302 Roundtable: Issues Unique to Closely Held Corporations

Michael J. Reilly
Vice President & General Counsel
Spang & Company

Tracey P. Rice
General Counsel
G.R. Sponaugle & Sons, Inc.

Todd H. Silberman
Vice President & General Counsel
Express Carriers

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).
Materials may not be reproduced without the consent of ACCA.
Reprint permission requests should be directed to James Merklinger at ACCA: 202/293-4103, ext. 326; merklinger@acca.com

Faculty Biographies

Michael J. Reilly

Michael J. Reilly is the vice president, general counsel, and corporate secretary of Spang & Company. Spang is an over 100 year old privately owned and family controlled manufacturer of soft magnetic electronic components, power control, and drive control systems. Headquartered in Pittsburgh, Spang operates manufacturing facilities in Pennsylvania, Ohio, Arkansas, and North Carolina.

Prior to joining Spang, Mr. Reilly was a management labor lawyer in a firm he helped to found which grew from six lawyers to over one hundred. He also served as chief counsel and chief of staff for an investigation conducted by the Pennsylvania House of Representatives into organized crime and public corruption and was First Assistant District Attorney of Allegheny County, PA.

Mr. Reilly chaired the Pennsylvania Crime Commission for nine years and the Housing Authority of the City of Pittsburgh for five years. He served on the board of St. Edmunds's Academy for six years including two years as board chair. He currently serves as vice president of the board of the Mount Nazareth Center.

Mr. Reilly received his BS from Georgetown University and his JD from Duquesne University School of Law.

Tracey P. Rice

Tracey P. Rice is the director of corporate services and general counsel for G. R. Sponaugle & Sons, Inc. This family owned company is based in Harrisburg, PA and specializes in various aspects and elements of engineering, construction, and communications. In her versatile role, Ms. Rice is responsible for human resources, risk management, office, and contract administration. In addition, she is the sole in-house counsel for the $55+ million organization.

Prior to joining Sponaugle, Ms. Rice served as staff attorney for The Wolf Organization. The Wolf Organization specializes in the distribution of building materials throughout the Northeast corridor and has been family owned and operated for more than 150 years. In her role as corporate generalist, Ms. Rice was responsible for real estate transactions, counseling company management with regard to employment matters, drafting policies and procedures, and contract review.

Ms. Rice has served on the Program Committee of ACCA's Central Pennsylvania Chapter and she currently chairs the Chapter's Social Committee.

Ms. Rice received her BA from The Pennsylvania State University and her law degree from Widener University School of Law.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Todd H. Silberman

Todd H. Silberman is vice president and general counsel for Express Carriers, an international trucking company, located in San Antonio, TX. His responsibilities include: strategic planning; institution of preventative measures; management and handling of cases in state and federal court; handling of claims and settlements; oversight of outside counsel; review, drafting, and negotiation of corporate contracts; labor and employment law; transportation law; customs issues; agency law; collections; real estate transactions; acquisitions; internal auditing; formation of subsidiaries and additional companies; revision of corporate regulations; advising managers and directors in corporate decisions and issues; advising departments and drafting guidelines and rules; legal research and drafting of legal memorandums; and the drafting and probating of wills and trusts.

Prior to that, Mr. Silberman had an office in which he was a general practitioner. His practice focused on the areas of family law, business, wills and trusts, personal injury, real estate, and insurance defense litigation.

Currently he serves as president of ACCA's San Antonio Chapter and also volunteers for the State Bar of Texas, Texas Young Lawyers Association, and the San Antonio Young Lawyers Association. Mr. Silberman also speaks at St. Mary's Law School about practicing law in-house, is a vice president and board member of Jewish Family and Children's Services, has volunteered at the Children's Bereavement Center, and as a mentor to at-risk youth.

