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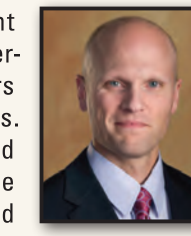
Legal Matters

Issue 2, 2013

Three Dimensions of Successful Family-Owned Businesses

by Benjamin J. Comin, Attorney



Family-owned businesses have a unique set of challenges when it comes to building a thriving, lasting business. Too often these challenges are under-appreciated or simply not recognized by family owners and, as a result, businesses suffer and even fail. Some family-owned businesses, however, manage to achieve phenomenal growth and last for generations. In fact, one-third of all companies in the S&P 500 index are considered family-owned. This success requires foresight, strategic planning, and proactive leadership in three key areas:

Leadership: There is no more challenging time in a family-owned business than when the business passes from one generation to the next. Often the rising generation is ill-prepared to assume the governance roles of the organization and non-family employees may resent the appointment of lesser-qualified family members to leadership positions. Successful family-owned businesses encourage outside education and employment to develop family leaders, have specific plans to develop family leaders within the ranks of the business, strategically utilize non-family talent, and take a meritocratic approach to management.

Ownership: Maintaining family control over a business can be quite difficult when outside capital is needed and shares are transferred, due to sale, death, or otherwise, to non-family members. Successful family businesses take the time to address these issues with quality legal documents before they

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HUTCHISON & STEFFEN NAMED

Law Firm *of the Year*

BY THE LAS VEGAS CHAPTER OF THE NATIONAL BAR ASSOCIATION

The Las Vegas Chapter of the National Bar Association, in conjunction with the LVNBA Foundation, has named Hutchison & Steffen, one of the largest law firms in the State of Nevada, the 2013 Law Firm of the Year for its commitment to diversity and pro bono legal services. The firm received the honor on Saturday, October 12, 2013, at the 25th Annual Scholarship Gala.

"It is an honor to receive this award," said Mark A. Hutchison, Founding Partner with the Firm. "For the Firm to be recognized for its commitment to a vibrant and diverse work place and pro bono legal representation to those who need our services but can't afford them is a real honor, and we're grateful to the LVNBA." ■

Hard Fought Victory for Personal Guarantors

Mark A. Hutchison

Jacob A. Reynolds

Hutchison & Steffen, LLC recently represented two guarantors on a $5 million loan that was secured by real property worth more than $6 million. When the debtor failed to make its payment, the creditor (a large national bank) pursued a foreclosure action instead of a business solution. The foreclosure action was stopped by a bankruptcy filing. The creditor pursued the guarantors in state court, but was successfully stopped by Hutchison & Steffen's counsel.

In the guaranty action, the creditor claimed it was owed $1.4 million in fees, costs, interest, and other expenses **in addition** to the amount owed on the loan. Hutchison & Steffen was able to work with experts and push a vigorous defense, eventually getting the creditor's expert to admit that many of the fees claimed by the bank were unreasonable, were incurred unreasonably, and therefore should not be awarded. The firm also successfully argued that certain judgments in the bankruptcy court should have preclusive effect in the guaranty action against the guarantors personally. Attorneys Mark Hutchison & Jacob Reynolds eventually convinced the Court that the additional costs that the debtor sought against the guarantors were unjustifiable and unreasonably incurred, leading the Court to award approximately $160,000 **total** against the guarantors including all fees, costs, interest, and principal owed. ■

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- Real Estate Law
- Trust & Probate Litigation

LIMITED LIABILITY COMPANIES

THE BEST OF ALL WORLDS?

A limited liability company (LLC) is a business structure that combines some of the best features of sole proprietorships, partnerships, and corporations. LLC owners, like their counterparts for partnerships or sole proprietorships, report profits or losses on their personal income tax returns. Like a corporation, however, the owners of an LLC have "limited liability," that is, they are shielded from personal liability for debts and claims arising from the business.

Limited Liability

The limited liability for LLC owners is not absolute. Owners still can be held liable if they (1) personally and directly injure someone; (2) personally guarantee a loan or business debt on which the LLC defaults; (3) fail to deposit taxes withheld from employees' wages; (4) intentionally commit a fraudulent or illegal act that harms the company or someone else; or (5) treat the LLC as an extension of their personal affairs rather than as a separate legal entity.

The last exception to limited liability is the most significant. It carries the potential for complete removal of the protections for individual owners. If the line between LLC business and personal business becomes too blurred, a court could find that a true LLC does not exist, leaving the owners personally liable for their actions.

Ownership

Most states allow a single individual to be the sole owner of an LLC. An LLC makes the most sense in circumstances where there is a concern about personal exposure to lawsuits stemming from operation of the business. Most laws prohibit establishment of an LLC in the banking, trust, and insurance fields.

Unlike corporations, LLCs can carry on their business without holding regular ownership or management meetings. Of course, formal meetings backed up by written minutes still may be advisable to document important decisions, such as a change in membership or a major expenditure.

Formation

Setting up an LLC is relatively simple. Articles of organization must be filed with the appropriate state office, usually the Secretary of State. The articles of organization include the name and principal office for the LLC, the names and addresses of its owners, and the name and address of the person or company that agrees to accept legal papers on behalf of the LLC.

