Cross-Selling Cliff Notes

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2019 First Quarter Edition

This internal-only publication is an opportunity for each practice group to provide an interesting fact, strategy or marketing nugget that will allow us to cross-sell our practices to our existing clients, centers of influence and referral sources.

What's New?

We have redesigned this *Cross-Selling Cliff Notes* guide for readability and interactivity, meaning that it is easier to understand and move throughout the document. Looking for the Family Law section? See something underlined? Click on what catches your eye and it'll take you right to that page!

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Bankruptcy Wave Hits Retail: What Trade Creditors Need to Know

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Author: Joyce Kuhns

SEPTEMBER 2018 EDITION

Toys "R" Us. The Limited. HHGregg. Radio Shack. In 2017, the pace of chapter 11 retail filings picked up significantly. So did store closings by Sears, Kmart, JCPenney's, and Payless Shoes... to name a few. The uptick in activity directly reflects increased competition between "bricks and clicks" retailers and changes in how and where customers shop. With the anticipated rise in interest rates, bankruptcy filings and store closings are expected to continue in 2018, according to Moody's and Fitch Ratings. If you're a trade creditor who has supplied goods or services to a customer before or after the customer enters bankruptcy, it is time to revisit the to know. Consider the following tips:

Tip 1 – Read Your Contract:

- Bankruptcy laws and rules generally apply to and only protect the entity/person with in the bankruptcy.
- Ask yourself the following questions:
  - Who is liable on the debt?
  - When is payment due?
  - How is payment made? (cash in advance, COD, wire or credit).
  - Is there security? (deposit, letter of credit, a debtor or non-debtor guaranty).

Tip 2 – Learn Your Contract Status:

- Ask yourself the following questions:
  - Is the debtor current or in arrears?
  - Are there goods in transit?
  - When was the last time the goods or services were supplied?
  - Are you under contract to continue to supply goods or services?

Tip 3 – Pick A Case Monitor and Advocate:

- Decide who will retrieve and review court pleadings, relevant documents, and calendar deadlines.
- Access the PACER (Public Access to Court Electronic Records) system to view and obtain copies from the court docket. In large cases, dockets and documents may be available through a link set up by the debtor's claims and notice agent at NO cost to you.
- Decide who will attend hearings and, if needed, file and pursue objections for you.

Tip 4 – Respect the Automatic Statutory Stay:

- An automatic statutory stay goes into effect on the filing of the case and halts all actions by creditors to collect prepetition debt from the debtor or against its property, with limited exceptions.
- This means you must:
  1. Stop all collection activity for prepetition debt and advise your employees and agents to do so, as well.
  2. Put a "hold" on pending litigation, administrative, or other proceedings against the debtor.
  3. Separate prepetition debt and invoices from post-petition debt and invoices and only apply post-petition payments against post-petition invoices.
  4. Seek court permission to terminate or modify a contract post-petition or to exercise a contractual or state law right of set off (I.e.: to apply a security deposit against a delinquent lease payment).
  5. Avoid monetary sanctions that may be imposed against you by the court if you knowingly violate the bankruptcy stay.

Tip 5 – Figure Out If You Can Claim "Priority" Status:

- Decide whether you have a preferred status you could assert without violating the automatic stay and:
  1. Perfect mechanics' liens within the periods required under nonbankruptcy law.
  2. Make bond claims timely.
  3. Decide whether to stop goods in transit not yet in the debtor's possession (unless the debtor is paying cash for delivery – then make sure the Debtor has the authority to make the payment).
  4. Determine the value of goods the debtor received within 20 days of case commencement that you sold to the debtor in the ordinary course of business as this claim may be a priority claim in the case.
  5. Investigate if you could be a "critical vendor" – entitled to be paid for unpaid prepetition services or goods early – you're critical to the reorganization effort. ◆

Once you take these basic "get smart" steps, you should be primed to navigate the bankruptcy world of 2018. Our next segment will explore tips for the smart "landlord" to maximize recovery and minimize loss when its tenant files.

If you have any questions about this topic or any other bankruptcy matter, please contact Joyce at jkuhns@offitkurman.com

Quick Thoughts on Bankruptcy & Divorce

Someone once said that: "The word 'Bankruptcy' is a lot like the word 'War.' You think you know what it means until you experience it." Now add in divorce law, and you have your first topic from the Creditors Rights |Bankruptcy Group.

Let's start with terms of art. A "discharge" is the bankruptcy relief of eliminating all debts permitted under bankruptcy law. "Dischargeability" refers to the elimination of a legal liability to pay a specific debt. Certain debts, such as obligations in the nature of alimony, maintenance and child support, are not dischargeable in bankruptcy while all other debts may be discharged in the case.

A Domestic Support Obligation ("DSO") is not dischargeable under any chapter of the Bankruptcy Code. See 11 U.S.C. §523(a)(5). A DSO is basically: a debt in the nature of alimony, maintenance and support; owed to a spouse, former spouse, or child of the debtor or such child's parent; and is established by a separation agreement, divorce decree, or property settlement agreement or an order of a court of record.

Sounds easy? Okay, let's say you have a separation agreement providing for the transfer of the principal residence to Wife. She is to make all mortgage payments until she refinances or sells, and she will indemnify him if she fails to do so. And she fails to do so and files bankruptcy. There is a $200,000 deficiency and the mortgagor holder sends a letter to the Husband asking him for $200,000. "But, she is supposed to pay the mortgage!" Husband claims that the Wife's indemnification is nondischargeable under (a)(5). What do you think?

Concerns: (1) What factors distinguish a DSO from a property division; and (2) A DSO is owed to a spouse or former spouse, not to a third party such as the lender.

But this is bankruptcy law so don't give up! Another nondischargeable debt under §523(a)(15) is one owed to a spouse, former spouse, or child of the debtor that is not a DSO and is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record. So the husband has nothing to worry about because of (a)(15), EXCEPT a couple of courts ruled that obligations under (a)(15) are not dischargeable only if the agreement or divorce decree created "new" rights in favor of a spouse. See In re Proyect, 503 B.R. 765 (Bankr. N.D. Ga. 2013). Is indemnification a "new" right? The Husband had a right of contribution prior to the execution of the separation agreement. But, in Maryland, the entry of the divorce decree enables the spouses to each enforce certain financial obligations that they could not enforce prior to the entry of the Divorce Decree. See e.g. Md. Code Ann. Family Law Art. §§8-203, 8-204, 8-205, 8-206, 8-207, 8-208, 8-209, 8-213 and 8-214. That does not end the issue. Property division and other non-support awards under Section 523(a)(15) are not dischargeable in Chapter 13 proceedings. See 11 U.S.C. §1328(a)(2).

Applying bankruptcy and divorce law in the same case can be quite a battle. ◆

So You Want to Sell Your Business? How to Prepare

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Author: Daniel Hofherr

SEPTEMBER 2018 EDITION

You are past the expansion phase and now you want to cash out... What do you do? Before you put a "for sale sign" in the front yard and begin courting potential buyers, you should create a presale plan.

Here are some steps to help you get ready to sell your business:

1. IS THIS THE RIGHT TIME?
The time to sell your business is when you're going strong. If your business or industry is in a lull, the focus should be on growing your net revenue and profits. This can be done in many ways, such as decentralizing your client base, focusing on your core competencies, and cost cutting. Buyers will want to see strong metrics, EBITDA (earnings before interest, taxes, depreciation and amortization) being the most commonly requested. The stronger your EBITDA, the higher multiple you can request.

2. POLISH YOUR BOOKS.
The buyer will be focused on metrics. Avoid potential red flags by having at least 3 years of manicured financials and tax returns. Having an independent CPA prepare these gives a buyer more confidence than financials prepared by an internal bookkeeper or do-it-yourself software. From the practical side, if your business is family-owned, do your best to remove any unnecessary expenses (e.g. your leased luxury vehicle, loans from your business to you, grocery store trips, and so on). Selling unnecessary or personal assets can also be beneficial.

3. KNOW YOUR WORTH.
Engage a reputable business broker or certified business valuation professional to give you a realistic idea of where you stand in comparison to similarly situated businesses with in your industry. This will also help you identify where you need to focus on improving.

4. SECURE YOUR KEY EMPLOYEES.
Every business has some element of human capital. Develop an action plan to incentivize long term commitment. Some approaches include incremental compensation increases and bonus programs, profit sharing pools, and equity incentive plans. Each of these have pros and cons, so be sure to pick the method that works best for your situation (e.g. giving an employee equity). Also, you may consider having your employees enter into non-competition, non-solicitation, and confidentiality agreements to prevent them from leaving with your customers and starting a competing business before you can sell to a potential buyer.

5. DOCUMENT OWNERSHIP OF YOUR BUSINESS.
Make sure you have clear provenance to the company equity that is held by each owner. Have a document for when each owner came on (e.g. equity purchase, grant, or founder's equity agreement) and when each past owner left, if necessary. Remember that web developer you promised equity to in exchange for a website when you did not have cash on hand? Do your best to document the transfer of that equity or consider a repurchase and release to prevent any problems down the road.

6. SQUARE AWAY YOUR INTELLECTUAL PROPERTY.
It is not uncommon for a large part of your business assets to be intellectual property. Whether that is branding, trademark, proprietary software, or process know-how, these items all add substantial value to your business. Buyers want to see you have good, clear title to them. Consider having your employees sign instruments that make it clear that you own the application code or product tooling design that you are paying them to develop (this is often called an "employee invention agreement"). Also, review your third party vendor and contractor agreements that involve creative material (e.g. website content, mobile application, and marketing materials) to confirm that that the work product is assigned to your business. If this is unclear, now is the time for curative action. You may also consider applying for federal trademark registration to secure your brand. This is one more feather in your cap to sell. The buyer will be happy to hear that you have taken the time to secure your brand.

7. MAKE A PAPERTRAIL.
More often than not, business is conducted by telephone and email without an underlying contract... This works until it doesn't. Get ahead of the curve by having signed agreements with your vendors and customers. If you use a broad range of vendors and they frequently hand you their contract to sign, it may be worth while to consider having a simple 2 page addendum that you can add at the time of signing (or renewal) with provisions that cover your basics (e.g. termination without cause by you, assignability to your buyer without consent, indemnification, clear independent contractor status, and confidentiality... to name a few).

8. KNOW YOURSELF.
You need to know your strengths and potential to develop a meaningful pitch deck. What are you selling and why? What is your EBIDA, cost of goods sold, and net revenue? What is your largest expense category? What are the synergies of your business ecosystem as a whole? Who are your top 10 customers and vendors? Remember that you are selling an assembled kit that generates revenue, not just pile of assets and a few financial statements.

9. MAKE THE MAGIC TRANSFERABLE.
   That is, de-emphasize your role and cross train others in your organization to make your business easier for the buyer to integrate post-sale (this is on the forefront of their minds, believe me). To prevent transition problems, get others involved with the relationship side of your business (e.g. give your employees customer and vendor contact). Human capital may be an attractive part of your business, but a buyer needs to know your revenue machine will plug into their brand and continue to operate when you are no longer at the helm.

10. GET ORGANIZED TO MAKE THE BUYER'S HOMEWORK EASY.
    Start organizing now. Your buyer will hand you a due diligence request list of things you must provide so that they can evaluate your business. If you have less than perfect housekeeping habits or a long operating history, an option might be to find a basic due diligence checklist and work it backwards in order to prepare for the big day. Recordkeeping has powerful optics. If your records are thorough and organized, the buyer will infer that your business has been run with the same precision. Conversely, if you provide a banker's box of archaic financials and an amalgamation of disjointed paperwork and .pdf files, your buyer will be less confident and may see a long tangled mess ahead.