Mr. Silberman received a BA from The University of Florida and is a graduate of South Texas College of Law.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Source: Family Business — Winter 1994 issue
Copyright © 2000. *Family Business* magazine. Subject to the provisions of the Terms and Conditions of the Family Business Web Site, subscribers to Family Business magazine may print and distribute copies of this article, electronically or otherwise, provided that (a) such printing and distribution is done only for your personal, informational, non-commercial purposes, and (b) you do not remove or obscure the copyright notice or other notices. For other uses, including reprint permission for non-subscribers, contact *Family Business* magazine.

A DIRTY DOZEN OF LIABILITY

There's no bullet-proof vest against liability that offers absolute protection. Even if your business is incorporated, you and your personal wealth are at risk in 12 types of circumstances.

By Kenneth P. Brier

Sam and Eddie, two brothers, had little concern about possible liabilities arising from their business — one of New England's best country inns. They carried insurance. They were current with their lenders and vendors. The business held sufficient working capital to cover all foreseeable expenses, even during the off-months. There was little additional property in the business which could be claimed by a creditor — the land and building were leased from a separate family trust. As for personal liability, well, they had incorporated the business, just as their advisors had told them to do. That meant no personal liability.

Sam and Eddie's nonchalance recently came to an end, the night that Mrs. Threadwell drank too much Chateauneuf du Pape with dinner and proceeded to drive her Jaguar off the inn's winding access road. She hit a tree and was killed. Her husband, who survived the crash with substantial injuries, has claimed that Sam and Eddie, as trustees and beneficiaries of the family trust, are personally responsible for failing to properly maintain the access road. Mr. Threadwell has also claimed that the corporation is liable for the accident, on account of the waiter's negligence in continuing to fill the drunk Mrs. Threadwell's glass, and further, that Sam and Eddie are personally responsible for any liability of the corporation under certain legal principles which call for "piercing the corporate veil."

The dollar damages which Mr. Threadwell is seeking in court far exceed any insurance coverage Sam and Eddie have. The brothers have had to hire their own lawyer to watch over the insurance company's. Already the legal payments have diminished cash flow, and they hardly know which of their ordinary expenses they can pay first.

Being in business means taking risks of all sorts. Our legal system has developed the business corporation as a legal "person," separate from its owners, to encourage risk-taking and foster economic development. The business corporation is designed to insulate shareholders from personal

liability arising from operation of the business. The idea is to encourage investment by limiting the capital at risk to the amount invested and no more.

Accordingly, most businesses above a minimal size are organized as corporations (or, to the same liability effect, as limited partnerships with a corporate general partner). Many states are now also providing for a new entity, the limited liability company, which for liability purposes should operate much like a corporation.
Incorporation remains one of the linchpins of liability protection, and for business owners it remains the necessary first step in minimizing their exposure to personal liability. For family business owners, being held personally liable cannot only compromise the business, it can ruin an estate plan and jeopardize family wealth. As Sam and Eddie have found out, however, incorporation is no panacea. There are at least 12 categories of circumstances or conduct which can lead to a business owner's personal liability. Every owner of an incorporated family business should become familiar with these 12 categories — the dirty dozen.

1. Failure to actually operate as a legal corporation. A corporation can offer its protection as a separate legal "person" only if it is operated as such. A business becomes a valid corporation when the owners receive written acknowledgment from the state government of the filing and acceptance of the articles of incorporation. A surprising number of owners, however, fail to file required annual state documentation, thus exposing themselves to personal liability and their companies to dissolution. Owners may also be exposed to personal liability for actions which go beyond those authorized in the articles of incorporation and for actions taken in a nonrepresentative capacity. An example of the latter would be signing a purchase order as "Sam Newell" rather than "Newell Inn Inc., by Sam Newell, president."

2. Business assets owned outside the corporation. Although you may think of your business holistically as one operation, for various reasons some of the business assets may be held outside of the corporation. Such an arrangement may make good tax sense and may represent a good way to protect the assets from the liabilities to which they might be exposed if held inside the corporation. As Sam and Eddie have found out, however, an asset like real estate held outside the corporation (which might include an access road) may itself become a source of personal liability. Such assets need their own insulation.

