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THE LEGAL PAD

A Newsletter of Current Business and Legal Matters

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BUSINESS PLANNING: *Establishing and Maintaining An Effective Corporate Entity*

By James A. Beck

Setting up a new business venture seems simple enough, particularly with all of the information available online. Many believe once they file their LLC or corporation with the Secretary of State, their business is established and they are protected from personal liability. Unfortunately, that belief is not accurate.

While technically the corporation or LLC exists upon filing, there are several reasons why the individual business owner still may not benefit from any corporate protection. Many business owners do not keep up with annual requirements and fail to take all necessary steps to protect their assets and personal interests.

As attorneys who often must be creative in identifying assets to satisfy debts owed by corporate debtors to our clients, one of the first steps we take is to determine whether there is any basis for officer liability. The average business owner is the sole owner of his or her business, incorporated the business without legal assistance, and is not educated with respect to the legal formalities of establishing and maintaining a corporation or limited liability company. As a result, business owners are often subject to personal liability despite the existence of a corporate entity.

It is our hope that our clients do not have to face these easily avoidable issues. We can help your business achieve the protection that the corporate structure is supposed to provide and would be happy to discuss your corporate status and documentation with you.

Some of the issues that are often overlooked by businesses with more than one owner is what happens to the business upon the death, retirement or resignation of one of the partners, what each owners' rights and obligations are, and what to do in the event of a dispute among the owners. These are issues that must be discussed before they occur, or expensive litigation may be inevitable.

When establishing a business or reviewing your business records, it is imperative that a business owner develop a thorough plan that addresses common issues and events in the life of a business. Whether you are starting a new business or focusing on improving an existing one, legal planning can be equally or more important as the other aspects of business planning.

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BANKRUPTCY PREFERENCE CLAIMS:
What are they? What do I do?

By Cody R. Loughridge

Unfortunately, there has been an unprecedented surge in bankruptcy filings over the past 3 years. This has led to companies of all sizes and concentrations becoming more involved in, and familiar with, the bankruptcy process. Perhaps one of the most common instances where perfectly viable, functioning companies come into contact with the bankruptcy code is in the form of a "preference claim."

Essentially, a preference claim is a claim by the Trustee (the person who administers the affairs of the bankrupt company) that the bankrupt company/individual paid one of its creditors preferentially over other creditors, prior to the filing of the bankruptcy. In other words, a particular creditor received special treatment by receiving payment, and the bankruptcy estate wants those funds back, to be distributed "equally or fairly" among all the similarly situated creditors.

The time period for a preference payment is 90 days prior to the filing of the bankruptcy petition. So, generally after a bankruptcy is filed, the Trustee is going to examine the books and records of the bankrupt company and identify all payments made within the 90 days leading up to the date that the company filed bankruptcy. If, for example, you received a payment from the bankrupt company 15 days prior to the bankrupt company's filing of its bankruptcy petition, it is highly likely you'll be receiving a demand letter from the Trustee, alleging a preference claim and demanding that you return the payments received.

So what happens when you receive a preference payment demand? **First, don't panic.** Simply because you receive a payment from a bankrupt company within 90 days prior to their bankruptcy filing it does not automatically constitute a preference payment. In other words, there are defenses to be asserted against a Trustee's demand. **Second, compile your documents**. There is no substitute for being prepared with the invoice history, payment history, contracts and all other documents that evidence the relationship you had with the bankrupt company unto the filing of their bankruptcy petition. **Third, don't ignore it**. By not responding to a Trustee's demand, you often will then find yourself in a lawsuit, called an Adversarial Proceeding, where the Trustee is actually suing you for a return of the preference payment. **Fourth, don't reflexively pay the demand**. You may have strong defenses against the preference claim that you should explore before simply writing the Trustee a check.