11. GET HELP. ASSEMBLE YOUR TEAM BOTH INTERNALLY (E.G. KEY EMPLOYEES) AND EXTERNALLY.
    Interview and hire a reputable accountant, attorney, business broker / investment banker, and other professionals to advise you during this process. The thought of engaging professionals may strike you as an unnecessary expense, but know that working with someone who has done this before and knows what is important to buyers will save time and help you in your quest to achieve your maximum value for your business.

In all, working through the above will assist you in getting ready to sell your business and will help you put your best foot forward when you enter the market.

If you have questions about buying or selling your business please contact Daniel Hofherr at dhofherr@offitkurman.com or 202-813-0979.

ABOUT DANIEL HOFHERR

Daniel Hofherr is an attorney in the Business Law and Transaction practice group. He advises clients that are in all phases of the business lifecycle from startup, to growth and expansion, and maturity and exit.

As a business lawyer, Mr. Hofherr assists clients in matters such as developing internal corporate governance framework, admission and separation of equity owners, private equity financing, employee retention incentives, customer contract management, intellectual property licensing, and business succession planning. ◆

Equity Sharing In the Closely-Held Businesses

Author: Daniel Hofherr

SEPTEMBER 2018 EDITION

Effective use of equity incentive tools in the closely-held company

I. Preliminary Notes:

- The form of a business entity (corporation, S corp., LLC) does affect implementation, but most concepts apply equally to LLC's as well as corporations. We use corporate nomenclature in this discussion - e.g. "stock" versus "membership interests."
- The tax attributes of the entity (S corp. and partnership) also affect implementation of the program. Most closely-held companies have flow-through of income and loss to owners by way of electing "S treatment" or partnership taxation.
- This is a basic summary. Many tax and other issues are not discussed. We recommend you speak to an accountant prior to implementing an equity compensation plan.

II. Reasons NOT to Share Equity:

- Loss of sole control. The owner is now accountable to all equity holders.
- Loss of privacy. Employees now have information rights.
- Loss of flexibility. Making decisions require others to agree.
- Perceived high cost/low impact as compared to cash compensation.

LESSON 1: Many successful businesses do not share equity.

Reasons to Share Equity:

- Retention of existing management and talent.
- Create a sense of ownership and proprietary thinking.
- Foster entrepreneurial culture and mindset.
- Attract new talent.
- Drive attainment of specific long-term metrics by employee participants.

LESSON 2: Pick the right tool for the job.

Reward short term goal achievement with performance bonuses. Equity is a long term incentive to reward significant value building.

III. Types of Equity Incentives and Their General Pros and Cons:

a. Stock Purchase:

i. **What is it?** An employee buys stock in the company for a defensible fair market value (often company-financed and often paid out of bonuses). The stock can be purchased from the company, or from the controlling stockholders.

ii. **Pros:** owner mentality leads to employee retention, employees feel like they have a "voice" in the business by voting, employees share in profit distributions to stockholders (feeling like they have a "piece of the pie"), and the seller receives money or a promissory note.

iii. **Cons:** Employees have rights (e.g. voting, information, notification), may have to approve certain actions depending on what percentage of equity they hold, and the employee must pay fair market value for the shares (or face tax consequences if sold at less than fair market value).

b. Stock Bonus:

i. **What is it?** A type of profit sharing plan paid in stock of the company, instead of cash.

ii. **Pros:** See stock purchase above. In addition, from the employee's perspective, he or she does not have to pay money for the stock, and from the company's perspective the value of the stock contributed to the plan is usually tax deductible.

iii. **Cons:** See stock purchase above. In addition, the award plan is subject to the limits of the Employee Retirement Income Security Act ("ERISA"), and there is immediate recognition of income to the employee (this usually limits usage to startups and distressed companies with low values).

c. Restricted Stock:

i. **What is it?** Stock that is purchased for fair market value by the employee, subject to a substantial risk of forfeiture (e.g. outright forfeiture or buy back rights of the company if the employee leaves the company before a certain time).

The company's right to repurchase the restricted stock can lapse in increments pursuant to a vesting schedule over-time subject to the employee's continued employment. The repurchase price for unvested restricted stock is typically the original cost of the equity or, in cases like termination for cause, can be the lower of the original cost of the restricted stock or the fair market value of the restricted stock on the date of termination. Restricted stock is most commonly awarded to a company's founders and initial employees in the start-up phase of the company because they can buy the stock for a nominal (e.g. $0.01 per share) cost due to the low value of the company when it is first created.

View the Equity Incentives chart »

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ii. **Pros:** See stock purchase above. In addition, the employee has the option to recognize income now, or when the restrictions lapse (and the employee has to make a tax election within a certain period of time after receiving the restricted stock). The company can make the stock subject to restrictions that lapse over time (which incentivizes the employee to stay with the company until all of the restrictions lapse).

iii. **Cons:** See stock purchase above. In addition, this is not typically used in companies who are beyond the start-up phase because the value of the company dictates a high purchase price for the employee's stock.

iv. **General Notes.** Restricted stock can also be coupled with outright forfeiture upon termination of employment.

d. Options:

i. **What is it?** An option is the right to purchase stock in the company at the end of a vesting period set by the company based on a set price, usually the current fair market value as of the date of the grant of the option (which allows for certain tax treatment). The company can have the options vest (i.e. become exercisable) incrementally over time subject to the employee's continued employment with the company, thereby incentivizing the employee to stay until he or she can exercise all of their options for stock.

There are two types of stock options: (A) Incentive ("ISO"), where no income is recognized by the employee at the time of exercise (only upon disposition), and gain can be capital if the holding period is more than one year. (B) Non-qualified ("NQSO"), which is compensation income recognized at the time of exercise.

ii. **Pros (ISOs):** Favorable tax treatment, and the employee benefits from the growth in value of the company from the option grant date upon exercise of the option for stock.

iii. **Pros (NQSOs):** Exercise of the option starts the capital gains holding period and the employee will have long-term capital gains treatment one year later, the employee benefits from the growth in value of the company from the option grant date upon exercise of the option for stock, and the company may be eligible for a tax deduction that is not available with ISOs (unless the employee makes a disqualifying disposition).

iv. **Cons (Generally):** The company must determine the fair market value of the stock at the time of each grant, the employee does not hold stock immediately (this reduces the value of the option as a method to retain employees), and unless repurchase mechanics are used, the option may seem like it has no value to the employee until exercised for the purchase of stock.

e. Performance share plans (aka "Phantom Stock" or "Stock Appreciation Rights"):

i. **What is it?** A contractual right to receive from the company, either: (A) shares of stock, or (B) a percentage of profits of the company (via the value of a specified number of shares of stock).

ii. **Pros:** The employee shares in profits. From the employer's perspective, the company does not have to grant stock (see stock purchase cons above).

iii. **Cons:** Employees may not feel like they have a "voice" in the business because phantom stock is not stock and has no voting rights, and the plans must be structured in a certain way to be exempt from or compliant with the Internal Revenue Code.

f. Employee Stock Ownership Plan:

i. **What is it?** An ERISA employee benefit plan that invests primarily in the stock of the company (i.e. the sponsoring employer).

ii. **Pros:** Certain tax advantages. This is best used as a tool to achieve other objectives such as liquidity for founders.

iii. **Cons:** Cumbersome and expensive.

IV. How much to share and who to share it with:

Rule of thumb: 15-20% of total shares on a fully-diluted basis; 2-5% each for C-Level executives or key employees.

LESSON 3: Use an alternative approach: *analyze the anticipated contribution of the proposed employee participant, and the value that contribution will create, and determine an equitable sharing of the value when created.*

V. Making equity sharing work in closely held

View the Equity Incentives chart »

companies:

LESSON 4: Companies should share information (open-book management).

LESSON 5: The company should share decision-making (which will allow employees to feel consulted and included).

LESSON 6: There is an emotional aspect of feeling involved. Ownership benefits must be continuously communicated to the employee participants. Financial benefits should be calculated at least quarterly. The company should include employees in company meetings, give employees titles on business cards and parking spaces, give employees owner-only retreats and planning sessions, et cetera. The company may need to recapitalize to combine related entities and/or to authorize additional shares so that each employee participant has a meaningful number in hand.

LESSON 7: The stock must be given liquidity. Because the company's stock has no market, the company can add perceived value for the employee to its incentive plan structure by emulating a market using either the company or the other stockholders or both (e.g. put options – employee forcing someone to buy them out, and call options – the company forcing the employee to sell). Consider the use of a valuation formula to focus management on enumerated key objectives of revenue, profit and/or other objectives, such as diversification of customer base.

LESSON 8: Require that the employee who receives or buys stock to enter into a stockholders' agreement as condition of the sale or stock grant to retain control of aspects of the company. Some of the things a stockholders' agreement can contain are (a) restrictions (e.g. cross purchase by other stockholders on certain events, repurchase by the company on termination of employment, noncompetition / nonsolicitation provisions), (b) repurchase rights (e.g. a put option - employee forcing someone to buy them out, or call option - the company forcing the employee to sell, (c) sale rights (e.g. drag along rights - giving the employee the right to sell their stock upon a sale of the company, tag along rights (a majority of the stockholders can force other stockholders to in the event of a third party purchase of the company, and right of first refusal), and (d) founder's rights (e.g. the ability to pick a certain number of directors as long as the founders hold stock).

VI. High points of design concepts:

a. **Vesting.** Benefits can vest over time or upon attainment of specific metrics by either the employee, or the company. Acceleration of vesting upon a liquidity event is customary.

b. **Covenants.** Non-competition and non-solicitation provisions in stockholders' agreement.

c. **Post-purchase or grant transfer restrictions** in stockholders' agreement (e.g. first right of refusal).

d. **Buy Back Considerations.**

   i. Formula versus fair value as determined by negotiation or appraiser.

   ii. Discounts generally and discounts based on the nature of the buyout event. Optional versus mandatory right of corporation to buy back.

   iii. Right of the company to pay over time for repurchased stock at a favorable interest rate if the amount would significantly impact cash flow, or if the company wants to have an effective means to enforce non-solicitation.

e. **Tag-along and drag along rights.** A stockholder has the right to sell stock in the event of a third party purchase of the company.

f. **Options.**

   i. Put Options - employee forcing someone to buy them out.

   ii. Call Options - the company forcing the employee to sell.

g. **Allocation of income and qualification of stockholders in an S Corporation.**

h. **Voting versus nonvoting stock.**

VII. Final Thoughts:

LESSON 9: An elegant and professionally prepared set of documents by themselves will not achieve desired results. Emotional aspects are as important as the financial aspects. The purpose of equity sharing is to fundamentally change how employees feel about their employer, which is first an emotional outcome. ◆

View the Equity Incentives chart »

New Tax Reform & Business Entities

Author: Mike Mercurio

JANUARY 2018 EDITION

One buzzed-about aspect of the *Tax Cuts and Jobs Act* is the bill's impact on "pass-through" business entities. Pass through businesses are so-called because their profits-pass through to the business owner's personal tax return, where the profits are taxed at the corresponding income tax rate. Most closely held businesses in the United States – including sole proprietorships, S corporations, limited liability companies, and partnerships – are pass-through companies.