3. Personal guarantees of corporate obligations. Banks and other lenders are intimately familiar with the corporate shell game. When dealing with smaller corporate customers, they commonly insist upon personal guarantees, which makes the individuals liable. Some other consensual creditors — providers of goods and services — also may ask for personal guarantees. This is a matter of negotiation.

4. Receipt of excessive corporate distributions. Owners of the family business (the "shareholders") may be liable to repay to the corporation certain excess shareholder distributions (dividends, liquidation payments, and the like). Such liability may arise if the corporation is insolvent or the

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

distribution renders the corporation insolvent. If creditors take control, or the corporation enters bankruptcy, and the shareholders have paid themselves excessive distributions on their shares, the creditors or trustee in bankruptcy may seek to recover the excess. The amount considered "excess" is usually determined in litigation or a settlement.

5. Personal fault for negligence or other tort. It is a common misconception that a corporation protects the shareholders from any liability for damages caused to other parties in the course of the corporation's business. While it is true that a shareholder generally incurs no vicarious liability for the corporation's torts — that is, the negligence of its employees and agents — a shareholder working for the corporation nonetheless is liable for his or her own acts of negligence. Thus, if Eddie were the Threadwells' waiter, he might be personally liable for having continued to serve Mrs. Threadwell.

6. Piercing the corporate veil. While a valid corporation generally insulates shareholders from liabilities actually incurred by the corporation, there are limits to the law's beneficence. Courts at times refuse to respect a valid corporation as a liability shield. The situations inviting such a "piercing of the corporate veil" generally fall into two categories.

First, the courts may hold owners personally liable if they do not treat the corporation scrupulously as a person separate from themselves. This entails adhering to legal formalities (such as holding required shareholder and director meetings and keeping minutes of such meetings), keeping business assets separate from personal, and maintaining complete and accurate books of account. Second, the courts may pierce the corporate veil if the corporation has been too thinly capitalized. If an owner started a business and so under-capitalized it that it eventually failed, the courts may order him to pay corporate creditors.

7. Payment of wages. Although shareholders generally are not liable for paying current wages, they may be liable for past, unpaid wages. Massachusetts, for example, provides for civil and criminal penalties for unpaid wages. Also, federal labor law provides for civil and criminal penalties for failure to pay minimum wages or required overtime pay.

8. Pension and profit-sharing plans and other ERISA plans. Although business owners tend to think of the business as encompassing its pension and profit-sharing plans, as well as its benefit plans (like medical plans), that conception is not completely true. All of these plans are regulated by the federal Employee Retirement Income Security Act (ERISA) law, which provides its own scheme of liability that preempts any state law. The compliance rules are highly technical and provide a fertile breeding ground for liability. These plans always require the designation of "named fiduciaries," including trustees and/or administrators — positions which commonly are filled by the principals of the business. If you are a "named fiduciary," you have assumed independent liability for the proper operation of the plan. Owners should consult a professional advisor to make sure they are following the compliance rules correctly.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

9. Trusteeships associated with nonqualified compensation arrangements. Certain compensation arrangements, such as deferred compensation for a few top employees, are often structured with trusts (so-called "rabbi trusts"). Any trusteeship carries with it an independent and heightened exposure to personal liability under state law. Though the IRS now basically prohibits business owners from serving as trustees of rabbi trusts, many owners still do so, exposing themselves to possible liability for loss of tax benefits, among other things.

10. Trust taxes. These are not to be confused with actual trusts. The so-called trust taxes include income taxes withheld from salaries, payroll taxes, and sales taxes collected from customers. These funds are collected by the business only as a middle man. The responsible officers, who may include shareholders, are treated as deemed trustees; accordingly they are personally responsible for ensuring that the funds are paid to the government. This is a common source of continuing liability for owners of businesses that have gone under.

