of an LLC may be placed in the articles of organization. However, these restrictions also may be stated in the LLC's operating agreement.
- The articles must be signed by one or more members or their authorized representatives.
- Articles of organization must be filed with the Secretary of State. The Secretary will not accept the articles for filing unless they are accompanied by a written appointment of an agent for service of process, and a written acceptance of the appointment signed by the designated agent.
- If the Secretary finds that the articles comply with the statutory requirements, the articles will be endorsed with the date of filing and a file number. The endorsed articles will be returned to the person who filed them. A copy of the endorsed articles will be kept in the records of the Secretary.


Filing FORMALLY CREATES the entity,
otherwise it is *de facto*.

SO YOU REALLY THINK IT'S A LAWFUL LLC?

- An LLC may amend its articles of organization at any time and for any proper purpose.
- An LLC must amend its articles within 30 days after any of the following occurrences:
 - (1) A change in the name of the LLC.
 - (2) The period of the LLC's duration is changed.
 - (3) The address to which persons may direct requests for copies of the LLC's operating agreement and bylaws is changed.
 - (4) Any other information set forth in the articles is changed.

In addition, the articles must be amended promptly upon discovery that a statement in the articles was materially false when made or that any other information in the articles has changed so that the articles are materially inaccurate.

CONSEQUENCE IS A LOSS STATUS AS AN LLC.



Lets talk...What
does this mean to
your client?

CORPORATIONS-ARTICLES OF INCORPORATION

HAND-OUT

file:///localhost/Users/bszacks/Documents/ZLG/01-form documents/corporate documents/form 4-03D=certificate of inc-Del. corp.rtf

Fill-In Exercise

file:///localhost/Users/bszacks/Documents/ZLG/01-form documents/corporate documents/ohio Inc/Minutes of 1st meeting of directors of newly formed corporation .doc

That was easy and yes you can do it online

PSHIPS, JV'S, TRUSTS, ASSOCIATIONS

These entities have formative documents but are not required to file these documents for the entity to have legal existence and to be created.

Various requirements exist for partners, joint ventures, trustees and board members of associations to register to do business and this is often done at the county, city or other jurisdictional level depending on what the business is of the entity.

STEP 7

A THOUGHT THROUGH AGREEMENT

- The members of an LLC enter into an agreement called an 'LLC Agreement' in Delaware, 'Regulations' in Texas, and an 'Operating Agreement' in Ohio.
- Whatever the label, this is the document that consumes all of the negotiating and drafting time in organizing an LLC.
- The operating agreement is not filed with the secretary of state. It is simply a private contract between or among the members and closely resembles a limited partnership agreement, a general partnership agreement, a close corporation agreement, or by-laws and regulations of a corporation or association.
- In many respects, the operating agreement, is;
 - a code of regulations and by-laws,
 - a partnership agreement,
 - a buy-sell agreement,
 - a financial distributions contract,
 - employment agreements,
 - spendthrift protection document,
 - an intended statement of tax treatment,
 - succession planning document and,
 - the rules by which people execute their respective tasks and obligations.

Steps 7 & 8 in the materials focus on LLCs because of their current prevalence and because they are a hybrid that bridge issues between partnership and corporation documents.

STEP 7 CONT.

- It can incorporate other documents, be independent of them and create sub-agreements among various member classes and even individuals. In it the default provisions of the state law can be modified.
- Ohio does not require a written operating agreement.
- However, a written agreement should be prepared. Without an operating agreement, or with respect to issues about which an operating agreement is silent, the statute provides the agreement terms. Statutory terms for LLC operating agreements include the following:
 - (1) Tax allocations will be proportionate to the value of capital and services contributed.
 - (2) Cash and property distributions will be proportionate to the value of capital and services contributed.
 - (3) The admission of new members will require the unanimous written consent of all existing members.
 - (4) The LLC will be member-managed rather than manager-managed, with voting power proportionate to the value of contributed capital.
 - (5) If the LLC is member-managed, a member may withdraw at any time.
 - (6) If the LLC is manager-managed, a member may withdraw at any time with six months advance written notice.
 - (7) Dissenting members will have dissenters' rights in the event of a merger.
 - (8) A member will be free to assign his or her economic interests and retain his or her voting rights.
 - (9) The transfer of a membership interest (including voting rights) will require unanimous consent from all other members.

