

# BUSINESS LAW NOTES

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Our law firm has provided exceptional legal services to clients throughout the state and the U.S. for more than 45 years. A full-service firm founded in 1955, we have built a reputation for helping clients solve difficult problems with sound counsel, sophisticated analysis and superior performance.

A hallmark of our firm is personalized client service. Recognizing that each of our clients has a unique set of issues, objectives and needs, our firm is committed to individualized attention and works as an integrated team to respond to our clients' needs. We serve diverse clients, including Fortune 500 companies, government agencies, professional associations, closely held corporations, limited liability companies, partnerships and individuals.

## Can your corporate shield be pierced??

# SHAREHOLDER PROTECTION FROM LIABILITY

F. Stephen Glass

One of the primary reasons a business owner chooses to incorporate it to establish a "corporate shield" against personal liability for liabilities of the business. This is also true for those business owners who choose the limited liability company (LLC) form of business entity. Business owners want the ability to shield their personal assets from claims of creditors.

The corporate entity or LLC is said to be like a veil that shields its owners from corporate debts and other similar obligations. For example, if a judgment is entered against a corporation or LLC, the business' assets — not those of the shareholder or LLC member — would be liable for the judgment.

But, unless the corporation or LLC is properly set up, maintained and operated, a judgment creditor may be

able to "pierce the corporate shield or veil."

As a general rule, courts will disregard the corporate entity if the business owner disregards it, and uses the entity as an "alter ego."

A corporation is not operating as a true legal entity and is being used by its owners as a "shell" or "alter ego" in a number of situations:

- The entity is not properly formed;
- No corporate stock is issued;
- Annual shareholder meetings are not held;
- Directors are not elected or do not function appropriately;
- Corporate records are not properly maintained;
- Failure to keep corporate financial records;

- The business' assets are used or comingled with those of the owner;
- The business owner exercises total dominion over the business entity, disregarding business judgment in favor of personal usage of the business entity and its assets.
- The business entity is used as a sham to defraud creditors.

While LLCs generally require less record keeping, courts have held LLCs to a similar standard of proper maintenance and operation to avoid business owner personal liability.

Business owners should work closely with their lawyer to assure that their corporate or LLC operations are appropriate to maintain the protection from personal liability — the primary reason for incorporating or forming an LLC.

Clear communications are essential to both client and attorney

## USING LAWYERS EFFECTIVELY IN YOUR BUSINESS TRANSACTIONS

M. Blen Gee, Jr.

Your business attorney is an indispensable tool (or at least a necessary evil) in any major business transaction. Below are some key points to maximize efficiency and minimize cost in using lawyers in business transactions:

- **Involve the lawyer early, before you sign anything.** For example, business people planning to sell a business or other assets frequently sign a broker's agreement without having it reviewed by their lawyer. Later they find that the broker's agreement is one-sided and may affect the proposed transaction in many ways. Also, by getting your lawyer involved early, he can help you shape the parameters of the transaction and point out key issues to be dealt with.
- **Introduce your lawyer to your CPA.** Make sure that they are communicating concerning tax and other financial issues.
- **Be sure that you understand your situation.** Before you ask your lawyer to draft documents, make sure that you have an agreement in principle with the other party on all the major terms. Clients sometimes request that lawyers draft all the documents in final form in the hope that the other party will sign them without further negotiation. This rarely works in practice. Instead, it frequently leads to unnecessary legal fees. A well-drafted letter of intent can help in this process. As a general rule of thumb, if the other side does not have their lawyer involved yet, it is probably too early to begin drafting documents. Once the lawyer begins drafting documents, changing your mind is expensive.
- **Communicate well with your lawyer.** Give him all the documents that he has requested. Tell him all pertinent information concerning your business, the transaction in question and the industry in general. Even rumors can sometimes be helpful. Remember, you know your business and your industry much better than your lawyer does and he may not always know what questions to ask. If new information comes to your attention, promptly communicate it to your lawyer. Rely on the attorney-client privilege and your lawyer's duty of confidentiality: ***never make the mistake of withholding information because of pride, embarrassment or other fear of disclosure***. Of course, the hourly rate meter is always running so do not overwhelm your lawyer with irrelevant or trivial information.
- **Insist that your lawyer communicate well with you.** You should expect to receive a copy of every letter and every draft document. Ask clear questions and insist on clear explanations.
- **Read what your lawyer has prepared.** Again, remember that you know your business and your industry better than your lawyer does. Your input is essential. If you are presented with some massive, incomprehensible document, have the lawyer walk you through the document and explain the provisions. Don't be embarrassed to ask questions.
- **Have a clear understanding about fees.** Make sure that this issue is discussed; ask for an estimate of costs; look at each bill and ask appropriate questions; and if the bill is appropriate, pay it promptly (nothing moves your matter to the head of the line faster than prompt payment of the lawyer's bill).
- **A letter or a contract** outlining the scope of the engagement of the lawyer is a good idea and can help avoid misunderstandings about what you want your lawyer to do or not to do.

## YOU'VE GOT TO KNOW WHEN TO FOLD 'EM

By Jean Winborne Boyles and M. Blen Gee, Jr.