The new law does not change how pass-through companies are taxed, but it does allow many owners to deduct 20% of their qualified business income (QBI), or taxable income, minus capital gains (whichever is lesser) on their annual returns. QBI comprises any domestic income besides reasonable compensation associated with S corporations and guaranteed payments associated with partnerships and LLCs. Unlike an itemized deduction, the QBI deduction is considered an "above the line" or "between the lines" deduction, meaning it reduces overall taxable income regardless of whether an individual claims the standard deduction.

Any business is eligible for the full 20% deduction, so long as the owner's taxable income falls below $157,500 (or $315,000 for married owners filing jointly). Note that businesses in specified service industries – such as health care, accounting, law, and professional services – cannot claim the deduction if their income exceeds $157,500 (or $315,000 for joint filers).

In light of this new law, I imagine many clients will be evaluating their tax burdens with renewed vigor and considering whether different business structures could present tax savings. While some, such as service-oriented companies with taxable income above the threshold, may find benefits in forming a new structure or "spinning off" an element of their business as a separate entity, clients should be aware of the various legal and financial advantages and responsibilities associated with each entity. For most businesses, taxes are a relatively minor factor in long-term growth and success. Attorneys should take this opportunity to review clients' large-scale objectives and develop a strategy that takes all of a client's unique issues and circumstances – including taxes – into consideration. ◆

Latest Tax Court Case Delivers Blow To State-Legal Marijuana Businesses On Application Of IRC Section 280e

A US Tax Court decision issued on November 29, in *Patients Mutual Assistance Collective Corporation (D.B.A. Harborside Health Center) v. Commissioner, 151 T.C. 11 (11/28/2018)*, is another defeat for businesses involved in selling state-legal marijuana. In particular, under the Tax Court ruling, any business that is largely a reseller of marijuana may effectively be prevented from claiming any federal tax deductions or credits, other than its inventory and transportation costs.

In general, the *Internal Revenue Code* allows a business to deduct all of its ordinary and necessary expenses paid or incurred in carrying on any trade or business. As a limitation to that general rule, Section 280E of the Code states that "No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business… consists of trafficking in controlled substances… which is prohibited by Federal law or the law of any State in which such trade or business is conducted."

In this case, Harborside, a California medical-marijuana dispensary, deducted expenses under Section 162 of the Code (for ordinary and necessary business expenses), and adjusted its cost of goods sold for indirect expenses under the Section 263A UNICAP rules for producers. It purportedly was one of the largest legal marijuana businesses in the United States, with reported revenue of over $100 million over a five-year period (2008-2012). Of that revenue, 99.57% came from marijuana sales. Harborside estimated that 55-60% of its employees' time was spent on buying and processing marijuana (both buds and marijuana-containing products) and another 25-30% on selling it.

Harborside also sold non-marijuana containing products, which the court acknowledged was entirely legal. Those products accounted for an estimated 5-10% of employees' time, less than 25% of the sales floor space, and less than 0.5% of the total revenue of the business.

The IRS audited Harborside – which filed tax returns as a "C corporation" – for its 2007-2012 tax years. The IRS denied most of Harborside's claimed deductions and adjustments for cost of goods sold and asserted tens of millions of dollars in deficiencies and accuracy-related penalties. The IRS based its adjustments primarily on the Section 280E prohibition on deductions or credits for amounts paid in carrying on a trade or business that consists of trafficking in controlled substances.

The Tax Court found that marijuana is a "controlled substance" for purposes of Section 280E. The court recognized the conflict between California and federal law but noted that the Supreme Court upheld the federal prohibition on marijuana sale and possession with respect to medical-use marijuana in California. See *Gonzales v. Raich, 545 U.S. 1 (2005)*.

Then, the principal debate in the case was over the language in Section 280E providing that the deduction disallowance applies if a trade or business consists of trafficking prohibited by law. More specifically, the parties and the Tax Court focused on what consists of means for purposes of Section 280E.

The IRS' position was that Section 280E applies to an entire trade or business if any one of its activities is trafficking in a controlled substance. Because Harborside sold marijuana that is illegal under federal law, it's business did consist of trafficking a controlled substance, according to the IRS.

In contrast, Harborside argued that its business did not consist of trafficking, because it engaged in several other activities that clearly were not illegal under either state or federal law. It's position was that it had four activities: (i) sales of marijuana and products containing marijuana; (ii) sales of products with no marijuana; (iii) therapeutic services; and (iv) brand development. Because not each of those businesses – or even a majority – was illegal, its trade or business did not consist of trafficking in a controlled substance.

The Tax Court rejected that interpretation and held that Section 280E prevents Harborside from deducting expenses for its business that consists of trafficking in marijuana.

Harborside also argued that even if Section 280E does apply, it still should be able to deduct its expenses for any separate, non-trafficking trade or business. The Tax Court agreed with the taxpayer on that point, citing its decision in a prior medical marijuana case, *CHAMP v. Commissioner, 128 TC 173 (2007)*, where it found that another California medical marijuana dispensary had two distinct trades or businesses: caregiving services and medical marijuana sales.

In this case, however, the Tax Court found that Harborside essentially had only one business – marijuana sales – and that its other business activities were part and parcel to that business. Thus, Harborside could not deduct any of its business expenses because that one business of the taxpayer was subject to the Section 280E limitation.

The Tax Court also addressed what expenses could be included in the "cost of goods sold" for purposes of computing Harborside's taxable income. The taxpayer argued that many of its indirect costs should be included in its "cost of goods sold" (or "COGS"). The court found that Harborside did not meet the requirements to be treated as a "producer" and should be treated instead as a reseller that could include in COGS its inventory and transportation costs only.

By holding that Section 280E applies to deny the Harborside dispensary tax deductions for its ordinary business expenses, and that it should be treated as a reseller that can include only limited expenses in its COGS, the Tax Court dealt the state-legal marijuana business a very damaging blow. ◆

Building Client Relationships: A Primer to Help Cross-Sell Construction Law Work

Offit | Kurman
Attorneys At Law

Author: Karin Corbett

JUNE 2017 EDITION

A construction project – is something which almost every Offit Kurman client will grapple at some point. Because the firm's target customer base consists of mid-market companies and individuals of wealth, development and the need to accommodate growth—both personally and professionally—is an inevitable need.

The lawyers in the Construction Practice Group represent owners, contractors, subcontractors, suppliers, and design professionals in both the commercial and residential setting, with the bulk of the firm's clients being contractors and subcontractors. As primarily small closely held businesses, contractors and subcontractors tend to benefit the most from our depth of knowledge on how the construction industry works and the common problems it presents both in the field and for a business. Clients find great value in our ability to clearly identify the practical reason for a problem, articulate the available solutions (whether legal or not), and recommend the option which best suits the specific needs of the client.

The array of services offered by the lawyers in the Construction Practice Group is wide-ranging. While construction law is often seen as a claims-based practice, clients often find more value in the group's integrated strategy with an emphasis on risk management, problem solving, and avoidance of expensive court battles, we allow for the more holistic approach that is at the core of the group's growth model. The following is a list of some of the services Offit Kurman's construction lawyers can offer:

Project Planning and Risk Management:

The document intensive nature of construction litigation makes it very expensive. As a result, advanced project planning efforts and risk management frequently provides the most value to clients. Offit Kurman's construction lawyers can discuss projects as early as the conceptual design stage in order to help evaluate and manage potential problems. Considerable decisions about project financing and payment, how to manage particularly risky job sites, the best way to address inevitable changes in scope and schedule, and how to generally ensure the appropriate party is protected in the event a problem develops on the project are among the topics the firm's professional staff handles regularly. These services come in the form of contract drafting and negotiation, assessing the risks and related insurance needs for the work to be performed, addressing potential scheduling and scope issues in the form of change orders as they come up, and ensuring proper project documentation is created. Spending this time during the construction process usually saves time and cost later. Clients who engage the firm's construction attorneys in this way are more successful in identifying and planning for potential hurdles to an effective project; and as a result, those clients avoid costly disputes more easily.

Construction Claims Work

No matter how hard clients (and their lawyers) try, some construction projects still result in claims. The Construction Practice Group has experience in all areas of the construction claims process. The types of disputes the group handles include payment claims, construction defect claims, scheduling and delay claims, change order claims of all types, construction related insurance coverage issues, professional negligence and liability claims, bond claims (payment, performance, and maintenance bonds), and an array of other cases. ◆

What Every Lawyer Should Know When Discussing The Filing Of A Mechanics' Lien Claim

Offit | Kurman®
Attorneys At Law

Author: Karin Corbett

OCTOBER 2017 EDITION

The ability to encumber an owner's real property to pressure payment is enticing to a client, particularly when the pain of non-payment is still raw. Consequently, contractors and subcontractors seeking payment of sums due often inquire about the possibility of filing a lien pursuant to the *Pennsylvania Mechanics' Lien Law of 1963 (the "Act")* . The filing of a mechanics' lien claim can leverage a client's position by creating significant problems up the chain, especially for owners whose lenders run title reports prior to releasing draws or for contractors who will have to indemnify an owner for liens filed by its subcontractors. Importantly, a mechanics' lien claim can also provide security (if there is equity in the property subject to the lien) in an industry rife with single purpose entities and contractors whose solvency waxes and wanes.

Despite its attractiveness, a mechanics' lien claim **does not always add value**. A lawyer analyzing the return on investment of filing a mechanics' lien must understand the full dynamic of the project and weigh practical considerations to target the appropriate pressure points. There are many factors involved in that analysis, so it is best to gather as much information from the client as possible upon intake. The type of project, the entities involved and the nature of their relationship, the financing of the project, the performance of parties on the project, and other information about the parties is required for a construction attorney to make an initial evaluation.

If a mechanics' lien is deemed an effective tool under the circumstances, it is critical to next determine whether a lien can be filed pursuant to the Act. It is essential that liens be filed only where all prerequisites are met and where it is possible to comply with all provisions of the Act; otherwise, the claimant will be exposed to liability for slander of title, abuse of process and to recovery of attorneys' fees, costs and other damages as provided for in the Act.

Prerequisites to Filing a Mechanics' Lien Claim:

There are several prerequisites to filing a lien claim. First, the claimant must have provided labor or materials in connection with the "erection, construction, alteration or repair" of an "improvement" to real property.

Second, a determination must be made as to who is in privity of contract with the prime contractor. If the prime contract is with the owner of the real property, the lien would be against the real property itself. If the prime contract is with the tenant, the lien would be against the tenant's interest in the real property and not against the property itself. In rare instances where the prime contract is with the tenant and the owner of the property agreed in writing prior to work commencing that the work would inure to the owner's immediate use and benefit, a claimant may file a lien against the tenant's interest and the owner's interest. While many leases expressly allow for the tenant to perform work, it is unusual that the leases indicate that the work is for the owner's use and benefit.

Third, the claimant must have been a general contractor, a subcontractor or a sub-subcontractor. A sub-contractor to a sub-subcontractor has no lien rights, as it is deemed too remote from the owner in the chain of privity. For the purposes of the Act, a supplier is considered a subcontractor (or sub-subcontractor, as the case may be).

Fourth, the lien claimant must not have waived its lien rights. A lien claimant may have waived its right to file a lien if it signed a written waiver of its right to file a lien, for example. A lien claimant that is a subcontractor on the project may also be precluded from filing a lien if the general contractor executed a written waiver of the subcontractor's right to file a lien if actual notice or constructive notice (in the manner defined in the Act) of the waiver to the subcontractor can be proven. Similarly, a subcontractor's lien rights are waived by the filing of a bond by a general contractor or owner in advance of commencing work and in an amount sufficient to pay all subcontractors.