STEP 7 CONT.

At a minimum, an LLC operating agreement should answer the following questions:

- How are credits allocated for tax purposes?
- How is cash distributed?
- Who has management authority?
- How are profits allocated?
- How are losses allocated?
- Are votes proportional, per position, per head, per class of membership interests?
- What vote is required for what decisions?
- What transfer restrictions apply to members?
- Can a member withdraw?
- What causes dissolution?
- What standard of conduct and decision making is required?
- What indemnification is available?
- What vote is required for amendment?
- What exceptions, if any, are there to a member's fiduciary duty to other members?
- What happens if a member has creditor problems, domestic discord passes away?

STEP 8

DRAFTING OF ADDITIONAL DOCUMENTS AS REQUIRED BY THE PARTICULAR “DEAL”.

Original Articles of Organization or Amended Articles with any needed public record restrictions or statements and Appointment of the Statutory Agent, or Notice of a Change in the agent, (or similar named formation documents), the documents that are advisable (*italicized below*) or may be required at times (marked with asterix *) are to capture the business arrangements are:

- *An Operating Agreement*, (By-laws & Code of Regulations or Partnership Agreement)
- *Agreements Among Members**,
- *Member Journals* and Interest Owner Records,*
- *A Record or “Minute” Book of Official Actions,**
- *Letters outlining any restrictions on members or managers authority,*
- *Side Agreements among the LLC and its members, managers, investors, employees,*
- *Termination Agreements,**
- *Descriptions of Membership Interest Classifications,*
- *Minutes of Proceedings of Managers or Members,*

Members = shareholders, directors,
officers, general partners, limited
partners

Managers = Chairperson of Board of
Directors, CEO, President

Membership
Interests =
Stock or
partnership
interest

STEP 8 OTHER DOCUMENTS....

- *Minutes of Proceedings or Actions of Officers,**
- *Minutes of Proceedings of Directors/Advisors,**
- *Designation of the Tax Matters Person,*
- *Tax Appendices to the Operating Agreement,*
- *Certificated Membership Certificates,*
- Confidentiality Agreements,*
- Non-Competition Agreements,*
- Buy-Sell Agreements,*
- Powers of Attorney,*
- Employment Agreements,*
- Consulting Agreements,*
- Future Services Agreements in Exchange for present member interests,*
- Any other specific side Agreement or letter that reflects the particulars of the LLC and its relationship to a stakeholder.*

STEP 9

FORMAL EXECUTION AND CLOSING OF THE DEAL AND RESPECTIVE DOCUMENTS.

Often the documents are not fully completed and the significance of creating this new legal “person” should impress on clients that formality is very important.

It is good practice to have a formal signing ceremony and also create official record books and electronic locked original replicas.

The paper trail is essential for accountants, creditors, person’s performing due diligence, estate planning of individuals, future valuation and of course litigation as well as administrative matters this new person will certainly encounter.

STEP 10

DISTRIBUTION OF THE DOCUMENTS AND CREATION OF THE COMPANY RECORD BOOK.

Corporate formalities require that the share journal be kept as well as minutes of actions. Certificated interests are securities and can be bought and sold.

Partnership formalities require that the partnership interests be spelled out and that actions by the managing partner be documented.

LLC formalities may be more flexible but having all members have copies is important and an ongoing member interest journal, possibly certificated interests and also records of actions taken are useful and lend credibility to the new person.

Failure to have these items originally and updated may impact challenges to its existence and diminish and even eliminate the liability shield.

Attorneys are often the caretakers of originals and if they do not exist and there is not documentation of distributing them in copy form, our profession takes the brunt of the hit.

STEP 11

BUSINESS AND TAX PLANNING REVIEW, EVALUATION, MODIFICATION AND ACTION PLANS

Iterationand transactional counseling.....

especially during the first year prior to filing the initial tax return, and in early years based on business performance can assist you in maintaining an ongoing client-attorney relationship and expand your reputation and practice.