11. Shareholder liability for taxes. Under special tax provisions, the government may still collect any taxes still owed by a dissolved corporation directly from the people to whom the corporation's property is transfered — that is, from the shareholders. If the corporation files a final tax and is then dissolved, and a subsequent IRS audit determines the corporation owes more, the shareholders can be held liable. Owners who are closing a company may want to hold some funds in escrow in case of an audit.

12. Environmental laws. The enactment of many new environmental laws is creating an expanding arena for personal liability. Several court cases have held shareholders to be "owners" or "operators" of contaminated sites, thereby rendering them liable for clean-up costs.

WHAT CAN YOU DO?

The first line of defense is to recognize that the dirty dozen exist. Many of the risks of personal liability — those arising by the shareholders' departure from the right road in operating the corporation—suggest their own solution. The key in any case is to obtain good legal advice.

Family corporations that are in trouble should pay special attention to the dirty dozen. When considering which creditors to pay, it is often smart to pay first the creditors who may have personal claims against the shareholders. For example, one of the most common survival tactics is to delay payment of payroll and sales taxes. The thinking here is that while workers and vendors will know quickly if you are holding back payment, and might cut you off, the government will take a long time to catch up with you. By then the company may either be bankrupt or back on its feet. "Borrowing" funds in this way, however, is often the most expensive move an owner can make, because the debt will not be discharged in bankruptcy, and ultimately someone in the business will be held personally liable.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

DEALING WITH PERSONAL LIABILITY

No matter how well you may run your family corporation, there remains an irreducible measure of personal liability to which you are exposed, simply as an owner of the business. Though a family shareholder can take sensible measures to reduce his or her exposure to personal liability, there is no inviolable strategy. The corporate form increasingly is a leaky dike holding back the floodwaters of personal liability.

The upshot is that any business owner now needs a second line of defense, a plan for protecting his or her personal assets (including the company stock itself) from creditor claims. There is much that can be done along these lines, including intelligent use of pension and profit-sharing plans, life insurance, certain annuities, gifts to family members, and creation of multiple family entities (such as corporations, partnerships, and domestic and offshore trusts).
Business planning for the family corporation thus invariably tails off into estate planning, including consideration of asset protection strategies. Neither the business planning nor the personal estate planning should be considered complete without a broad consideration of such strategies. For protecting family wealth, incorporation of the family business is the necessary first step, not the last.

Kenneth P. Brier *is a director of Powers & Hall Professional Corp., a law firm in Boston, where he concentrates on taxation, estate planning, trusts and estates, and employee benefits.*

Copyright © 2000, *Family Business* magazine

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Source: Family Business — Summer 1999 issue
Copyright © 2000. *Family Business* magazine. Subject to the provisions of the Terms and Conditions of the Family Business Web Site, subscribers to Family Business magazine may print and distribute copies of this article, electronically or otherwise, provided that (a) such printing and distribution is done only for your personal, informational, non-commercial purposes, and (b) you do not remove or obscure the copyright notice or other notices. For other uses, including reprint permission for non-subscribers, contact *Family Business* magazine.

Why it pays to use the right legal tools

Too many family firms are lax when it comes to observing legal formalities and customizing documents to meet their own

By Scott E. Friedman

Although many family businesses are established as traditional legal entities such as partnerships, corporations, or limited liability companies (LLCs), in practice they function quite differently from their publicly owned counterparts. As a result, legal, financial, and other related planning tools that may be well suited for other businesses are often misused by family businesses, with unfortunate consequences.
Indeed, many families fail to even consider how their family structure could best mesh with their business operations, and as a result, structure operations in a haphazard manner. Ironically, traditional plans and planning tools may thus sow the seeds for later problems and conflict. Family businesses can avoid these problems first by recognizing them, then by applying certain conventional planning tools in a variety of creative ways.

Absence of evidence

Many families spend a great deal of time and money on legal work establishing their business. Corporations are formed, bylaws prepared, and shareholder agreements reached.