The two most common defenses to a preference claim by a Trustee is the "ordinary course" defense and the "new value" defense. The "ordinary course" defense is essentially that, although you received the payment within 90 days prior to the bankruptcy filing, the payment was in the "ordinary course" of the relationship and was typical of the payment arrangements between the parties. For example, assume that during your relationship with the bankrupt party, it was ordinary for the now bankrupt party to pay 45 days after being invoiced. This pattern continued for years; the life of the relationship. This includes the last payment received from the now bankrupt company, but which fell within the 90 day preference period. The pattern of the relationship shows that you were not preferentially paid, even though it came during the 90 day preference period. In order to establish this defense, you must show that payments received during the preference period were similar in pattern to payments received before the preference period. The "new value" defense allows you to offset some, or all, of the alleged preference payments by illustrating that after you received the payment(s) within the 90 day window, you extended additional and new value (credit, goods, services, etc.) to the now bankrupt company because of the payment received. In other words, the extension of additional value was predicated on the receipt of payment(s) during the 90 day preference period.

Dealing with the United States Bankruptcy Code is a daunting task. It is highly recommended that you contact a licensed attorney to assist you in addressing bankruptcy issues and to help navigate preference claims. We will be happy to help answer any questions you may have.

LIFE PLANNING:
A Journey

By Nan E. Hannah

Generally, a law firm's newsletter articles are scholarly and directed at a specific legal issue. This article is different and personal, but hopefully no less helpful. In recent months, I have again been reminded of my grandmother's old saying that "old age is not for sissies." Thinking about my personal age, I realize that most of our clients are relatively close in age and stage to the position in which I currently find myself and therefore may well be facing some similar issues. The issues involve end-of-life planning – not mine, I plan to be around for a good long time – but dealing with aging parents, relatives and friends. What should you know?

WHAT IS AN "ADVANCE DIRECTIVE" AND WHY WOULD YOU GIVE SOMEONE A HEALTH CARE POWER OF ATTORNEY?

The personalization of this story involves the failing health of my father and the rapid aging my mother is showing. Though nothing is absolutely imminent, the health care professionals dealing with my father met with my brother, mother and me a few weeks ago. Decisions were made related to what his wishes were when certain critical points are reached. The great comfort in this process is that as a family, we had had all the necessary conversations and more importantly, my lawyer father had executed all the right documents.

There is a Health Care Power of Attorney naming not only my mother, but also my brother and myself as his health care agents. We can act for Dad since he is no longer able to make those decisions known to others.

In recent years, these forms were updated to include what is known as an "Advance Directive." This language is very specific dealing with the type of treatment the individual wants in specific situations such as when they have an incurable or irreversible condition and can no longer naturally eat and/or drink; a permanent coma or other permanent loss of consciousness; or advanced dementia or other loss of cognitive function. By completing this document, the person retains some control over their last days and, as I am learning, alleviates a good amount of emotional stress in the family

by allowing those with the power of attorney to feel they are following the wishes of their loved one.

HIPAA AUTHORIZATION – WHY BOTHER?

The HIPAA (Health Care Information Privacy Authorization Act) form is another of those "bothersome" documents you are asked to sign if you go to an estate planning attorney and many folks wonder, why? Experience is a wonderful teacher. We wanted to take Dad to a specialist for further evaluation. Dad's illness has robbed him of the power of speech. We needed copies of all of Dad's medical records so the specialist could do her work without having to re-do all the various tests. Thankfully, Dad had completed a HIPAA AUTHORIZATION FOR USE AND DISCLOSURE OF PROTECTED HEALTH INFORMATION form. With that and his power of attorney, all of his health care providers were legally authorized to provide us the necessary records. Given Dad's loss of capacity, without this form, he probably would have either had to forego the visit to the specialist, or bear the expense of having additional tests, or the specialist would have had to make the diagnosis without the complete medical history. None of these are good options.

ESTATE PLANNING – WHY BOTHER?