Follow all steps and you and your client will benefit.


Think 1yr2yr3yr1yr2yr3yr



HYPO

3 People want to start an internet website business.

- ✓ **One has money.**
- ✓ **One has time and computer skills.**
- ✓ **One loves to sell stuff.**



Who wants to talk first?

“CLIENTS” CONSIDER THEIR CO-OWNERS AS ‘WATCHING THEIR BACKS’ AND THAT IS AKIN TO BEING A FIDUCIARY.

When performing the various steps in forming a particular Company under the law of a particular jurisdiction, care and conversation should be had about

- what level of fiduciary duty is expected,
- what duty of loyalty is acceptable and
- what level of proof is required for there to be a breach of the duty and how it needs to be shown before a tribunal.

To this degree, like a close corporation where fiduciary notions are altered, the drafting concept is to inform and draft consistent with the expectations of the members, managers, partners, directors, officers, shareholders and stakeholders in the company.

Practice Pointer



STANDARD CONTRACTS & SECURED TRANSACTIONS

CONTRACTS

- The Elements of a Contract
- Oral Contracts
- the choices that parties make when forming contracts often leave a data trail: Principals typically record the terms of their agreement in a way that is less likely to happen within the context of, say, tort or criminal law.
- Large, centralized repositories of contract data are now available, including databases of historically executed contracts, litigated case law, and other relevant sources.

SECURED TRANSACTIONS

Who gets paid?

Who gets collateral?

Who gets something if it all goes bust?

What is it worth?

CONTRACT DRAFTING CONSIDERATIONS

- ✓ Contract law is a social and linguistic construct, as well as an instrument for the regulation and promotion of exchange.
- ✓ Once a deal becomes a standard re-occurrence does there need to be a written contract- consider most purchases made in the normal course of business.
- ✓ Standard contracts promote enforceability.
- ✓ Selection of contract default rules is much more difficult than simply picking the most popular terms.
- ✓ Start with agreed upon deal terms, and then create definitive clauses that define the responsibilities and the performances that complete the bargain.
- ✓ Challenge the parties to misinterpret the words by asking “what if” questions.

SECURED TRANSACTIONS

Business dealings that grant a creditor a right in property owned or held by a debtor to assure the payment of a debt or the performance of some obligation.

A secured transaction is a transaction that is founded on a security agreement. A security agreement is a provision in a business transaction in which the obligor, or debtor, in the agreement gives to the creditor the right to own property owned or held by the debtor. This property, called collateral, is then held by either the debtor or the secured party to ensure against loss in the event the debtor cannot fulfill the obligations under the transaction.

The law of secured transactions varies little from state to state because all 50 states plus the District of Columbia and the U.S. Virgin Islands have adopted Article 9, the secured transactions portion of the Uniform Commercial Code (UCC).

SECURED TRANSACTIONS

The **purchase of a car through financing** is an example of a secured transaction. The car dealership or some other lender pays for the vehicle in return for a promise from the buyer to repay the loan with interest. The buyer receives the vehicle, but the **lender retains the title** to the car as security against the risk that the buyer will be unable to make the loan payments. If the buyer defaults on the payments, the lender, called the secured party, may repossess the car to recover losses from the default.

If the same transaction was unsecured, the buyer would receive the title to and possession of the car, and the lender would receive only the buyer's promise to repay the loan. If the buyer defaulted on the payments, the lender could sue the buyer, but the simple remedy of taking the property would not be available.

A security interest may be transferred, or assigned, to a third party. The party receiving the assignment becomes the secured party, and the original secured party no longer holds a claim to the collateral.

The law of secured transactions varies little from state to state because all 50 states plus the District of Columbia and the U.S. Virgin Islands have adopted Article 9, the secured transactions portion of the Uniform Commercial Code (UCC).

SECURED TRANSACTIONS

Common Forms of Secured Transactions

Secured transactions come in many forms, but three types are most common for consumers: pledges, chattel mortgages, and conditional sales.