Once this initial work is completed, however, families may forget all about these "legalities" and instead go about their business as if these new organizations and related documents didn't even exist. The annual meeting of shareholders and directors exists only on the company lawyer's word processor, to be generated from time to time as the auditors or bank officer may request. Records of decisions reached ("minutes") are created years after the actual decisions are made—often only as a result of an IRS auditor's request. Some families perceive that the cost of adhering to

such legal formalities is unwarranted; for others, the effort and inconvenience are simply too much.

The failure to attend to certain fundamental legal formalities can create problems, however. For example, the failure to hold an annual meeting of a family business's shareholders and directors serves to reduce communication when it should be enhanced. The failure to record agreements that have been reached and decisions made on fundamental issues may result in family members having honest (yet important) differences in their recollections as to what the "real agreement" was. Depending on the subject of the purported agreement, such differences can result in hostility and conflict. If minutes were available to refresh recollections, many arguments could be avoided entirely.

The importance of observing minimal business formalities was highlighted in the case of Samia v. Central Oil Co. of Worcester (1959). In this case, three sisters, who claimed to be stockholders of Central Oil Company of Worcester, Massachusetts, sued their three brothers for failing to properly account for certain charges and expense credits. Because of a variety of complex circumstances, it was not clear that one of the sisters was actually a shareholder of the corporation. For this reason, the brothers claimed she was not entitled to assert claims for damages to the corporation that may have been caused by their actions.

The evidence indicated that the family had reached an agreement to make a gift of some stock to the sister, but stock certificates to reflect the gift may not have actually been prepared. The brothers argued that the failure to prepare the stock certificates supported their position.

The Massachusetts court found sufficient evidence to conclude that all of the siblings were stockholders in spite of the absence of stock certificates, thus permitting the suit to proceed. The court explained that the siblings all seemed to regard one another as stockholders at the time the corporation was created; the absence of certificates was therefore not fatal to the sister's case.

Acknowledging the obvious difficulty in reaching a decision in the absence of relevant documentation, the court simply commented that the factual determination on this subject was "made upon conflicting oral testimony and documentary evidence. It may well be that, in this ambiguous family situation, other [findings] would have been equally reasonable."

The easiest way to avoid an argument like the siblings had in Central Oil is to adhere and attend to appropriate legal formalities, including the preparation of relevant documentation. In the absence of clear, documented evidence of the terms of a

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

purported agreement, business fortunes can be as easily lost as won on the determination of a judge or jury who, charged with the impossible task of mind-reading what a family has actually agreed upon, is as likely to make an incorrect decision as a correct one.

Tailor your bylaws

Another common mistake made by many owners of family businesses is the failure to customize legal documentation such as bylaws, shareholder agreements, and employment contracts to suit their family's particular circumstances and objectives. Instead, such owners (or their advisers, who might not be sensitive to the peculiar realities of family businesses) utilize "boilerplate" documents that are designed with the hypothetical "standard" business in mind. Because there is no such thing as a standard business, these documents are often unsuitable for the particular families who use them and, indeed, may cause more problems than if they were not used and the parties were left simply to sort things out from time to time.

Bylaws are the agreed-upon ground rules that establish the ways in which corporations are governed. Among other subjects, bylaws ordinarily specify how a corporation's officers and directors are elected and the voting standards that will determine when they are authorized to take action on behalf of the corporation.
Canned bylaws are frequently prepared in a manner that authorizes a board of directors to take action upon securing a simple majority vote in support of such action. As a result, stockholders in such corporations elect their directors by majority vote, and the directors, in turn, elect officers (president, secretary, treasurer, and so forth) by majority vote as well.