Fifth, the project cannot have been for a "purely public purpose." Essentially, if the work performed is part of a public project, a mechanics' lien claim cannot be filed.

Finally, the claimant must have fully complied with all of the requirements of the Act. Courts routinely hold that strict compliance is required given that the unilateral right to effect a lien on real property belonging to another is extraordinary and imposes a substantial hardship upon the owner.

Time to File a Mechanics' Lien Claim:

Lien claims must be filed within six months of the date the claimant last supplied labor or materials to the project under its contract. The "date last worked", as it is often called, is prudently calculated from the last substantial work performed, and not on punch list or warranty work which may be viewed by the court as an improper attempt to extend the time limitation. This is especially the case if the punch list or warranty work was performed after a long period of no work being performed.

While a claimant directly contracted with the owner or tenant need not take any action prior to filing the lien, a subcontractor claimant does not enjoy that luxury. A subcontractor must serve formal written notice of its intent to file a lien upon the owner or tenant at least thirty days before filing a lien claim. Therefore, a

subcontractor considering filing a lien must make its decision to do so thirty days before the last date to file the lien, effectively truncating the time to begin lien proceedings to approximately five months. The notice of intent to lien must include the name of the party claimant and the person with whom he contracted, the amount claimed to be due, the nature and character of the labor and materials supplied to the project, the date of completion of the work for which his claim is made and a description sufficient to identify the property subject to lien.

Procedures of Filing and Perfecting a Mechanics' Lien Claim:

Lien claims are filed in the office of the prothonotary (or equivalent office) of the county where the property is located. The claim must include the name of the party claimant, whether it is a contractor or subcontractor, the name and address of the reputed owner, the date on which the claimant completed its work, the amount claimed to be due, a description of the improvement and the property claimed to be subject to the lien. If the claimant is a general contractor, it must identify the contract and provide a description of the labor or materials provided. If the claimant is a subcontractor, it must provide the name of the contractor with whom it contracted and the date on which the formal notice was served. In the event that the contract is not for an agreed upon sum, such as a time and materials contract, the claimant must provide a detailed statement of the labor and materials provided and the prices charged for each.

It is critical that the lien claim is prepared thoroughly and without error, as a lien claim may only be amended where the parties agree or the court grants leave to amend. After the expiration of time to file a lien, a party is expressly barred from amending to substitute or correct a property, change the identity of the owner (or contractor in the case of lien filed by a subcontractor) or increase the amount of the claim.

To perfect the lien once it is filed, the lien claimant must serve the lien upon the owner within thirty business days. The claimant must identify the court, court term and number and indicate the date of filing. Service is made by a sheriff's deputy in all counties other than Philadelphia where a competent adult may make service. Should an owner evade service or instances where the address is unknown, the sheriff (or process server if in Philadelphia) may make service by posting the lien claim conspicuously at the property. An affidavit of service or an acceptance of service signed by the respondent must be filed within twenty business days of the date of service. Courts require strict compliance with all deadlines set forth in the Act – even a delinquency of one day's time will render a lien invalid.

Owner's Option to Discharge a Mechanics' Lien Claim Filed by a Subcontractor:

An owner served with a notice of intention of lien has several avenues to protect itself in the event the contractor fails to pay a subcontractor. First, the owner may retain from amounts owed or to become owed to the general contractor an amount sufficient to protect itself from loss until the claim is settled, released, defeated or discharged (although a contract provision is usually required to support such a position).

Second, the owner may provide written notice to the general contractor providing details of the claim and the amounts it is withholding as a result, specifying that the owner must settle the claim, undertake to defend the claim or provide security against the claim; otherwise, the owner will pay the claim of the subcontract and be subrogated to the rights of the contractor or undertake a defense to the claim and hold the contractor liable for all costs and fees regardless of whether the owner prevails in defending the claim. Upon receipt of notice by the owner, the general contractor must settle or discharge the claim and provide the owner with a written copy of a waiver, release, or satisfaction of the lien claim signed by the claimant, agree in writing to defend the owner against the claim and provide the owner with sufficient security to protect the owner (which may include funds already retained by the owner) if the defense is unsuccessful or abandoned, or provide the owner with security sufficient to protect the owner from loss caused by the claim.

Owner's Right to Discharge a Mechanics' Lien Claim Filed by Any Tier of Contractor:

Owners of a property subject to a lien claim have the right to discharge the lien by depositing cash equal to the amount of the claim with the court or by posting a bond or other security subject to approval by the court in an amount no less than twice the amount of the claim. This outcome is favorable to the lien claimant in most circumstances, because while the clearance of the encumbrance alleviates a pressure point – particularly for an owner seeking to transfer the property or use it as collateral – the bond or cash collateral creates a "liquid" form of security so that the claimant will not have to take the property to sale.

There is a carve-out for residential projects of one or two units. If the owner has paid a general contractor in full, the owner may petition for discharge of the lien immediately and without posting security or depositing cash because such a lien is not permitted. A client filing a lien on a one or two unit residential project should be advised of this possibility in advance, to avoid the surprise of this unfavorable outcome.

Enforcement of a Mechanics' Lien Claim:

A mechanics' lien will sit as a recorded cloud on title, but to enforce the claim, a claimant must seek judgment upon the claim by filing a complaint to enforce with the prothonotary in the county where the lien is filed within two years of filing the lien claim. Failure to timely enforce the claim will result in the discharge of the lien.

In an action to enforce, a defendant is not permitted to bring a counterclaim, although it may allege a set-off to the extent it arises from the same transaction or occurrence as set forth in the lien claim. This limitation often results in multiple pending actions which can amplify the costs for both sides. As a result, a claimant does not often object to the misjoinder.

Additional Considerations for Projects Worth More Than One and a Half Million Dollars:

Recent amendments to the Act, made effective on December 31, 2016, impose new procedures for construction projects over one and a half million dollars, whether the project includes new construction or alterations and repairs. The amendments provide four new types of notices permitted under the Act: (a) notices of commencement; (b) notices of furnishing; (c) notices of completion; and (d) notices of non-payment. Each such notice is to be filed in an online "Notice Directory" operated by Pennsylvania's Department of General Services.

Per the amendments, an owner will have the option to make the project a searchable project by filing a Notice of Commencement on the Notice Directory. This Notice of Commencement must be filed in the directory and posted at the project site before work on the project commences. The owner must also make a reasonable effort to ensure any Notice of Commencement is part of the contract documents. There is a proscribed form that must be followed for the notice to be effective. An owner may delegate the task of filing the Notice of Commencement to the general contractor as a matter of contract.

Once a Notice of Commencement is filed, a Notice of Furnishing becomes mandatory for any subcontractor or supplier that has rights under the Act. The failure to file a Notice of Furnishing if a Notice of Commencement is filed will be deemed a waiver of lien rights. General contractors do not have to file a Notice of Furnishing because they have a direct contract with the owner. The Notice of Furnishing must be filed in the Notice Directory no later than forty five business days after first supplying labor or materials to the project to be effective. Like the Notice of Commencement, there is a proscribed form that must be followed.

Notices of Completion are filed by the owner (or the general contractor, if properly delegated) to mark the end of work on the project. These notices are entirely optional and must be filed within forty five business days of actual completion of the work as defined in the Act. The Notice of Completion cannot be used for any purpose other than to provide notice to those working on the project. For instance, it is expressly stated in the Act that it cannot be used for things like determining when the warranty period begins.

A Notice of Non-Payment is filed by a subcontractor or supplier that has lien rights to indicate it has not been paid. It has no proscribed form, no time limit, and no legal effect on lien rights. However, it may be useful leverage and open the lines of communication with similarly situated contractors on the Project.

All of these new provisions will operate under long standing case law which states that the Mechanics' Lien Law is in "derogation of the common law" and must be strictly construed. In practical terms, this means that the failure to adhere to the requirements of the Act very closely will result in the loss of lien rights and the lien being stricken. Consequently, it is critical to understand these amendments not only when filing a lien, but also when working with a client on the front end of such a project.

Mechanics' Lien Laws in Other States:

Most states have mechanics' lien laws, but they all differ from one another in many respects. For example, in New Jersey there are many differences including that the time to file a lien is limited to ninety days from the date last worked, the general contractor is a required party in an enforcement action, and the lien is filed with the clerk of the county rather than with the court. Nonetheless, reviewing all of the information relevant to filing a mechanics' lien claim in Pennsylvania as it applies to a client's work on a project will provide the groundwork for discussing client's ability to lien in states where such a remedy is available and provide context to discuss other claims such as breach of contract and violations of various prompt pay statutes. ◆

How to Defend, Settle or Avoid a Preference Claim

Offit | Kurman® Attorneys At Law

Author: Albena Petrakov

DECMBER 2018 EDITION

With the Sears' bankruptcy filing and the retail carnage of 2018 becoming a reality, including the filings of Mattress Firm, Nine West, Claire's, The Bon-Ton Stores, The Walking Company, Brookstone, and many other big and small retailers, it is in our best interest to remember that when your client, a supplier of goods or services, receives a demand letter or a complaint alleging a preferential payment, there is still a way out. Even if the Trustee or Debtor in Possession ("DIP") can establish all the elements of a preference, the client may successfully assert defenses. The most common defenses are described below.

1. **Contemporaneous Exchange:** This defense is applicable when the parties intended and actually executed an exchange of goods and/or services for a payment that was substantially contemporaneous.

2. **Ordinary Course of Business:** This defense is the most difficult to prove and disprove so there is a basis to negotiate. It comes into play when the debt was incurred in the ordinary course of the debtor's and creditors' business or the payment was made according to the ordinary business terms used in the industry.

3. **Purchase Money Security Interest:** To qualify for this defense: a) the security interest must be intended to allow the debtor to acquire new property; b) the new property must be shipped after the security agreement is signed; c) the security agreement must describe the property as collateral; d) the new value must have been in fact used to acquire the property and e) the security interest must be perfected on or before the debtor receives possession of the property.

4. **New Value:** This is common and useful defense when the creditor shipped additional inventory, provided additional services or extended additional credit after receiving the alleged preferential payment. The new, unpaid invoices may reduce the preferential transfer. A recent development in the Eleventh Circuit during the Bruno Supermarkets bankruptcy case puts creditors facing preference litigation in Florida, Georgia and Alabama relying on this defense in a better position. Until recently, the Eleventh Circuit was in the minority of circuit courts, which required the new value defense to remain unpaid on the filing date. As of August 2018, the Eleventh Circuit does not limit the new value defense to new credit remaining unpaid. Thus, a creditor is now entitled to a defense in the amount of the deliveries made, and paid, during the 90-day pre-bankruptcy period, to offset what would otherwise have been the preferences created by a debtor's late payments.

5. **Statutory lien** – a statutory lien, such as mechanic's lien—not otherwise avoidable—is exempt from preference liability.

   Limiting or avoiding preference claims exposure when dealing with a distressed company can be difficult or close to impossible. A few steps that could minimize liability are:

   a. **Apply payments to most recent invoices instead of to the "stale" invoices;**

   b. **Require delivery upon payment or order;**

   c. **Require third-party guaranties;**

   d. **Do not accept post-dated checks; and**

   e. **Keep accurate records and consistent credit policies.** ◆

The Third, Seventh and Eleventh Circuit previously applied the "remains unpaid" approach. In contrast, the Fourth, Fifth, Eight and Ninth Circuit applied the new value defense in a way that allowed credit for new value that was paid with transfers that the creditor was forced to return.