A pledge is the delivery of goods to the secured party as security for a debt or the performance of an act. For example, assume that one person has borrowed \$500 from another. Assume further that the debtor gives a piece of expensive jewelry to the creditor. If the jewelry is to be returned to the debtor after the debt is repaid, and if the creditor has the right to take full ownership of the jewelry if the debtor does not pay the debt, the arrangement is called a pledge.

SECURED TRANSACTIONS

Common Forms of Secured Transactions

A chattel mortgage is like a pledge, but in a chattel mortgage transaction, the debtor is allowed to retain possession of the property that is put up as collateral. If the debtor fails to repay the debt, the creditor may take ownership of the property.

A third type of secured transaction, the conditional sale, uses a purchase money security interest. A purchase money security interest arises when a creditor lends money to a borrower, who uses the money to purchase a particular item. To secure repayment of the loan, the creditor receives a lien on, or claim to, the purchased item. The lien gives the creditor a claim to the property that may be asserted if the borrower does not repay the loan.

HIGH YIELD INVESTMENT POSSIBILITIES

The vast vast majority of so-known as "higher-yield" investments are bonds or other categories of debt investments that both have been rated beneath investment grade or are marketed by businesses that have not long ago been trouble. Of course, there is quite typically crossover involving these two classes.

Outside of the reputable channels of the higher-yield bond market place, substantial-yield investments should only be approached with caution, and one should only participate in such investments with people or firms that can be trusted.

Speculators are looking for gains as high as three percent a day or fifty percent a month. Unfortunately, the vast majority of these so-called opportunities (which are popular enough to have an acronym HYIP), are scams that take advantage of gullible people.

Caution to you and your clients.

BASIC SECURITIES LAW

SECURITIES

- **Stocks**
- **Contract Rights**
- **Interests in partnerships**
- **Interests in LLCs**
- **Equities**

TRADABLE & EXCHANGEABLE

- ❖ **Exchanges**
- ❖ **Web trading**
- ❖ **Buyer/Seller**
- ❖ **Broker**
- ❖ **Spread**

OHIO DEFINITION

any certificate or instrument, or any oral, written, or electronic agreement, understanding, or opportunity,

that represents title to or interest in, or is secured by any lien or charge upon the capital, assets, profits, property, or credit of any person or of any public or governmental body, subdivision, or agency."

This definition includes such common items as shares of stock, warrants, options, promissory notes, membership interests in limited liability companies, bonds, and debentures.

Limited partnership interests are considered to be securities, while general partnership interests are generally not considered to be securities.

The statutory definition additionally includes the term "investment contract," which has been construed by judicial decisions to include numerous investment opportunities and business schemes which at first glance may not appear to fit within the definition of "security."

the full meaning of sale as applied by, or accepted in, courts of law or equity, and includes every disposition of, or attempt to dispose of, a security."

If the Ohio Securities Act applies, its fundamental requirements are (i) that all sales of securities be registered with the Division, be properly exempted from registration, have notices filed, and also (ii) that the persons selling the securities be licensed by the Division or be properly exempted from licensure.

Automatic Exemptions,

The 3 (o) Form > 35
shareholders/security owners?

EVALUATING MERGERS

INDIVIDUALS

- ? Do personalities mesh
- ? Who will dominate
- ✓ Relative Strengths
- ✓ Relative weaknesses
- ✓ Estate Impact
- ✓ Structure of Deal

COMPANIES

- ? Business compliment
- ? Resources
- ? Bank/Finance
- ✓ Short Term
- ✓ Long Term
- ✓ Goals to measure by

MERGERS CAN BE MARRIAGES OR STEPPINGSTONES

Based on the entities and tax structures mergers require careful planning and much of the conditions precedent to a successful merger are made during negotiations

Coordinate :

- competing tax benefits
- Asset mixes
- Key employees & success influencers
- Know the tier goals