Although decision-making by majority vote appeals to a sense of democracy and fairness, it may well be inappropriate, unfair, or unwise in a family business. For instance, if a family business is owned by three siblings, a decision by two siblings to borrow an unprecedented amount of money to expand business operations in a whole new venture unrelated to what the family business has done in the past may be unfair to the third sibling, who opposes such expansion as unnecessarily risky.
A family business may be better served by bylaws that provide that certain decisions can be made only by majority vote, other decisions by supermajority vote (say, 75 percent or 85 percent of the stockholders or directors), and still other decisions by unanimous consent of the owners. Such decisions can be identified with any degree of specificity the parties find desirable. Common subjects for such supermajority voting standards include borrowing money in excess of a specified sum, particular compensation agreements with family members, dividend decisions, capital improvement programs, and decisions to buy new businesses or sell existing ones.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Routine use of boilerplate documents also creates problems when family businesses, on formation of a corporation, create only one class of stock that gives all owners voting rights and an attendant degree of legal control over the business based on their percentage ownership interest. A more effective approach for a family business is to divide the ownership interests between voting stock and nonvoting stock. In this approach, the ownership interests are equal, but only those holding the voting stock have the right to vote on key ownership decisions. By creating two or more classes of stock, a senior family member can pass along his or her ownership interest equally to all the children, while vesting management control in just a few of them.

Observe the chain of command

Many family businesses lack an orderly chain of command due to the difficulty, if not impossibility, of determining in what capacity a family member may be acting. For example, corporation law distinguishes the roles filled by shareholders, directors, officers, and employees. As a result of these distinctions, simply being a shareholder of a portion of a family business doesn't confer management authority; nor does it mean that the owner is entitled to make minor or routine decisions on behalf of the business. Instead, corporate law provides that shareholders elect directors who, in turn, oversee the management of the business. Directors, in turn, elect officers to run the day-to-day operations of the business. Indeed, except for a limited number of specific extraordinary decisions, such as the sale of the corporation, shareholders ordinarily have no mandated right to make decisions affecting a corporation's business operations.

Families often fail to recognize and observe these distinctions, however, and that creates significant problems. For example, an owner of a family business who inherited his interest and is not employed by the business may nevertheless view his role as encompassing the responsibilities intended to be reserved for directors and officers. As a result, this owner may insist on participating in the family business's employment, compensation, and operating decisions. In effect, this owner decides to disregard the established chain of command. In another instance, a spouse who does not own an interest in the business may not only be making decisions behind the scenes at home, but may even show up at the office and give directions to company employees!

Disregarding the chain of command has several adverse consequences:

- A greater likelihood of making poor business decisions, since those with the expertise and training to make good decisions have their hands tied by those who do not.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

- Increased tension between owners who would like such decisions to be made by the appropriate decision-makers and owners who believe it is their right to do as they see fit.

In order to ensure that good business decisions are made, owners of family businesses must recognize the appropriate role each family member should fill and agree to respect the family business's formal chain of command. It may, of course, be desirable for certain family members to fill multiple roles in the family business, but these decisions should be made on a case-by-case basis. In order to minimize an inactive owner's concern that he or she otherwise has no voice in the family business, mechanisms like family councils can be effectively used. By providing forums for effective communication and input while maximizing the authority of capable decision-makers, families can strengthen their bonds and their businesses at the same time.

Segregate operations

Another common instance of inartful planning by owners of family businesses is a tendency to lump business operations together. For example, the Smith family may own two separate apartment complexes across town from each other. Instead of considering the merits of owning this real estate in two separate businesses—for example, Smith Properties One LLC and Smith Properties Two LLC—it is more common for the properties to be owned by a single business, Smith Properties LLC. Although each situation needs to be analyzed on its own merits, there are several reasons why it may be eminently sensible for family business properties to be segregated into separate and distinct legal entities:

- A liability of one business may be contained in only that business, keeping the other business unscathed.
- It is easier for newer businesses to be owned by members of a family's younger generation, which can reduce the senior family members' estate tax obligations.
- It is easier for family members to have day-to-day job responsibilities on separate "turfs," which may help improve intrafamily relationships.
- Physical distance between family members can help minimize intrafamily conflict, since it reduces the occasions when family members need to reach agreement on day-to-day decisions.
- It is easier to spin off specific business operations to some family members and other assets to others, if that is desired one day.