Even if it is not legally required, the owners should prepare an operating agreement that spells out the owners' rights and responsibilities. The absence of an operating agreement will mean that state statutes will govern the operation of the LLC by default. An operating agreement acts as a guide for resolving common issues that an LLC will face, and thereby helps to avert misunderstandings between the owners. It also underscores the authenticity of the LLC itself, which can be helpful when a judge is deciding whether the owners are protected from personal liability.

A standard operating agreement includes the members' percentage interests in the business; the members' rights and responsibilities; the members' voting power; allocation of profits and losses; how the LLC will be managed; rules for holding meetings and taking votes; and "buy sell" provisions that control what happens when a member wants to sell his interest, becomes disabled, or dies. Although it is frequently overlooked when an LLC is created, a buy sell agreement is important as a sort of "premarital agreement" among the owners. The buy sell provisions can clarify and ease the transition when the inevitable changes come to the members of the LLC.

Taxes

Since an LLC is not considered separate from its owners for tax purposes, the LLC pays no income taxes itself. Like a partnership or sole proprietorship, an LLC is a "pass through entity." Each owner pays taxes on a share of profits, or deducts a share of losses, on a personal tax return. The IRS regards each member as a self employed business owner, not an employee of the LLC. There is no tax withholding, and owners must estimate taxes owed for the year, then make quarterly payments to the IRS.

Conversion

By converting to the LLC business structure, sole proprietors and partnerships can gain the protection afforded to LLC owners without changing the way their business income is taxed. Conversion usually can be accomplished either by filling out a simple form or filing regular articles of organization. Federal and state employer identification numbers will have to be transferred to the name of the new LLC, as will such items as sales tax permits, business licenses, and professional licenses or permits.

The process for creating an LLC is streamlined and free of highly technical considerations. However, there is an important place for professional advice concerning such matters as choosing an LLC over other business structures, preparing or reviewing the operating agreement, and setting up accounting systems. ■

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become a problem. Bylaws, operating agreements, buy-sell agreements, and shareholder agreements are some of the ways families can restrict and control the ownership of company shares/interests and maintain management control.

Protecting Core Assets: Like many businesses, family-owned businesses are frequently dependent on a few core assets for their continued success. These core assets may be key relationships developed by the founders, key employees, technological advantages, trade secrets, or referral sources that account for a substantial portion of business. Successful family businesses find ways to protect these core assets. This can often be as simple as using employment and independent contractor agreements, non-competition agreements, patenting proprietary technology, using supplier and vendor agreements, and formalizing handshake deals. ■

IDENTITY THEFT POLICIES FOR BUSINESSES

The Federal Trade Commission (FTC) has revised and clarified its "Red Flags Rule" to help covered businesses comply with requirements for preventing and responding to identity theft directed at their customers. The Rule requires many businesses and organizations to implement a written Identity Theft Prevention Program designed to detect the warning signs (or "red flags") of identity theft in their day to day operations.

The ultimate goal is to make businesses better able to spot suspicious patterns that may arise and to thwart identity theft. Obviously this is good for customer relations, but it also may avoid the necessity for the stressful and costly process of cleaning up the mess once thieves have struck.

The FTC describes an Identity Theft Prevention Program as a "playbook" that must include reasonable policies and procedures for detecting, preventing, and mitigating identity theft. With such a program in place, an organization should be able to (1) identify relevant patterns, practices, and specific forms of activity—the "red flags"—that signal possible identity theft; (2) incorporate business practices to detect red flags; (3) detail appropriate responses to any uncovered red flags, to prevent and mitigate identity theft; and (4) update the program periodically to reflect changes in risks from identity theft.

The Red Flags Rule includes guidelines to help financial institutions and creditors develop and implement a program, including a supplement that offers examples of red flags.

Some general categories of red flags are notifications or warnings from a consumer reporting agency or from the customer himself; suspicious looking documents or personal identifying information; and unusual use of, or suspicious activity related to, a covered account. The FTC and the federal financial agencies also have issued Frequently Asked Questions and answers to help businesses comply with the Rule.

The Rule requires "financial institutions" and "creditors" that hold consumer accounts designed to permit multiple payments or transactions—or any other account for which there is a reasonably foreseeable risk of identity theft—to develop and implement an Identity Theft Prevention Program for new and existing accounts. The definition of "financial institution" includes all banks, savings associations, and credit unions, regardless of whether they hold a transaction account belonging to a consumer; and anyone else who directly or indirectly holds a transaction account belonging to a consumer.

A 2010 change in the law amended the definition of "creditor" and limits the circumstances under which creditors are covered. The previous definition of "creditor" was so broad in its language and interpretation that it swept too many within the Rule's reach.

The new law covers creditors who regularly, and in the ordinary course of business, meet one of three general criteria. They must (1) obtain or use consumer reports in connection with a credit transaction; (2) furnish information to consumer reporting agencies in connection with a credit transaction; or (3) advance funds to, or on behalf of, someone, except for funds for expenses incidental to a service provided by the creditor to that person. ■