Cross-Selling: Estate Planning Services

Offit | Kurman
Attorneys At Law

APRIL 2016 EDITION

"[w]e need to ask our clients about their legal needs and often prod them into the realization that obtaining competent legal assistance is more effective than procrastinating over their legal issues. Clients are reluctant to reach out to their attorney beyond their immediate legal need. Don't be afraid to cross-sell them other legal services that you can provide." - Michael Hurley, Esq.

INTRODUCTION

Making a referral to the estate planning department is probably the easiest referral to make. After all, every person you meet needs one of the following services:

- Estate Planning (Wills, Trusts, Powers of Attorney, Living Wills)
- Tax Planning (inheritance taxes, estate taxes, income taxes)
- Elder Law (nursing homes, hospice, protection of assets from care costs)
- Guardianships
- Special Needs (public benefits, special needs trusts)
- Estate and Trust Administration
- Asset Protection

Estate planning is not a "bunch of forms requiring just some names to be filled in." It is a very thoughtful process requiring each document to be customized to address the specific goals of the client.

The key to cross-selling estate planning services is getting to know your client and asking the client the "right" questions. By doing this, the client will at some point realize that they would be making a big mistake by not meeting with a member of the estate planning department. Here is a list of the key questions you should be asking your client in an effort to motivate them to address their estate planning needs.

- GENERAL: What will happen to your family upon your death or incapacitation? Will a significant portion of your estate be lost to taxes because of the lack of planning? Will your family know how to administer your affairs or will it be utter chaos for them? Will there be sufficient assets and income to enable each member of your family to maintain the same standard of living they enjoyed while you were living? Are you concerned about any one or more of your family members making ill advised financial decisions upon receipt of an inheritance?
- CLIENT WHO IS A BUSINESS OWNER: If you die or become incapacitated, how will we preserve and protect what may be the largest asset in your estate? Who will address the day to day operation of the business when you are unable to do this any longer? Do you have a "doomsday" book to guide your family and employees on how to continue operating the business? Do we have a plan on whether to sell or continue the business following your death or incapacitation?
- CLIENT WHO IS IN THE PROCESS OF GETTING DIVORCED: Do you want to run the risk that your "ex" may handle your affairs or inherit from your estate under the terms of the documents you executed prior to the dissolution of the marriage?
- CLIENT WITH YOUNG CHILDREN: Have you addressed who will take care of your children in the event that you and your spouse both die? Does it concern you that without an estate plan, your children stand to receive their inheritances outright at the age of 18 (and will the child be able to handle managing money at that time)?
- CLIENT IN A SECOND MARRIAGE: Do you want to ensure that your children from the first marriage will be guaranteed to receive an inheritance at some point? Do you realize that if you predecease your second spouse and he/she inherits the assets, he/she can ultimately leave the assets to his/her children and completely cut out your children?
- CLIENT PURCHASING AN INVESMENT ASSET OR BUSINESS: Have you given thought to how you should take title to the asset for estate planning and asset protection purposes? What will happen to this asset upon your death or incapacitation?
- CLIENT WITH SPECIAL NEEDS CHILD: Have you considered where your child will live after you and your spouse both pass away? Do you want to know about what public benefits may be available to defray the cost of your child's medical care costs?
- CLIENT WITH ESTATE PLAN: Do you realize that with new tax laws, the provisions found in estate planning documents prepared more than five years ago actually may make the administration of your estate more complicated and more expensive than necessary?
- CLIENT WITH AGING PARENTS: Have you considered options for protecting your parents' assets from their potential nursing home care costs?
- CLIENT WITH A PROBLEM CHILD: Have you considered placing your child's inheritance in a trust to protect the child from ill advised decisions he or she may make following your death?
- CLIENT AT HIGH RISK OF GETTING SUED: Have you considered having your parents place your inheritance in trust to protect your inheritance from your potential creditors?
- CLIENT IN PROCESS OF SELLING A BUSINESS: Have you considered restructuring the ownership of the business to ensure that the proceeds from the sale do not become subject to estate taxes upon your death? Also, have you considered options for protecting your wealth from potential lawsuits? ◆

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New Tax Reform & Estate Planning Services

Offit | Kurman®
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Author: Rajiv Goel

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Under existing law, the federal estate, gift and generation-skipping transfer tax exemption is $5.49 million per person and $10.98 million per married couple (in 2017). Under the new tax tax law, Congress will immediately increase this exemption by $5 million. If this law becomes enacted as a result of indexing for inflation, it is projected that the 2018 exemption will then be as much as $11.2 million per person and $22.4 million per married couple. It should be noted that in the House version of the bill, there will be a complete repeal of the estate tax in six years (in 2024).

If the exemption increases as noted above, it is projected that there will be less than 3,000 decedents in the entire country who will be subject to estate taxes. Because most clients equate estate planning to addressing estate taxes, the risk then becomes that clients will become complacent and not seek legal counsel in addressing estate planning needs. However, attorneys should be mindful to advise clients that estate planning should never only be about estate taxes. For most people, more wealth is lost to financial abuse, lawsuits, divorce, spendthrift heirs and other risks than from estate taxes. Properly drafted estate plans can address all of these concerns while building in flexibility to address unexpected events in the life of a family. ◆

Alert: New Landlord Tenant Laws In Montgomery County, Maryland

Author: Revée M. Walters

APRIL 2017 EDITION

If you're a landlord or property manager in Montgomery County, you need to know about new changes to the law effective March 13, 2017.

INCLUDING A LEASE SUMMARY WITH THE LEASE

When providing a lease to a tenant, you must include a Lease Summary. The Lease Summary is a form document created by the Montgomery County Department of Housing and Community Affairs (DHCA), and requires you to include certain key terms of the lease, such as the term of the lease, the amount of rent, the date on which rent is due and the tenant's responsibility for utilities, if any. It also explains tenant rights and the services available to tenants from DHCA. You can find the lease summary at here[1], however, you may create your own form summary so long as it contains the requisite information. You will also want to include a new Lease Summary for every lease renewal after the initial term.

DHCA HANDBOOK COPY AND POSTING INFORMATION

The DHCA handbook is a guide for both landlords and tenants concerning their respective rights and responsibilities. To ensure that tenants have access to this handbook, you must now provide a copy of the DHCAHandbook[2] with each lease unless the tenant signs a statement declining your copy and accepting referral to a copy, which can be found on Montgomery County's website at link above.

You must also conspicuously display a sign in the lobby, vestibule, rental office or other prominent public place on the property that includes information regarding filing a complaint with DHCA and prohibited retaliatory practices. Your sign must also be displayed in the following languages: English, Spanish, French, Chinese, Korean, and Vietnamese.

DISCLOSING UTILITY BILLING INFORMATION

If you operate a multi-family building constructed prior to July 1, 1978, and the units in the building are not individually metered for gas and/or electric billing, you must provide each tenant with all information required under the Public Utilities Article of the Maryland Code and applicable COMAR provisions governing electric and gas sub-meters and energy allocation systems.

TWO YEAR LEASE OFFERING AT INITIAL TERM AND RENEWAL

Previously, you were only required to offer a two year lease to the tenant during the initial term. Now, you are required to offer your tenant a two year lease for the initial term and at renewal. In order to offer a term less than two years you must have reasonable cause and include a statement of reasonable cause with the lease. Additionally, you must advise the tenant of his/her rights to challenge your cause by submitting a complaint to DHCA.

NEW WAYS FOR A TENANT TO TERMINATE THE LEASE EARLY

Tenants are now afforded a greater ability to early terminate their leases when there are circumstances beyond their control requiring them to vacate. Additional reasons for which a tenant may early terminate their lease include: (1) the tenant and/or tenant's child is a domestic violence victim; (2) tenant or tenant's spouse is at least 62 years old, can no longer live independently and must move to a nursing home/senior citizen housing; (3) the tenant becomes incarcerated or declared mentally incompetent; and (4) the housing provider harasses the tenant or violates the tenant's privacy.

INCREASED NOTICE FOR RENT INCREASES

In Montgomery County, you used to only have to provide your tenant with 60 days written notice if you intended to increase his/her rent. Now, you must provide 90 days' notice.

NOTICE FOR LEASE TERMINATIONS

Previously, landlords could provide a tenant with 60 days' to terminate the lease any time after the lease expires and the tenant becomes month-to-month. Now, if a landlord does not intend to offer a tenant a renewed lease term, the landlord must provide 60 days' notice of their intent to terminate the tenant's tenancy at lease expiration. If the tenant is in breach of their lease, however, this 60 days' notice is not required as you may be able to terminate his/her tenancy with a 30 days' notice instead.

FREE MEETING SPACE FOR TENANT ORGANIZATIONS

You must now allow tenant organizations to meet for free, at least once each month, in any available meeting rooms at the property. If, however, the tenant organization meets more than once per month, you can charge the tenant organization a reasonable fee associated with the use of the meeting room after the first meeting of each month.

[1] *https://montgomerycountymd.gov/DHCA/Resources/Files/housing/landlordtenant/lease_summary_eng.pdf*

[2] *https://montgomerycountymd.gov/DHCA/Resources/Files/housing/landlordtenant/handbook_olta_eng.pdf*

Alert: New Landlord Tenant Laws In Montgomery County, Maryland

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Author: Revée M. Walters

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HOUSING CODE ENFORCEMENT AND INSPECTIONS

All multifamily properties in Montgomery County will be inspected at least once every three years by DHCA. Once inspected, and depending on the result of the inspection, DHCA may decide to inspect the property more frequently. Inspection results that may trigger more frequent inspections include: (1) rodent or insect infestation affecting at least 20% of the units at the property; (2) extensive and visible mold growth in exposed areas; (3) defective windows that prevent safe entry and exit; (4) pervasive and recurring water leaks in more than one unit at the property; (5) lack of one or more working utilities such as gas, electricity, water or sewage disposal (not caused by tenant's failure to pay the utility); and (6) if the DHCA identifies the property as a trouble property due to severe and frequent violations.

If DHCA determines that annual inspections are necessary, you will be required to submit to DHCA all maintenance complaints you receive from tenants at the property.

Whether the inspections occur every three years or annually, any time an inspection is scheduled for the property, the landlord must provide your tenants with 72 hours' advance notice.

ADDITIONAL REMEDIES WHEN DEFECTIVE TENANCY EXISTS

The Montgomery County Commission on Landlord Tenant Affairs (the "Commission") is the department in Montgomery County that investigates allegations of defective tenancies. In addition to the other remedies it can issue, the Commission can now issue an order permitting a tenant to correct the defective condition in the unit and abate the tenant's rent, for the reasonable costs incurred by the tenant to correct the defective condition.

Offit Kurman's Landlord Representation Group can assist you to ensure your compliance with these new changes, and many other lease and landlord-tenant related issues in Maryland, DC and Virginia. To get in touch with Revée please email her at rwalters@offitkurman.com. To learn more about our landlord representation services please go to offitkurman.com/service/landlord-tenant-representation. ◆

Cross-Selling: Family Law

Offit | Kurman®
Attorneys At Law

Author: Linda Ostovitz

SEPTEMBER 2018 EDITION

What's new in Family Law?

The ground of Mutual Consent for an uncontested divorce has been expanded to include families with children. Previously, a couple could only proceed on this ground if they were childless.

1. If they had children, they had to wait for some other grounds for divorce to ripen, for instance, a one year separation. They still must have a written agreement that resolves all issues, must both appear in court, and must not have moved to set aside their agreement. But now, they can acquire their divorce more quickly.