If you have kids, lots of assets, or real property, there are good reasons, which we all know at heart, even if we do not like thinking about that part of our future. But, the aspect of the end-of-life planning process which few consider is the impact it has on the family left behind. There are laws which will control in the event a person dies without a will. However, that distribution process may not reflect the wishes of the decedent and may have the unintended consequence of increasing stress on those left behind. This is, hopefully, not in the form of family squabbles over who gets what, but more that those who are grieving are now faced with additional decisions at a time they would rather be honoring the memory of their loved one. Estate planning is a final act of kindness by the decedent to his/her heirs and loved ones.

If you have not undertaken the end-of-life and estate planning process, there is no time like the present. Think about the 40-year-old Congresswoman currently rehabilitating in a Houston hospital. The need for this type of planning can arise at any time. Consult your attorney to begin this process for you or your loved ones.

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EXCLUSION OF CONSEQUENTIAL DAMAGES:
A Provision for Every Sales Contract

By Richard A. Prosser

Representing sellers and distributors of goods – most often, suppliers of construction materials – is a large component of our practice. The most significant portion of this representation is litigation: meaning our client is in a dispute with a current – soon to be, former – customer, informal negotiations have failed, and a lawsuit has been commenced.

When the dispute arises from the sale of goods, the dispute, by its nature, is almost always a contract dispute – one party sold goods to the other and the other is dissatisfied with the purchased product. The purchaser asserts that the seller breached the purchase contract by selling a defective product. In this sort of dispute, the issue is frequently not whether there is a legitimate basis for the purchaser's dissatisfaction, but whether the seller is responsible for the purchaser's damages – and if responsible, the limits of responsibility.

The limits of responsibility are defined by contract law. Contract law defines the remedies and damages available to the injured purchaser. Although the law is static, its application can vary significantly depending on the terms of the contract between the parties. Through the contract terms, the parties can modify the default application of contract law to limit the available remedies and damages.

One such limitation is the exclusion of consequential damages. With sales of goods, consequential damages essentially are the additional costs and injuries tied causally to the defective goods, i.e., damages beyond repair or replacement of the goods. Examples might include: labor costs incurred in installing and then removing defective goods, or property damage incurred from installing or attempting to make use of defective goods. By excluding consequential damages, a seller of goods can greatly reduce its exposure, effectively limiting liability to the cost to repair or replace the goods.

Such a limitation on damages is obviously valuable, but from a practical standpoint, it can be outcome determinative. The types of disputes that end up in litigation are frequently driven by the injured parties' belief that they are entitled to the types of damages that constitute consequential damages. If these damages are eliminated from the equation, there is less likelihood of litigation, and if there is litigation, there is increased likelihood of settlement.

So, the obvious question for sellers is: how do I exclude consequential damages? The simple answer is to include an express exclusion in the terms of the contract. If the transaction is a sale of goods on credit, the contract will most often be in the form of a credit application. If it is a COD transaction, the contract will most often be in the form of a purchase order, or invoice, or combination thereof. Either way, the contract document is the place for the exclusion, and the simplest exclusion is to state exactly what you mean: "Seller excludes all consequential damages incurred as a consequence of the breach of the terms hereof."

A caveat is necessary if you intend to employ an exclusion of consequential damages in your contract documents or rely upon an exclusion, if you already utilize such a provision. There are limits to the enforceability of exclusion provisions dependant upon the specific facts and circumstances. In certain instances, enforceability may be at issue. For this reason, you should seek the advice of a licensed attorney before employing or relying upon such a provision.

NAN E. HANNAH RECOGNIZED AS LEGAL ELITE

Nan E. Hannah has been recognized for her knowledge, experience and dedication in the area of Construction Law by Business North Carolina magazine. To be included in the Legal Elite means Nan has been recognized by her peers as one of the state's top practitioners.

Nan has practiced in the area of construction law in excess of fourteen years. Her knowledge and experience speaks volumes when working for clients. She is also currently serving as the Chair of the Construction Law Section for the North Carolina Bar Association.

Vann & Sheridan Attorneys is proud of Nan's accomplishments, commitments, her dedication and loyalty. She leads by example and works tirelessly to help her clients, the profession and our community.