WEIGH ALL CONSIDERATIONS AND HAVE A BASIS FOR UNEMOTIONAL ANALYSIS

Focus on what matters most minimizing the unimportant



Negotiating Acquisitions

- Negotiations begin usually before things get serious
- Consider the human elements in the transaction
- Size up people for experience & sophistication
- Study written communications and compare to oral statements and consistent action
- If appropriate. draft Letter of Intent (LOI), Memorandum of Understanding (MOU) and/or, Deal points
- Move to documents to solidify and focus positions
- Identify areas of agreement FIRST
- Identify areas for compromise and the target areas of disagreement
- Persuade based on practical situations. (Remember everyone thinks all parts of their deal is unique and that is an emotional reaction)
- Create leverage points
- Plot & diagram scenarios of possible interactions and relative positions

LEGALLY & FINANCIALLY **DO** DUE DILIGENCE

- Due diligence is a misnomer of sorts.
- What diligence was actually appropriate is a “hindsight assessment”.
- Focus on resources and explain shortfalls based on resources that can commit.
- Identify and disclose items left undone due to any constraints.
- Distinguish business issues from legal issues.
- Anticipate what is known and what is unknown and then weigh importance of each.

Employment Matters

Employees are the key to success and failure.

- Written employment contracts define relationships & expectancies.
- Employees can be assets.
- Employees can be liabilities.
- Employees become competitors.
- Employees who are loyal and think like owners are invaluable.
- Navigate the employment law specific to the industry.
- Employees' brains hold intellectual capital and trade secrets.
- Nurture agreements that incentivize employees to align their interests with the employer.

KEY LEGAL EMPLOYMENT CONSIDERATIONS

WRITTEN

- Employment contracts
- Employee handbooks
- Written policies
- Industry Standards

UNWRITTEN

- Course of dealings
- Oral agreements
- Ignored written agreements
- Unenforced policies

Learn and listen.

Ask historical & human issue questions.

BASIC TAX

TAX LAWS USUALLY EVOLVED FROM A NEED OR SOCIAL NORM

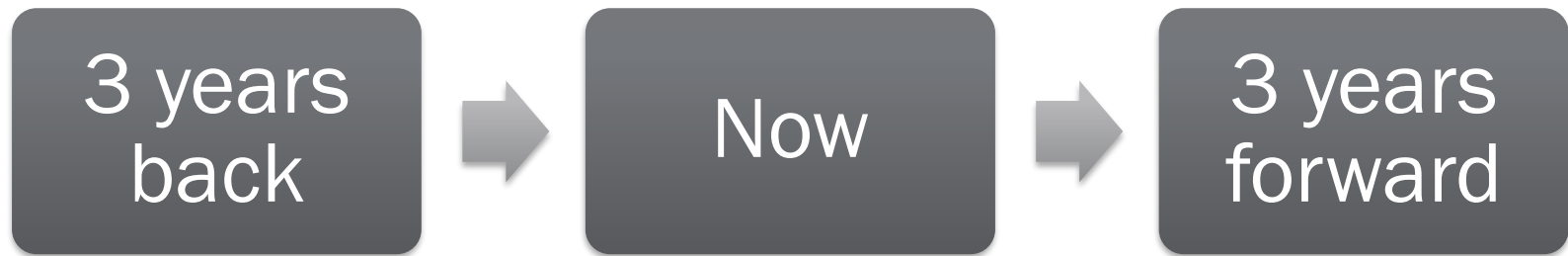
Types

- Federal tax laws
- State tax laws
- Local tax laws
- Property Tax laws
- Sales & Use Tax
- Transfer Taxes
- Excise Tax
- Income Tax
- Estate Gift Inheritance Taxes

Documents

- *Forms are the litmus test and proof of what a tax authority bases its determinations on*
- *Know what was filed when*
- *Understand the impact of timing*
- *How long to keep originals and what about software programs?*

TAXATION HAS A LIFE CYCLE



Try to keep whole view when dealing with any tax issue.

IDENTIFY THE TYPE OF TAX AT ISSUE, FOCUS ON ITS IMPACT

Example is that income tax is different that property tax than sales tax.