2. Alimony will no longer be a tax deduction for the payor and no longer will be taxable income for the payee, effective January 1, 2019. This is huge. Issues will yet evolve concerning the effects of dates of agreement, pendente lite relief, final divorce, and modifications.

Some Of What Family Law Does:

1. Prenuptial and Postnuptial Agreements: Resolve, in advance, how property will be addressed in the event of a divorce. Attractive to previously married parties, parties with children, and particularly important to business owners.

2. Retirements: Generally handled with a Qualified Domestic Relations Order. These enable us to move retirement money without the necessity of a withdraw, and the consequent tax and penalty consequences.

3. LGBT Issues: In the reproductive arena, new law is being made daily. Who are the parents, especially with a same sex couple, what rights and obligations are created when one donates sperm or an egg? While these events have become more common place occurrences, the statutory scheme has not kept up. The LGBT community will need significant guidance on these issues, including the use of a 3rd party surrogate. ◆

New Tax Reform & Family Law

Offit | Kurman
Attorneys At Law

Author: Ron Ogens

JANUARY 2018 EDITION

Regarding the Tax Cuts and Jobs Act, the most material and problematic area of concern for Family Law attorneys is the proposal to disallow payers from deducting - and payees from including - alimony for income tax purposes. This impacts settlements or court orders that provide for payment of alimony by one spouse to the other, where the agreement or court order is entered into on or after January 1, 2018.

Prior to this bill, spouses have been able to deduct or include alimony payments from or in their income. Attorneys and tax advisors have for many years counseled the payer spouse to consider the actual out-of-pocket payment after first deducting state and federal taxes. Without deductibility of alimony, the payer may be willing to pay considerably less. When a court considers the issue, the attorneys involved will undoubtedly advise the court of the material change in taxability and will likely present evidence of the actual needs of the recipient spouse, rather than present their needs while considering also that payment of taxes is not a factor. The use of an expert accountant or tax advisor will likely materially increase.

Although they could use a complex computational formula to address the tax burden, parties now will most likely simply agree upon a lesser payment, which theoretically meets the needs of the recipient spouse. Where the alimony payment is modifiable, there is another whole new set of problems, and most advisors will want to include language (permitted by statute) that the alimony (spousal support) provisions of the agreement shall not be subject to modification by any court.

The current proposal to disallow mortgage interest deductions for mortgages in excess of $500,000 may have a lesser impact, given that in most cases, an existing mortgage will be grandfathered, and a new mortgage - or refinanced mortgage - used to obtain funds to buy out the interest of the other spouse in the jointly owned home will have to be in an amount which is $500,000 or less. Where this cannot be done, because the need for buy-out funds materially exceeds $500,000, the buy-out may not occur, or the excess amount may not be deductible. Current Maryland law allows the court to transfer a jointly owned home from one spouse to the other, provided that the spouse being bought out is release from the lien on the house. This issue is more complicated because existing marital property law did not take into account the possibilities which may exist if the new limit is enacted.

One way to attempt to solve the problem might be for the purchasing or transferee spouse to transfer other marital or non-marital assets to the transferring spouse, thus eliminating the need for a mortgage for buy-out purposes. This also avoids the possibility that refinancing of a mortgage may result in obtaining a new mortgage with a materially higher interest rate. ◆

Divorce by "Mutual Consent?"

Offit | Kurman®
Attorneys At Law

Author: Ron Ogens

APRIL 2017 EDITION

Recent Maryland legislation permits parties to obtain a divorce on the ground of "Mutual Consent," without a period of separation, provided that the parties have no minor children in common and they have executed and submitted to the Court a written settlement agreement signed by both parties, that resolves all issue related to alimony and the distribution of property, and neither party files any pleading to set aside the settlement agreement prior to the divorce hearing. Currently, to obtain a divorce on this ground, both parties must appear in Court for the hearing, which would normally take place at a hearing, set on the uncontested divorce calendar. Other recent legislation permits the parties to obtain a divorce, on any ground (other than insanity of a party), without requiring a third-party "corroborating witness" to testify about the grounds for divorce, which allows parties to obtain their divorce more privately, more easily, and with potentially less expense.

This recent change to allow Mutual Consent as a ground for divorce should be of particular interest to those parties who have no minor children in common and who, after signing a written separation and property settlement agreement which resolves all issues, wish to divorce without waiting the usual 12-months of separation to expire, since no particular period of separation is required, even where the parties continue to reside under the same roof. ◆

Cross-Selling: Financial Institution Regulatory Services

Offit | Kurman
Attorneys At Law

Author: Danielle Casseres

JANUARY 2018 EDITION

What types of clients might you cross-sell to?

Our practice group focuses on providing regulatory services to:

- community banks
- credit unions
- regional banks
- mortgage companies
- mortgage brokers
- mortgage servicers
- marketing companies servicing the residential mortgage lending community
- realtors
- title companies
- other real estate settlement service providers

The Financial Regulatory Services group has a deep knowledge of consumer lending laws affecting the origination, servicing and marketing of residential mortgage loans. We have a niche practice that is only offered at a few other large firms and some boutique firms throughout the country. Most commonly, our clients include community bank or regional banks clients with residential lending divisions that are seeking regulatory support. Importantly, we represent companies, and not individuals seeking advice on their mortgage transactions.

What can we offer your clients?

We can counsel your client on everything from compliant consumer disclosures, to mortgage transactions, to purchasing a new mortgage company or business. The residential lending industry is heavily regulated both at the state and federal level. If your client is engaged in residential lending, they must ensure regulatory compliance in almost every aspect of their business. Below are some of the matters where we can offer regulatory assistance:

- Regulatory investigations and enforcement actions
- Federal or state compliance examinations
- Fannie Mae or HUD operational reviews
- Employee compensation plans
- Mergers & acquisitions
- Licensing and agency approvals
- Fair lending reviews
- Information security and privacy
- New product development and disclosures

How do I introduce the practice group?

Set up a client meeting or call with one of the attorneys in our practice group.

We have a national practice with clients from Hawaii to Maine. The lawyers in our practice group are regularly traveling to meet with clients across the country or to speak at industry events. If your client is not local, there may be an opportunity for an attorney in our group to meet with them in person.

Send a prospect the practice group's marketing materials.

We have print and pdf marketing materials that give an overview of our practice group and services.

Invite them to a webinar or to meet us at a speaking event or conference.

We host a "Quarterly Compliance Update" webinar to discuss regulatory updates for current and prospective clients. We are also very involved with the local and national Mortgage Bankers Association, as well as several other industry groups. We regularly speak at or attend industry-wide conferences that your clients may also be attending. Our speaking engagements are updated on the practice group's website if you would like to send a link or let your client know that our firm will be speaking a particular event.

If you would like assistance with cross-selling the Financial Institution Regulatory Practice Group's services, please reach out to dcasseres@offitkurman.com

To learn more about the group please visit https://www.offitkurman.com/service/financial-institutions-regulatory/ ◆

Insurance Policy - Commercial Lease Agreements: Who Pays The Deductible?

Offit|Kurman® Attorneys At Law

Author: Joseph M. Armstrong

APRIL 2017 EDITION

Deductible? What Deductible? Who Pays The Deductible?

Your distraught client calls to advise that one of their locations burnt to the ground in a fire the previous day. The building, valued at $1 million before the fire, is a total loss and the client seeks only your reassurance that their commercial lease agreement has insurance requirements that fully protect their interests. The tenant had taken out a high deductible policy to lower the costs of the policy.

For attorneys whose practice includes negotiating commercial leases or litigating disputes under commercial leases, this type of call from a client, whether landlord or tenant, is bound to occur. However, unlike other calls, the client is more concerned about who pays the deductible. The landlord client is distressed that tenant client is refusing to pay the deductible on a triple net lease, while the tenant client is worried that the deductible is too high and does not want to pay it. **Who is required to pay?**

Deducible To Be Paid By Tenant Client (Most Likely Scenario)

In the end, the tenant will likely have to pay the deductible, unless they were able to negotiate a special lease in the insurance coverage provisions.

Commentators in the area, such as Milton R. Friedman, are of the opinion that if a party to a lease must secure insurance for the benefit of another and obtains a policy with a deductible, then that party is liable for the deductible. *3 Milton R. Friedman, Friedman on Leases, § 38.1 at 1687 (3d ed. 1990).* The rationale for this rule is that the party obtaining the insurance pay less for a deductible policy and assumes the risk of having to pay the deductible in order to achieve savings on the premium. This insight does not, in itself, answer all of the questions that may arise from a commercial lease with no provisions addressing deductible insurance policies.

Courts have held that obtaining an insurance policy with a deductible may not satisfy a party's obligation to provide insurance coverage in fully adequate amounts. See, e.g., *Carpet Central, Inc. v. Johnson, 222 Ga.App. 26, 28 (1996); Owens Illinois, Inc. v. Lake Shore Land Co., Inc. 457 F.Supp. 896, 905 (W.D. Pa. 1978)* (holding it was improper for the tenant to secure a policy with a $5,000 deductible when the lease required fire and extended coverage on the property). A different result may possibly be reached where the party entitled to insurance coverage under the commercial lease was aware of the deductible prior to the loss but did not object. See, e.g., *Aerospatiale Helicopter Corp. v. Universal Health Services, Inc., 778 S.W.2d 492, 503 (Tex.App 1989).*

LESSON LEARNED: INSURANCE PROVISIONS IN LEASES ARE VERY IMPORTANT AND SHOULD HAVE A PROVISION FOR A DEDUCTIBLE

Both landlords and tenants frequently rely on insurance requirements in a commercial lease to allocate and manage the various risks arising from their business relationships. Commercial leases will very often state the specific types of insurance and corresponding minimum amounts of coverage required to be maintained. A provision requiring a tenant to maintain property insurance with limits of no less than $1 million insuring the property and improvements against loss or damage resulting from stated perils, including fire, may at first glance seem to suffice. Finding such a provision in the commercial lease of our hypothetical client (whether landlord or tenant), counsel calls the client to convey assurances that since the lease required applicable insurance of no less than $1 million (the value of the building), there should be no out-of-pocket loss to the client.

How then does one respond when the client landlord calls back a few days later advising that the tenant did have $1 million policy in place, but does not have the funds to pay the deductible? Whether a deductible is permissible, and if so, how much and who pays it are issues frequently left unstated in a commercial lease, but should be addressed along with a host of other insurance and risk mitigation and shifting questions. With the building and the tenant's business now gone, at least temporarily, it may be quite a challenge to secure payment of the a high deductible by the tenant.

Both landlord and tenant would be well-advised to include specific detailed provisions in their commercial leases that address: (1) whether a deductible is permitted; (2) what is the maximum amount, if any, of a permitted deductible; and (3) who is responsible for payment of the deductible in the event of a covered loss. ◆

Cross-Selling: Intellectual Property ("IP") Group

Author: Jonathan Wachs

JUNE 2017 EDITION

Why should you care about cross-selling in general?

Any business development strategy worth adopting should be highly likely to succeed. Recent studies have shown it is far easier and more effective to expand client service relationships with your existing network than to be constantly searching for new clients only within your own practice area. Consider the following:

- The average U.S. business loses 50% of its customers every 5 years
- It costs 6-7 times more time and effort to find a new client than to keep an existing client
- The probability of you closing a business opportunity with an existing client is 60-70% vs. 5-20% for landing business with a client prospect

Sources: https://www.helpscout.net/75-customer-service-facts-quotes-statistics/ ; https://hbr.org/1996/03/learning-from-customer-defections

Why you should care about cross-selling our IP services

- **Easy Sell.** The opportunities to cross-sell IP projects of varying sizes, durations and budgets provide considerable latitude when approaching a client. A lot of "low-hanging fruit" exists. IP issues well-published.
- **High Value.** Because most business assets are intangible, a small investment in IP protection can yield large returns. Most clients fully understand the value proposition of IP as a critical area for protecting and growing their businesses.
- **"Most Favored Client" Treatment.** The IP Group remains committed to providing your clients with the same level of attention, professionalism and care that we provide to clients we have originated. Give us a chance to prove our commitment to you!