The strategic segregation of certain family business operations may also make an owner's retirement and estate planning easier to complete. If Mr. Smith has built a nest egg capable of financing most of his retirement years, he may wish to transfer

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

ownership of Smith Properties One LLC to his children but retain ownership of Smith Properties Two LLC. Owning one property, which Smith can lease to his children at a fair market rate, may satisfy his financial requirements for his retirement years. By contrast, retaining ownership of both properties may be financially unnecessary and counterproductive to his ultimate estate-planning objectives.

In short, taking a considered approach to building a family business today may create one, or even several, unforeseen advantageous opportunities tomorrow.

How good is your planning?

1. Does your family business provide all of its owners with limited liability protection?
2. Are your business assets all held in one company? Does it make sense to segregate such assets (or future assets) into two or more entities?
3. Are your business documents customized to fit your family's unique situation or are you using boilerplate forms?
4. Does your family business observe legal formalities by, among other things, holding regular meetings and taking written minutes?
5. Does your family business have a recognizable chain of command that is observed in practice?
6. Does your family have both a succession plan and an estate plan and, if so, do the plans complement each other or contradict each other?

Copyright © 2000, *Family Business* magazine

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

ROUNDTABLE: ISSUES UNIQUE TO CLOSELY HELD CORPORATIONS

ACCA 2002 Leading the Way: Transforming the In-House Profession
Washington, D.C.

Most participants at past annual meetings agree that the roundtable discussions are among the most practical and useful sessions that they attend. However, there is always room for improvement.

This roundtable discussion is intended to be among counsel to closely held or family run companies. We have provided a list of suggested topics with accompanying hypotheticals and questions. However, please do not feel limited to any topics or questions. The intent is to provide you with something to help the discussion start. However, if you have particular issues you have encountered or wish to discuss, please do so as this is the best time to find out how others handle similar situations.

In prior years many felt that their table didn't spend enough time discussing the topic of most interest to them or they later heard that something of real value to them was discussed at another table and many wished the discussions could have continued beyond the time limit set for the session.

This year we are addressing each of these issues as follows:

Didn't spend enough time discussing my topic

One or more tables (depending on participant interest) will be focused on each of the six suggested discussion topics. The facilitator at that table will begin the discussion with that topic and continue to focus on it until it is exhausted or the session ends. A sign will be posted on the focused discussion tables identifying the lead topic to be discussed.

I missed a good discussion at another table

To allow all of us to profit by the discussion at each table a summary of each table's discussions, prepared by the facilitator or a volunteer, will be posted on the Section's website in a format which will allow the discussion to continue on-line.

I wish the discussions could have continued after the session

See above.

If you have any interest in a topic not among the 6 suggested topics feel free to suggest it to your facilitator.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

To encourage candor in the discussions, comments made at the tables will be edited before placing them on the Section website to remove any attribution to a participant or identification of the company discussed.

RULES: PLEASE REMEMBER TO BE RESPECTFUL OF OTHERS IDEAS AND OPINIONS. ALL INFORMATION DISCLOSED AT THE TABLE AND IN THE ROOM SHOULD BE KEPT IN CONFIDENCE AND NOT DISCLOSED TO ANY OTHER PERSON, THUS ALLOWING EVERYONE THE ABILITY TO BE CANDID. PLEASE ALLOW EVERYONE TO ASK QUESTIONS AND RESPOND WITH AN ANSWER AS ONE OR TWO PEOPLE CONTROLLING THE ENTIRE CONVERSATION IS LESS THAN PRODUCTIVE. TRY TO AVOID INTERRUPTING OTHER SPEAKERS AND KEEP YOUR VOICE AT A LEVEL WHERE OTHERS AT YOUR TABLE CAN HEAR YOU, BUT YOU DO NOT DISTURB OTHER TABLES.

