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PROTECTING YOUR INVESTMENTS (Better Than Wall Street Has)

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Stocks are down, foreclosures are up, and world banks and businesses are struggling through the worst financial crisis in decades. In the midst of a recession that is now over one year old, investors are faced with sagging portfolios and negative returns. Not all of your investments, however, must be left to the mercy of the markets. There are steps you can take to shield assets from the effects of the down economy.

Non-Competition Agreements

Your business may have certain key employees whose services are vital to its success. They may have unique skills, knowledge or experience, or access to confidential information regarding your products, services or customers which would be detrimental if shared with competitors.

You should consider protecting your business from the loss of such employees with a well-drafted Non-Competition Agreement. These agreements typically provide that an employee leaving a company may not compete with the company or solicit its customers or, in some cases, solicit other employees. A well-drafted Non-Competition Agreement will contain anti-disclosure provisions, prohibiting the employee from disclosing confidential information which might impede a company's ability to compete in the marketplace.

While such agreements are typically executed when employment commences, continued employment may be sufficient consideration for enforcement by New York courts.

In this troubled economy, with unemployment rising and employees hesitant to leave their current positions, now may be the time to enter into Non-Competition Agreements with your key employees, adding a layer of protection for your business in the event those employees move on.

Intellectual Property Agreements

Often in the course of employment, employees conceive or develop a product, process, procedure or concept that may have significant value to your business or in general. This is typically referred to as intellectual property. If the employee leaves your company, the question is "Who owns it?" A simple written agreement can help your business avoid the loss of significant commercial opportunities afforded by intellectual property, and can save significant litigation expenses to resolve the ownership issue.

Shareholder Agreements

If you are one of multiple holders of equity interests in your business, consider implementing a Shareholder Agreement. Shareholder Agreements provide mechanisms by which business

To our Clients and Friends:

The Corporate Department of Hancock & Estabrook, LLP is pleased to send to you our new Corporate and Business Newsletter. The Newsletter contains information on the latest developments, trends and governmental activities which relate to doing business. Our first issue gives you some suggestions on how to protect your valuable business assets in the current economic chaos. Please call or email any one of us in the Department with any questions or suggestions for future topics you may have. As always, we stand ready to service your legal and business needs.

Robert H. Altman, Esq.
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owners can maintain harmony with their partners. Typically, they forbid shareholders from transferring their interests to anyone other than other shareholders or the business itself. A well-drafted Shareholder Agreement provides payment terms in the event of a share transfer, and mechanisms to spring shares from a deceased or retired shareholder or a shareholder who has committed certain adverse acts against the business. It often contains a non-competition clause, which serves a purpose similar to the Non-Competition Agreement described above. Shareholder Agreements may contain voting covenants designed to allow those currently in control of the business to maintain control regardless of who the shareholders are.

In the absence of such an agreement, shares may be readily transferable and you could be saddled with a business partner you don't want. New shareholders could have the ability to pool their votes to gain majority control of your board of directors and ultimately usurp control of day-to-day operations.

Worse yet, in certain instances, unauthorized transfers of shares of a business may run afoul of rules and regulations of the Securities and Exchange Commission, subjecting your business to substantial fines and penalties. If your business is an "S Corporation," there are limits on the number and types of shareholders you may have, and a violation could increase your tax burden dramatically.

Vendor/Customer Agreements

You should carefully review the various contractual relationships your business has with other commercial parties. A contract does not have to be in writing, and a written document doesn't have to be titled "Contract" or "Agreement" to be enforceable. A contract can arise from oral communications, a past course of conduct or even correspondence exchanged between parties, such as a written purchase order by one party followed by a confirmation by the other, each of which may have conflicting provisions. If a dispute develops, which document controls?

This situation is commonly referred to as a "battle of the forms" and most states have statutes which provide guidance. Winning this battle can be as easy as inserting language which can affect not only which party wins, but also issues such as where litigation will occur — preferably, the jurisdiction where your business is located. Do your documents contain the right language to best position your business to prevail in a battle of the forms?

Maintaining "Corporate" Structure

Ideally, nearly every business should be operated as a limited liability company, a corporation, or the like. Sophisticated corporate structures such as these require certain up front costs, such as filing fees, but provide a higher degree of insulation from liability for business owners than general partnerships or sole proprietorships while the tax burden is generally commensurate.

To protect your assets from the liabilities of your limited liability company or corporation, be sure that you adhere to principles of good corporate governance: (1) keeping proper

corporate records, such as minutes of shareholder or director meetings, (2) holding required shareholder and director meetings, (3) electing directors and officers, (4) issuing stock, (5) adequately capitalizing the company, (6) avoiding commingling company and personal funds or shuttling personal funds into and out of the company and (7) keeping separate the business of the company and personal business. Failing to adhere to the above can allow a court to "pierce the corporate veil" of your business and impute its liabilities to you.

If your business has multiple locations or readily separable divisions, consider forming separate entities and operating each entity in accordance with the above principles. This will isolate the liabilities of any one entity, protecting its parent and sibling entities against potential loss.

Credit Facilities

If your business maintains a credit facility with a bank, pay careful attention to loan terms, especially the circumstances under which the bank may call a loan due. During this economic downturn, banks are searching for ways to increase the value of their balance sheets and retain as much cash as possible. While previously they may have overlooked a reporting requirement or a flirtation with a debt coverage ratio, they may not be so forgiving now.

If you have a demand line of credit, the bank is probably permitted to call the loan due at any time. If you have a revolving line of credit or a term loan, however, it typically may be called only in certain circumstances, most notably if you breach a covenant in the governing agreement. These covenants may include promises by your business ranging from the substantive, such as a promise to pay amounts due or maintain a certain ratio of assets to liabilities, to the mundane, such as a promise to submit financial statements by a certain date. A breach of even the most mundane covenant, however, can allow the bank to call a loan due. Don't let this happen to your business. Understand your credit documents and comply with every requirement.

Finally, if you executed a security agreement, note or personal guaranty in connection with any credit facility, be certain that you understand those documents as well. They may contain additional events of default that could allow the bank to call a loan due or even, in certain circumstances, seize the assets of your business or hold you personally liable for amounts due.

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