Know if the tax authority inquiring is :

- **Civil**
- **Criminal**
- **Task Force**

APPRECIATE THE PRESERVATION & SIGNIFICANCE OF THE CLIENT-ATTORNEY PRIVILEGE

Last vestible of protection so plan based on what you anticipate could happen

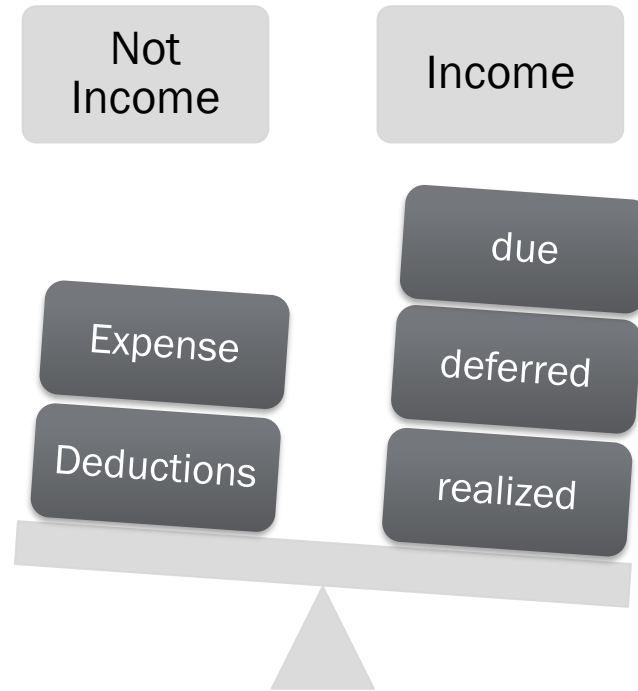
Discern when to:

- Fire & hire accountant
- Protect under work product
- Raise or allocate concern

COMPUTATIONS ARE NOT EXACT

Deductions

Credits



HOW TO FIGURE GAIN OR LOSS

You figure gain or loss on a sale or trade of property by comparing the amount you realize with the adjusted basis of the property.

- **Gain.** If the amount you realize from a sale or trade is more than the adjusted basis of the property you transfer, the difference is a gain.
- **Loss.** If the adjusted basis of the property you transfer is more than the amount you realize, the difference is a loss.
- **Amount realized.** The amount you realize from a sale or trade of property is everything you receive for the property. This includes the money you receive plus the fair market value of any property or services you receive.

If you finance the buyer's purchase of your property and the debt instrument does not provide for adequate stated interest, the unstated interest that you must report as ordinary income will reduce the amount realized from the sale.

If a buyer of property issues a debt instrument to the seller of the property, the amount realized is determined by reference to the issue price of the debt instrument, which may or may not be the fair market value of the debt instrument.



Please no number
games we are in a
casino.....

HOW TO FIGURE GAIN OR LOSS (CONT.)

However, if the debt instrument was previously issued by a third party (one not part of the sale transaction), the fair market value of the debt instrument is used to determine the amount realized.

- *Fair market value.* Fair market value is the price at which property would change hands between a buyer and a seller, neither being forced to buy or sell and both having reasonable knowledge of all the relevant facts.
- *Debt paid off.* A debt against the property, or against you, that is paid off as a part of the transaction or that is assumed by the buyer must be included in the amount realized. This is true even if neither you nor the buyer is personally liable for the debt. For example, if you sell or trade property that is subject to a non-recourse loan, the amount you realize generally includes the full amount of the note assumed by the buyer even if the amount of the note is more than the fair market value of the property.

HOW TO FIGURE GAIN OR LOSS (CONT.)

Example.

You sell stock that you had pledged as security for a bank loan of \$8,000. Your basis in the stock is \$6,000. The buyer pays off your bank loan and pays you \$20,000 in cash. The amount realized is \$28,000 (\$20,000 plus \$8,000). Your gain is \$22,000 (\$28,000 minus \$6,000).

Payment of cash. If you trade property and cash for other property, the amount you realize is the fair market value of the property you receive. Determine your gain or loss by subtracting the cash you pay and the adjusted basis of the property you trade in from the amount you realize. If the result is a positive number, it is a gain. If the result is a negative number, it is a loss.