When a business gets in financial trouble, the owner's fundamental instinct is to do everything possible to keep that business alive. After all he has worked for years to build it and with just a little bit of luck, it can be turned around. All too often, however, the business owner makes a super human effort to save a doomed business and finds that he has depleted his personal assets and jeopardized his own personal solvency to no avail. In many situations, the only smart move is to close the doors and work out payments with the company's creditors. Here are some crucial legal issues:

- **TAXES MUST BE PAID.** One of the biggest mistakes that a business in financial trouble can make is to fail to pay employee withholding, sales tax and similar taxes. Obligations for taxes are not dischargeable in bankruptcy! Worse, officers of the company can be held personally liable for these taxes; your business could be shut down, you could file for personal bankruptcy and still owe thousands of dollars to the federal government or the state for unpaid taxes. In some cases, the taxing authority to might even criminally prosecute key officers. Income tax returns should be filed even if there is no money to pay the tax.
- **PROTECT YOUR RETIREMENT.** For North Carolina residents, your retirement plan is exempt from claims of Your creditors. You should think long and hard before you cash in you pension plan, paying hefty taxes and penalties and put your retirement savings into a failing business. You may be far better off closing your business and keeping your retirement savings safe from creditors.
- **PROTECT PERSONAL AND FAMILY LOANS TO YOUR COMPANY.** If you feel that it is necessary to invade your personal savings to bail out your company, secure the loan the same way that a bank would do, with a lien on all of the company's assets.
- **TIMELY SALE OF BUSINESS.** Selling your business before it is too late can sometimes be the smart move. Every business has a "goodwill" value that is greater than the value of the inventory, furniture, fixtures and equipment. Before you lose your best employees, alienate customers with poor service and alienate your vendors by non-payment, you may be able to substantially salvage your company's goodwill by a timely sale.
- **BUSINESS WORKOUTS.** Your lenders, regular suppliers, employees and creditors all have a stake in the survival of your business. A comprehensive workout plan agreed to, or at least acquiesced to, by your company's creditors, lienholders, lessors and other interested parties will allow them to limit their losses and also allow your company to survive.
- **THE BANKRUPTCY OPTIONS.** You may liquidate your company under Chapter 7 of the Bankruptcy Code. All the company's debts are discharged and its assets are liquidated to pay creditors. If you have personally guaranteed the businesses loans, or have personally loaned money to the business without security, a Chapter 7 liquidation may not be advisable. A Chapter 11 (business reorganization) is substantially more costly but enables the corporation to reorganize debt while continuing to operate if there is sufficient business to preserve. Also, some businesses liquidate in a Chapter 11 so that they can control the liquidation while continuing to operate prior to closing the business down.

**When a business gets in financial trouble, the owner's fundamental instinct is to do everything possible to keep that business alive.**



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### ➤ About the authors:

**M. Blen Gee, Jr.** is an honors graduate of the University of North Carolina School of Law. His areas of concentration include business and corporate law, including sales of businesses; business litigation, including arbitration and mediation; franchise law; automobile dealer law; and insurance company insolvency.

**F. Stephen Glass** is the author of *The Legal Handbook for North Carolina Businesses*, and *Your Estate Planning Handbook*. His practice is concentrated in the areas of business, employment and corporate law, business litigation, business succession planning and estate planning. He serves on the Cary board of Capital Bank.

**Jean Winborne Boyles**, concentrates her practice in health law, corporate law, bankruptcy and creditors' rights, commercial leasing, antitrust and state administrative law.

"No, I'm not retired; just enjoying the practice of law more."

## **SAM JOHNSON CELEBRATES HALF CENTURY OF DISTINGUISHED LAW PRACTICE AND EXEMPLARY PUBLIC SERVICE — AND IS STILL GOING STRONG!**

On September 3, 2003, Samuel H. Johnson, founder and senior member of our firm, celebrated fifty years of a most distinguished law practice as hundreds of his friends and clients honored him at a gala reception in Raleigh hosted by our firm.

Sam Johnson was born September 13, 1927 in Sampson County, N.C. He attended Pfeiffer College and following service in the Navy at the Naval Research Laboratory (1946-1948), he attended Mexico City College and graduated from the University of North Carolina (A.B.) in 1950, and in

1953 from the U.N.C. School of Law (J.D.). He was admitted to the N.C. bar on September 3, 1953. He is admitted to practice in the U.S. District Court, Eastern District of N.C. and U.S. Supreme Court.

He served in the N.C. House of Representatives from 1965 to 1974. He has also served as a Trustee, University of North Carolina, 1967-1972; Chairman, N. C. Local Government Study Commission, 1967-1973. N.C. Joint Select Commission on Fiscal Trends and Reform, 1992-1993; Advisory Budget Commission of N.C., 1969-1971; and

Special Counsel to Speaker of House of Representatives and Lt. Governor, 1975-1977.

Mr. Johnson's professional and civic memberships and accomplishments are too numerous to mention here. He was a general practitioner in the early part of his career; his current practice areas are legislative practice; estate planning; business law; and trade association law.

Far from being retired, Mr. Johnson maintains his active practice with the firm but finds more time to enjoy his family and his various hobbies such as amateur radio, cooking and the beach.