Which clients does the IP Group currently represent?

We currently represent a diverse set of businesses and individuals in various industries. IP clients are NOT limited to biotech and software companies (although we represent several companies in both industries). Any person or business with a name, a customer list, an employee, a website or a business plan has an intellectual property asset to be protected. We maintain large trademark and patent dockets for the firm's clients and a "watch list" for certain IP assets to detect evidence of infringement.

What additional IP clients would we like to represent?

We are well-suited to attract additional institutional IP clients (i.e., universities, hospital systems, and large multi-national corporations) in search of comprehensive IP portfolio management services at reasonable rates.

What is the IP Group's process for onboarding new clients?

The IP Group developed its own process to assist clients in a comprehensive and cost effective manner. We start with a diagnostic evaluation of the client's IP-related legal needs to ensure its intangible assets are protected properly and thoroughly. We then create scalable "legal action plans" to address the client's IP protection issues in a manner that reflects its stated goals, limitations and priorities. We move through the agreed-upon legal action plan in a way that the client can appreciate and afford.

We call this our "IP ME" approach to IP asset management. For each new client, we strive to create a detailed, affordable and sustainable plan to IDENTIFY, PROTECT, MONETIZE and ENFORCE the applicable assets. You can obtain a list of potential specific IP concerns (the IP Audit Checklist) here - http://www.offitkurman.com/intellectual-property-audit-review-checklist/

What are the specific offerings of the IP Group?

One of the most important things for any business to consider is navigating the multi-faceted concerns regarding its IP portfolio. Learning how to properly identify, categorize, register and enforce one's IP assets can make or break a business. Whether the IP assets in question are inventions, brands, works of authorship, confidential business information or all of the above, we can help!

Here are some of the IP Group's offerings you can cross-sell to your clients:

IDENTIFY

- IP Audits To Classify Assets and Determine Best Form of Protection
- Branding Counsel, Opinion Letters and Fair Use Determinations
- Invention Disclosures; Review of Prior Art and Public Disclosures; Opinions for Freedom to Operate, Patentability, Infringement and Invalidity
- Transactional Due Diligence
- Chain of Title Studies for IP Assets
- Assessment of Data Rights and Markings

PROTECT

- Prepare and File Trademark, Patent and Copyright Applications with the USPTO, the US Copyright Office and Foreign IP Agencies
- Review/Develop Policies and Procedures to Ensure Trade Secrets are Well Preserved and Maintained

Cross-Selling: Intellectual Property ("IP") Group

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Attorneys At Law

Continued

- Review and Draft Terms for Employment Agreements, Non-Competition Agreements, IP Assignment Agreements and IP Development Agreements
- File Renewals, Declarations and Extensions for Existing Registrations

MONETIZE

- Subscription Agreements and Other Licenses
- Asset Transfers/M&A Transactions
- Security Agreements and Investment Documents
- Marketing and Reseller Program Documents
- Private Label Agreements and Development Agreements

ENFORCE

- Watch Service and Trademark Clearinghouse Registrations
- Website Terms and Conditions of Use and Guidelines
- Opposition and Cancellation Proceedings
- Litigation, Mediation and Arbitration
- Research of the Competitive Landscape
- Trade Secret Investigations and Enforcement
- Co-Existence Agreements

How can you increase your "close rate" for cross-selling our IP services?

- Set up a client meeting or call
- Tell us what you do, so we can cross-sell your related legal services
- Get others to subscribe to Friday Factoids, our weekly IP blog (www.fridayfactoids.com).
- Arrange for a review of your client's IP assets
- Opportune times to discuss the IP Group with clients and contacts –
- When the other person is starting, selling or buying a business
- When the other person is developing, revising or transferring any product, service offering, work of authorship, website or brand
- When the other person expresses an in interest in the value of any of his or her IP assets
- When you receive the other person's business card and see all the brands to be registered, watched and/or enforced

Questions to ask in order to identify IP issues –

- Did you register the copyright in your website?
- Did you register all company names, logos and tag lines?
- Do you have contracts and procedures in place to protect your company's proprietary information?
- Are you checking to see in anybody is violating your intellectual property?
- Are you checking to see if your company is violating anybody else's IP?

OUR CROSS-SELIING PROMOTIONAL OFFER TO YOU

Send an email to Jonathan Wachs at jwachs@offitkurman.com with the website address for one of your clients. Based on a cursory review of the website, we will send you an e-mail identifying all of the IP-related issues that the client may want to address. You can forward the e-mail to your client and arrange for a follow-up call to discuss the same. It's that easy. What do you have to lose? Many of our lawyers have landed several new IP projects through this process. We do the work, you get the origination credit. This offer is initially limited to the first 20 responders, so procrastinators may be penalized. ◆

More Employees, More Problems: If you have employees, you need an employment attorney

Companies often put the formation, maintenance and implementation of employment policies and procedures at the bottom of their to-do list without realizing how vital they are to protecting the interests of the company. As a company grows, it becomes increasingly important to implement and maintain employment policies and move this task to the top of the list. Below are some common questions and statements made by clients who need an employment lawyer, whether they know it or not.

"I started out with 10 employees and now I have 80. What should I be doing?"

Like a client's workforce, federal and state employment regulations are constantly changing and developing. It is important for companies to frequently review the following for compliance with current federal and state laws:

- Internet/personal e-mail usage
- Personnel file contents
- Whether they have properly posted required notices and posters
- Proper pre-employment testing procedures
- Family Medical Leave Act
- Military Leave
- Pregnancy Leave
- Sick Leave
- Drug-Free Workplace Compliance
- Sexual Harassment (training and reporting
- resources)
- Americans with Disabilities Act accommodations
- Overtime Polices
- Employee Classifications
- COBRA Compliance

One way to stay on top of compliance is to review and rework handbook policies. Handbooks are the blueprint for how companies manage their workforce. They can be instrumental in guiding the actions of both employees and managers and are a way to demonstrate established policies should litigation arise. Additionally, certain regulations do not "kick in" until a company has a certain number of employees. For example, the Family Medical Leave Act only applies to companies with over fifty employees. A frequent review of policies and procedures can help a company manage their human capital and better prepare for the regulatory changes that come along with a larger workforce.

The Bottom Line: Employers should conduct periodic reviews of their employment policies and procedures. This is best done though a handbook review or audit of their policies.

"Can I fire this person?"

The most likely time for a lawsuit in the employee life cycle is at termination where employers are often left in a position where they are forced to be reactive instead of proactive. As a company's workforce grows, it becomes more diverse as to ideas, gender, race, ethnicity, etc. This can lead to an increase in workplace conflicts and complaints. When these events end in termination, they are ripe for discrimination claims. Employers can be proactive instead of reactive by ensuring they have set employment policies and are building a thorough employee record leading up to and through termination.

As previously mentioned, established company polices in the employee handbook and in orientation materials can be used as evidence of a company's position on discrimination should litigation arise. In conjunction, employers should be documenting their compliance with these polices. Throughout an employee's time at the company, the company should be maintaining a personnel file that includes incident reports, annual evaluations, job descriptions, history of infractions and how they were handled, and documentation of both good and bad incidents. Creating a "paper trail" that could be used to defend any potential litigation is essential to disposing of litigation quickly and inexpensively. Another way to be proactive is to examine the facts and circumstances surrounding the employee's employment and termination to determine whether a severance agreement with a release of claims is appropriate. A well drafted severance agreement can all but eliminate the risk of litigation at a reasonable cost.

Bottom Line: Document, document, document. Create a "paper trail" of policies, procedures, and what happened leading up to termination. Consider minimizing risk by drafting a carefully worded severance agreement.

"I don't need an employment attorney, I have independent contractors."

Wrong. Companies frequently make the costly mistake of classifying someone as an independent contractor when they are actually an employee under the Fair Labor Standards Act ("FLSA") and accompanying state laws. Misclassifying employees can lead to lengthy and expensive legal battles when employees classified as independent contractors assert wage and hour claims.

Fundamental to assessing whether someone is an employee or an independent contractor is determining whether they are dependent on the employer or are in business for themselves. Some signs that your client has employees, not independent contractors, are that the company controls or manages the way job duties are performed, provides equipment necessary to perform job duties, relies heavily if not exclusively on "independent contractors" as part of their business, and the "independent contractors" work exclusively for the company. While no single factor mentioned is conclusive, if any factor is present, your client should take a deeper look into whether they really have independent contractors. If they in fact have employees, they will need to adjust their pay structure, procedures and policies to avoid falling victim to a wage and hour lawsuit.

The Bottom Line: Calling someone an independent contractor and having them sign an "independent contractor agreement" does not make them an independent contractor. Companies need to dig deeper into the actual actions of their workforce to determine whether they indeed have independent contractors or whether they need to start treating their workforce as employees.

The Pitch:

While there is no guaranteed method of avoiding litigation, clients can reduce their risks by revising policies to be compliant with all applicable laws and taking the steps necessary to ensure actual practices are consistent with compliant policies. Put your client in the driver's seat. If your client has employees, they have employment needs and we are here to help! ◆

Cross-Selling: Delaware

Offit | Kurman
Attorneys At Law

Author: Frank E. Noyes, II

JANUARY 2018 EDITION

Delaware has three courts that are nationally recognized centers of litigation in their respective jurisdictions: Chancery Court (corporate and business disputes); Federal District Court (patent and intellectual property litigation) and; Bankruptcy Court (bankruptcy). As an it also has a fourth business-oriented court you have probably not heard of: Delaware Superior Court's Complex Commercial Litigation Division. Businesses who can have the option of bringing litigation in Delaware often choose to do so because it is a very favorable venue. For that reason, businesses are often sued in Delaware even if they have no physical presence or connection to the state. [1]

Offit Kurman clients are likely to have litigation matters in Delaware at some point – for example, by statute, directors of Delaware corporations and managers of Delaware LLCs are subject to jurisdiction in Chancery Court for any claim relating to that status, even if the business has no contact with Delaware other than getting formed there.

While Offit Kurman has a Deleware office, albeit small, that is enough to allow us to represent clients in the region.

CHANCERY COURT

This five-member court of equity has been perhaps the leading court in the country for corporate and business disputes. Its reputation for expertise and flexibility are well-deserved and are jealously guarded through the appointment process and through the development of state law for corporations, LLCs, and other business entities. These five judges (a Chancellor and four Vice-Chancellors) take the "equity" designation seriously, and will provide flexible and proactive case management at the pace that the parties want, and give the litigants latitude on scheduling.

SUPREME COURT

This 5-member court also has a strong reputation, especially in corporate law. Since there are no intermediate courts, the Supreme Court has the opportunity to address issues in all areas of law, but is especially renowned in the area of corporate law. Many of the landmark cases you studied in Corporations Law are from this Court. The current Chief Justice was elevated from Chancery, and its other members include a former Chief Judge of Superior Court, and two prominent corporate law practitioners. Their docket tends to move pretty quickly despite fact that cases can be appealed of right. They hear most matters in panels of three, and only hear matters en banc if the panel is not unanimous.