No gain or loss. You may have to use a basis for figuring gain that is different from the basis used for figuring loss. In this case, you may have neither a gain nor a loss.

TAXES ARE NECESSARY

MAKE THE ISSUE FUN BECAUSE TAXES ARE REALLY PART OF THE SOCIAL COMPACT

- Ethical Standards and Civil Liability

[2] As a representative of clients, a lawyer performs various functions. As advisor, a lawyer provides a client with an informed understanding of the client's legal rights and obligations and explains their practical implications. As advocate, a lawyer zealously asserts the client's position under the rules of the adversary system. As negotiator, a lawyer seeks a result advantageous to the client but consistent with requirements of honest dealings with others. As an evaluator, a lawyer acts by examining a client's legal affairs and reporting about them to the client or to others.

II. COUNSELOR

RULE 2.1: ADVISOR

In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations, such as moral, economic, social, and political factors, that may be relevant to the client's situation.

Comment

Scope of Advice

[1] A client is entitled to straightforward advice expressing the lawyer's honest assessment. Legal advice often involves unpleasant facts and alternatives that a client may be disinclined to confront.

Comment

Scope of Advice

[1] (cont.) In presenting advice, a lawyer endeavors to sustain the client's morale and may put advice in as acceptable a form as honesty permits. However, a lawyer should not be deterred from giving candid advice by the prospect that the advice will be unpalatable to the client.

[2] Advice couched in narrow legal terms may be of little value to a client, especially where practical considerations, such as cost or effects on other people, are predominant. Purely technical legal advice, therefore, can sometimes be inadequate. It is proper for a lawyer to refer to relevant moral and ethical considerations in giving advice. Although a lawyer is not a moral advisor as such, moral and ethical considerations impinge upon most legal questions and may decisively influence how the law will be applied.

[3] A client may expressly or impliedly ask the lawyer for purely technical advice. When such a request is made by a client experienced in legal matters, the lawyer may accept it at face value. When such a request is made by a client inexperienced in legal matters, however, the lawyer's responsibility as advisor may include indicating that more may be involved than strictly legal considerations.

[4] Matters that go beyond strictly legal questions may also be in the domain of another profession. Family matters can involve problems within the professional competence of psychiatry, clinical psychology, or social work; business matters can involve problems within the competence of the accounting profession or of financial specialists.

[4] (cont.) Where consultation with a professional in another field is itself something a competent lawyer would recommend, the lawyer should make such a recommendation.

At the same time, a lawyer's advice at its best often consists of recommending a course of action in the face of conflicting recommendations of experts.

Offering Advice

[5] In general, a lawyer is not expected to give advice until asked by the client. However, when a lawyer knows that a client proposes a course of action that is likely to result in substantial adverse legal consequences to the client,

the lawyer's duty to the client under Rule 1.4 may require that the lawyer offer advice if the client's course of action is related to the representation.