We hope you enjoy the discussion and leave with more information than you had when you arrived. If you are unable to finish discussing topics of importance, suggest to the other people at the table that you meet later at the Small Law Department dinner and/or on the Small Law Department discussion board on line.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

SUGGESTED DISCUSSION TOPICS

•DRAFTING & INTERPRETING RESTRICTIVE PROVISIONS

-Stock Ownership, Transferability & Succession

Hypothetical: The family you represent wants provisions allowing transfer of interests, for estate planning purposes, among members of the family including the parents, children, and grandchildren. However, as the brilliant attorney, you realize that one or more of the assignees may not be interested in participating in the company in any way and therefore needs a way to sell or disclaim their interests. Consider the company's right of first refusal, right of class members to buy shares (and in what proportion, if any) and valuation. Also consider the creation of other classes of stock that do not have voting rights or other privileges associated with holders of common stock.

•CONSIDERING CONVERSION TO SUB-S

-Considerations Before & Experiences After Sub-S conversion

•CORPORATE FORMALITIES

-Piercing the Veil, Bank Resolutions, & Review of the Corporate Minutes

Discussion Points: Do the minutes tell the story of the corporation, including benefits, insurance, banking issues, authority of officers, etc..

•EFFECTIVE & HONEST DEALINGS WITH THE OFFICERS & BOARD

-CEO/CFO/Board Relationship

-Conflicts-When (and How) Do You Need to Tell the Owners You Can Not Represent Them

-Representing company employees

Hypothetical: This family owned company has a Share Restrictive Agreement in place. Shareholders A, B and C would like to make changes to the agreement. A and B agree on certain changes to the Agreement that they have not communicated to C and C would like to make different changes. A and B have come to you asking you to review the proposed changes to the Share Restrictive agreement and requesting advice on how to gain C's agreement to these changes.

•OUTSIDE COUNSEL

-When to Recommend Outside Counsel

-Who Chooses the Outside Attorney

-Outside Counsel on the Board (and Sometimes a Relative)

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Hypothetical: You are asked to negotiate a contract on behalf of a third party entity which is owned exclusively by some of the corporation's shareholders of the corporation, including the President, Executive Vice President and CFO, to whom you report. These three shareholders own more than 60% of the corporation.

Hypothetical: You are asked to advise the President and CFO (between them owning a 60% share of the corporation) how to segregate one of the corporation's divisions into a separate entity that will be owned exclusively by the two. Current industry information and trends would indicate that the particular division in question has tremendous profit and growth potential. You report to the CFO.

•ALL IN THE FAMILY: INSIDERS & OUTSIDERS

-Inside & Outside Family: Who Has a Say & Who Really Makes the Decisions (dividend revenue v life in business)
-Terminating/Disciplining Family Member/Stockholder
-Communications Management
-Family Counseling
-Additions to the General Counsel's Toolkit: Identify a Criminal Lawyer, Private Investigator, & Bail Bondsman

<u>Discussion points</u>:

How to learn and understand the balance of power in the family.

Strike a balance between adhering to ethical requirements to represent the corporation and recognizing who makes the decisions.

What is counsel's ethical duty to minority shareholders.

How much information to you disclose to a shareholder with a controlling interest in the corporation who does not hold an executive management position but is a member of the Board of Directors.

How to handle transactions typically requiring approval of the Board if you know the Board is a rubber stamp for Executive Management's decisions.

Hypothetical: You represent a family owned corporation. The President and Executive Vice President of the corporation, who together own 60% of the shares, ask for your advice regarding the employment of their cousin. The cousin does not hold a management position, has been with the company for 25 years, and has failed to adequately perform any of several positions she has held during that time period. This particular cousin is her family's representation of their 40% ownership in the company and she is a member of the Board of Directors. The cousin's performance deficiencies have been documented and are undisputed by her.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).