FEDERAL DISTRICT COURT

The District of Delaware is relatively small, with four judges (two of whom are in the process of taking senior status), but is a busy court with a reputation for expertise in patent and intellectual property matters. It also has three very good magistrate judges, one of whom (Mary Pat Thynge) has been in her position for 30+ years. Both of Delaware's Senators are democrats (one is a former 3d circuit law clerk), so assuming the appointment process is not too distorted under President Trump, the next federal district judges will carry on the tradition of relatively strong competence. Three of the four current judges are former prosecutors; the current "acting" US attorney is a former colleague of Frank's.

BANKRUPTCY COURT

Since the early 1990s, Delaware's small bankruptcy court has held a nationally prominent position in this area. For a while it was severally undermanned, because congressional politics blocked the creation of additional positions as other states vied for more bankruptcy work. Right around when additional seats were finally approved, bankruptcy cooled off, but it is still a busy and respected bankruptcy venue. The Bankruptcy rules allow out of state lawyers at Offit Kurman to pretty much handle the cases on their own, giving our clients a real advantage over firms who have to hire local counsel.

SUPERIOR COURT COMPLEX COMMERCIAL DIVISION

Because of Delaware's split between equity (Chancery) and law (Superior Court), many business disputes are potentially subject to jurisdictional issues, since they often involve both equitable claims for injunctive relief and legal claims for damages. The preference is usually to get into Chancery Court, which traditionally can decide 'mixed' claims as long as equitable relief predominates. But business cases sometimes have to go to the Superior Court, which is also highly respected, but is larger (21 judges) and its judges are not as consistently strong. A few years ago, a special business court was created within Superior Court to handle only business cases where the amount in dispute is at least $1 million, and it is permitted to provided equitable relief even if a case does not qualify for Chancery Court. Conveniently, the assigned judges are among the best in Superior Court. This program only gets a handful of cases a year.

[1] *Delaware also has a well-resected and carefully crafted set of statutes for corporations, LLCs, and other alternative entities. It should always be considered as a viable option when forming entities for your clients.*

DELAWARE'S LEGAL CULTURE

It is a small state and a small bar, admitting only around 200 new lawyers each year. The center of the legal community is Wilmington, and while you can't quite say that everyone knows each other, a lot of lawyers know each other. The prevailing culture is one emphasizing collegiality and respect, and reputation goes a long way.

In terms of the judiciary, the state's political climate very intentionally works to maintain high quality on the bench, because the courts act as an important part of the state's economy. Judges are politically appointed, and there is a custom of maintaining partisan diversity, but the nominees are generally drawn from a small, highly

accomplished pool of applicants. In the last few years, there has been significant turnover on the Supreme Court and Chancery, but it continues to be the case that Chancery judges are selected from among leading corporate law practitioners, and Justices are appointed from Chancery, Superior Court, or prominent corporate law practitioners.

ACCESSIBILITY TO OFFIT KURMAN LAWYERS

Although Wilmington has many corporate, patent and bankruptcy practitioners that can hold their own against major national firms, the Delaware legal community has thrived for decades on providing local counsel expertise for out of state firms who regularly litigate in Delaware. (Only one Wall Street firm – Skadden Arps – has its own Wilmington office.) Clients of those firms have to pay two law firms to represent them. Offit Kurman clients do not have to face that problem, because we have our own "local" counsel, Frank Noyes, who is ready, willing and able to provide as much or as little support as our clients need. Delaware courts freely and quickly grant pro hac vice motions, and unless the out of state lawyers misbehaves or is particularly obnoxious, out of state lawyers are welcome. In addition, while the courts have their own local rules, practices and customs (especially Chancery!), the rules are all modeled on the Federal Rules of Civil Procedure, so out of state lawyers are not challenged by dealing with foreign or mysterious rules. So even if you have never practiced in a Delaware Court, with the assistance of our "local" counsel, you can handle your client's Delaware litigation needs with confidence. ◆

ROADLESS ROADSHOW

Offit | Kurman
Attorneys At Law

Commercial Litigation South

Commercial Litigation – South Roadless Roadshow

This Roadless Roadshow features the Commercial Litigation – South Practice Group.

Doug Kay and a few members of the team will provide you tips and techniques for helping to sell the Commercial Litigation Practice Group to your clients, prospects and referral sources.

Equity Incentives Chart - 1

Type of Award	General Description	Advantages	Disadvantages	Federal Tax Treatment	Accounting Implications
Incentive Stock Options (ISOs)	Right to purchase employer stock at a set price. Must comply with Code Section 422's requirements for favorable tax treatment to apply.	Favorable tax treatment for employees. Good incentive for companies anticipating substantial growth. May be exercised at election of holder.	Holder must pay exercise price. No employer deduction on exercise. Complicated tax treatment and rigid requirements (such as a holding requirement). Cannot be granted to non-employees. Limited flexibility to amend due to tax and accounting restrictions. Limited incentive if stock price not increasing.	No tax on grant or vesting. No tax on exercise but spread is an adjustment for calculating alternative minimum tax (AMT). Employer is not entitled to a deduction on exercise unless a disqualifying disposition occurs. On sale, if the holding requirement is met, excess of sale proceeds over exercise price is taxed at capital gains rates.	Fair value (estimated using option pricing model) must be recognized as a compensation expense as of the grant date and amortized over the vesting period.
Non-Qualified Stock Options (NQSOs)	Right to purchase employer stock at a set price. Must have at least fair market value (FMV) exercise price to be exempt from Section 409A.	More flexibility than ISOs. Employer entitled to deduction at exercise. Good incentive for companies anticipating substantial growth.	Employee must pay exercise price. Limited incentive if stock price not increasing. Unlike ISOs, can be granted to non-employee directors, consultants, and other advisors. May be exercised at election of holder.	No tax at grant or vesting. Ordinary income recognized on the spread at exercise (and corresponding employer deduction). At sale, capital gain or loss on the difference between the sale price and the sum of the exercise price paid plus the ordinary income recognized on exercise.	Fair value (estimated using option pricing model) must be recognized as a compensation expense as of the grant date and amortized over the vesting period.
Stock Appreciation Rights (SARs)	Right to receive excess of FMV of shares at exercise over exercise price. Must have at least FMV exercise price to be exempt from Section 409A. Typically paid in cash. Sometimes referred to as phantom equity.	Employer deduction at exercise. Good incentive for companies anticipating substantial growth. Unlike options, employee does not pay exercise price. May be exercised at election of holder.	Limited incentive if stock price not increasing. Limited flexibility to amend due to tax and accounting restrictions. No capital gain treatment. Variable accounting.	No tax at grant or vesting. Ordinary income recognized on the spread at exercise (and corresponding employer deduction).	Fair value must be recognized as a compensation expense and is accrued over the vesting period and periodically re-estimated and the liability adjusted until the SAR is paid.

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Equity Incentives Chart - 2

Type of Award	General Description	Advantages	Disadvantages	Federal Tax Treatment	Accounting Implications
Restricted Stock	Grant of actual shares of stock, but subject to forfeiture or repurchase until end of restricted period. Holder receives voting and dividend rights.	Holder is the beneficial owner of shares at grant, aligning interests with shareholders. Award retains some value even if stock price declines. Holder does not typically pay anything (or nominal amount) for award. For stock with little or no value on grant date, ability to make Section 83(b) election can offer substantial tax benefit. Not subject to Section 409A.	If 83(b) election is made and stock is forfeited, no refund of taxes paid. Holder must come up with money to pay tax at vesting (or grant if 83(b) election is made). Time-vesting restricted stock may be less incentivizing than performance shares.	Governed by Code Section 83. If no 83(b) election is made, no tax at grant. Ordinary income at vesting on excess of FMV at vesting over amount paid (if any). At sale, capital gain or loss on the difference between the sale price and the FMV of the stock at vesting. If 83(b) election is made, ordinary income on FMV at grant. Capital gain or loss on the difference between the sale price and the FMV of the stock at grant. Employer entitled to deduction corresponding to amount of ordinary income recognized by employee. Dividends paid on unvested shares are taxed at ordinary income rates.	Fair value (typically based on FMV) must be reflected as a compensation expense as of the grant date and amortized over the vesting period. Dividends paid during the vesting period are generally not recognized as additional compensation cost
Performance Shares	Award of target number of shares which are held in escrow until they vest. The number of shares earned depends on performance against applicable performance criteria during the performance period (often three years). Value of ultimate award depends on number of shares earned (often it is possible to earn between 0% to 200% of target number of shares) and stock price.	Incentivize and reward specific performance criteria. Performance awards are favored by shareholders and shareholder advisory groups. Can be structured as qualified performance-based compensation exempt from Code Section 162(m)'s $1 million deduction limit. Holder does not pay anything for award.	Less retentive effect if it becomes likely during performance period that goals will not be achieved. Administrative complexity in determining whether performance goals have been achieved.	No tax at grant. Ordinary income recognized on FMV at vesting (employer entitled to corresponding deduction). At sale, capital gain or loss on the difference between the sale price and the FMV of stock at vesting.	Grant date fair value (based on FMV of expected number of shares to be earned (typically target)) must be reflected as a compensation expense as of the grant date and amortized over the vesting period.

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Equity Incentives Chart - 3

Type of Award	General Description	Advantages	Disadvantages	Federal Tax Treatment	Accounting Implications
Performance Share Units (PSUs)	Company's unfunded, unsecured promise to award a target number of shares (or cash equivalent) in the future if performance targets are achieved during the performance period (often three years). A PSU is equal in value to one share of company stock. For information on cash-settled PSUs, see Phantom Stock.	Incentivize and reward specific performance criteria. Performance awards are favored by shareholders and shareholder advisory groups. Can be structured as qualified performance-based compensation exempt from Code Section 162(m)'s $1 million deduction limit. Holder does not pay anything for award.	Holders are not beneficial owners – no voting or dividend rights (although company may grant dividend equivalents). Must be structured to comply with or be exempt from Section 409A. Administrative complexity in determining whether performance goals have been achieved.	No tax at grant or vesting if complies with or is exempt from Section 409A. FMV of PSU subject to FICA and FUTA at vesting. Ordinary income recognized at settlement (employer entitled to corresponding deduction). At sale, capital gain or loss on the excess of the sale proceeds over the FMV of the shares at settlement.	Grant date fair value (based on fair market value of expected number of shares to be earned (typically target)) must be reflected as a compensation expense as of the grant date and amortized over the vesting period.
Phantom Stock or Phantom Stock Units	Company's unfunded, unsecured promise to pay the value of shares of stock, typically in cash, in the future. Designed to replicate company stock without giving away actual stock. Vesting can be tied to service or company performance, or both.	Preferred by private companies that want to share economic value of company with key talent without giving away actual equity. Flexibility to design in various ways, including bonus plan, deferred compensation plan, or sale plan.	Difficult to understand. Holders are not beneficial owners – no voting or dividend rights (although company may grant dividend equivalents). Must be structured to comply with or be exempt from Section 409A. Company must have liquidity to pay cash when due. No capital gain treatment. Variable accounting.	No tax at grant or vesting if complies with or is exempt from Section 409A. Subject to FICA and FUTA at vesting. Ordinary income recognized at settlement (employer entitled to corresponding deduction). Dividend equivalents are taxed at ordinary income rates.	Fair value must be reflected as a compensation expense as of the grant date and is re-measured at the end of each reporting period until settlement. Dividend equivalents paid during vesting period are typically not recognized as additional compensation cost.

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