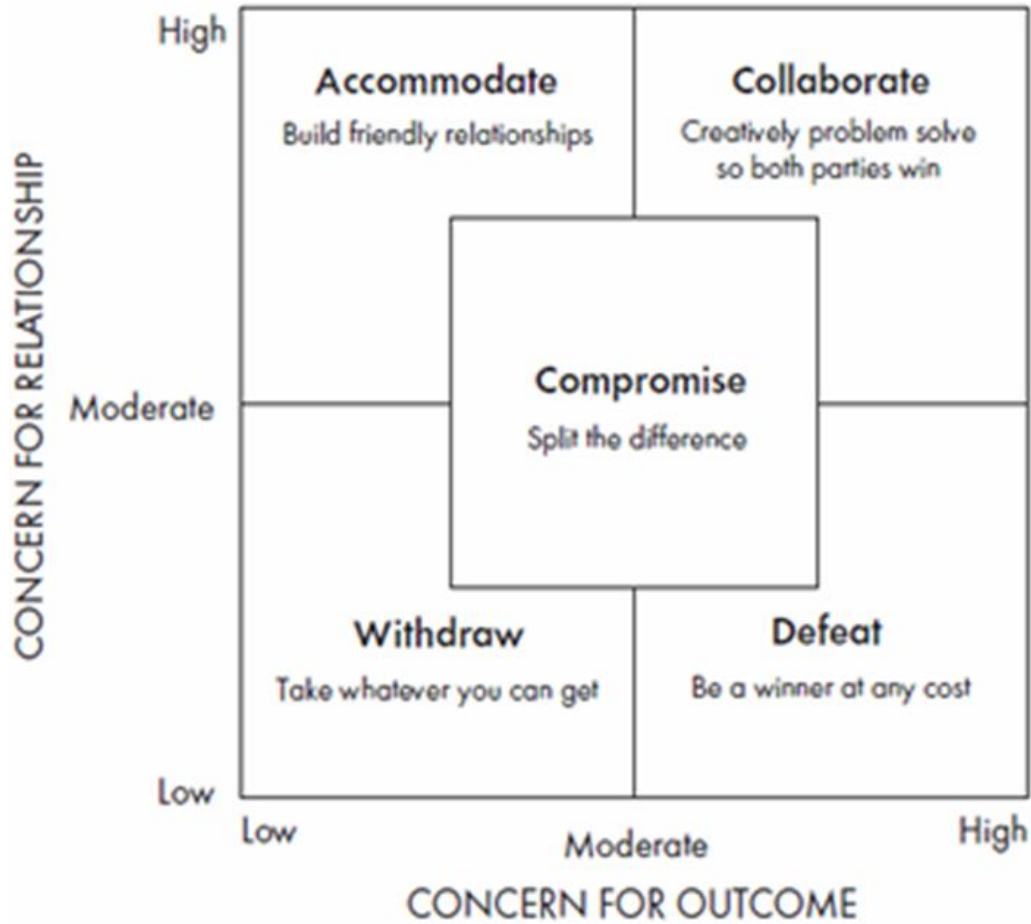
Offering Advice

Similarly, when a matter is likely to involve litigation, it may be necessary under Rule 1.4 to inform the client of forms of dispute resolution that might constitute reasonable alternatives to litigation.

**Mediation-Arbitration-Push/Pull-Walkaway
Compromise Certainty**

Offering Advice

[5] (cont.) A lawyer ordinarily has no duty to initiate investigation of a client's affairs or to give advice that the client has indicated is unwanted, but a lawyer may initiate advice to a client when doing so appears to be in the client's interest.



Scenario One:

- During contract negotiations, one party includes a clause (often in a form contract) that is often used but is invalid.
- The other party objects to the clause being included, but the drafting party responds that "if the clause is not valid, why worry about it? Why not leave the clause in?"
- The other party, lacking bargaining power, acquiesces but does not comply with the clause.

Scenario Two:

- During contract negotiations, one party includes a clause that is often used but is invalid.
- The other party does not know about the invalidity but objects to the clause as unfair, unnecessary or undesirable.
- The drafting party does not disclose the invalidity and prevails in keeping the clause in.
- The other party then complies with the clause, never learning of its invalidity.

" Scenario Three:

During contract negotiations, one party includes a clause that is often used but is invalid.

The other party does not object to the clause and later complies with the clause without learning of its invalidity.

Scenario Four:

- During contract negotiations, one party includes a clause that is often used but has been the subject of criticism in commentary and has been invalidated in other jurisdictions.
- The other party does not object to the clause and later complies with it without learning of the arguments against its validity

Scenario Five:

During contract negotiations, one party includes a clause that is often used in similar contracts.

After contract formation, a court in that jurisdiction rules that these clauses are invalid (for instance, that the term is unconscionable or against public policy).

The drafting party learns of the decision, but the other party does not and subsequently complies with the clause.

**THANK YOU FOR YOUR TIME
& ATTENTION.**

Benjamin S. Zacks, Esq.

bszacks@zlglaw.com

Office 614.236.8000 Fax 614.236.3236



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Counselors & Practitioners at Law

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