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Update On Asset Protection

From time to time, it is a good idea to review some of the ways which are available to help us protect some of the assets for which we work so hard.

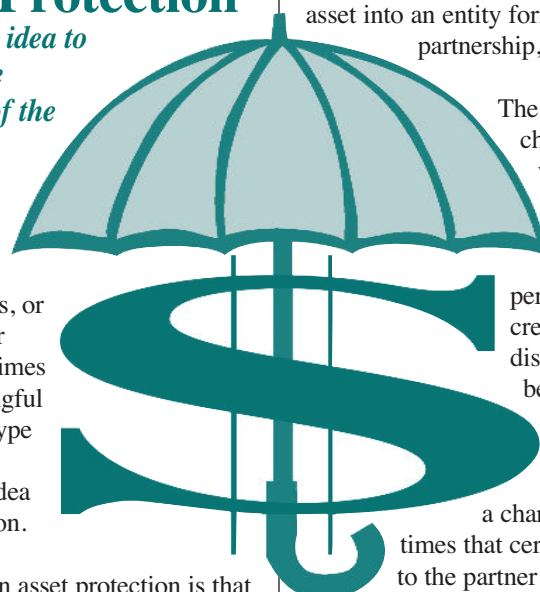
According to a recent survey, every year at least one out of ten Americans is sued. All of us, in our day to day lives, are subject to accidents, or become involved in contract disputes or bad investments. Employers are sometimes on the receiving end of claims for wrongful discharge, sexual harassment or some type of illegal discrimination. For these and many other reasons, it is often a good idea to consider some form of asset protection.

The important thing to remember in asset protection is that timing is of ultimate importance. If you wait until an event actually occurs, then it may very well be too late. All states have what are known as fraudulent conveyance laws which provide that if a potential judgment debtor transfers assets with either actual or constructive knowledge of the fact that he may be subject to liability, that transfer may be set aside as being a fraud against creditors.

However, if assets are properly protected prior to the time that such event occurs (i.e., when the waters are calm), then one may be able to protect a good deal of one's wealth from the possible reach of creditors.

Insurance, in the form of general liability, business liability, professional liability and umbrella coverage, is one way of protecting assets. In the event that one is sued, a reputable insurance company will provide for both the payment of legal expenses for the defense of the action and for the payment of all or part of any ultimate judgment that may be rendered.

Another classic technique is to transfer property to another party. If you don't own it, then it is not subject to claims of creditors. However, gifts of property to another person may become subject to a gift tax and that property may be subjected to the claims of creditors of your beneficiary.



A more traditional form of protection is transferring the asset into an entity form such as a corporation, limited partnership, or limited liability company.

The use of such techniques will sometimes change what might otherwise be an asset which is attractive to a judgment creditor into an unattractive asset. The main reason for this is that the partnership or LLC interest is considered to be personal property. That is, the partner's creditor has a right to share in any distributions or income that the partner may be entitled to receive from the partnership but that creditor is not entitled to any share of the partnership assets. This occurs as a result of a court order called a charging order. In a partnership there are times that certain amounts of the profits are allocated to the partner without there actually being any cash distribution made to cover that (continued on page 2)

NEWS OF THE FIRM



Robert E. Ganz has been elected President of the Guilderland Public Library. He has also been selected by the NYS Bar Association to lead chair an Albany-based continuing legal education program on "forming and advising businesses". ■

Jed Wolkenbreit continues to be selected by various organizations to teach LLC and partnership law. He was selected to speak to the NYS Association of family physicians on "asset protection". ■

Richard H. Friedman, for the 10th year, is conducting collection law seminars for the Lorman Group. ■

David E. Siegfeld has been honored by the United Jewish Federation of Northeastern New York as part of its Foundation for the Future Program. ■

Sharon A. Pedersen has joined the firm as secretary/assistant to Rick Friedman and Robert Ganz. Sharon comes to us with over 30 years' experience as a legal secretary in many leading firms in the capital district. ■

Update on Asset Protection *(continued)*

profit allocation. What makes this particularly unattractive to creditors is that, in such a situation, the creditor who has a charging order against a partner may be responsible for paying taxes on the income allocated to that partner even though he may not receive any actual cash distribution.

The other major asset protection technique which is being used with varying degrees of success, is the transfer of assets to trusts. There are basically two types of asset protection trusts: the domestic asset protection trust (DAPT) and the foreign asset protection trust (FAPT). Domestic asset protection trusts essentially are only useful if they are created in a state which allows what are known as self-settled trusts.

An asset protection trust must essentially have four basic characteristics:

1. It must be self settled, that is it must allow that the creator of the trust is also allowed to be a beneficiary of the trust;
2. It must be irrevocable;
3. It must have what are known as spendthrift provisions which are provisions which protect against creditors attempting to reach the assets; and
4. It must have a tail period, which is generally a period during which claims against the trust can be filed. Once that period had elapsed, then no claim against the settlor can be deemed to be a debt of the trust.

There are only five states, Alaska, Delaware, Nevada, Rhode Island and Utah, that have rules that allow this type of trust and there is some question as to whether trusts created in those states for non-residents have that protection. In most states, spendthrift provisions are not recognized in favor of the grantor of a self-settled trust.

Because of this, foreign or off-shore trusts have become a means of attempting to protect assets. These are effective in many cases since most foreign jurisdictions will not enforce U.S. judgments and many jurisdictions do not allow contingency fees. This means that one has to hire an attorney in the foreign jurisdiction at an hourly rate in order to enforce the claim against the asset. This can be extremely expensive for a creditor and, therefore, may not be cost effective. There is also some psychological barrier when assets are out of the country. The main benefit of the foreign asset trust is that the grantor can be a beneficiary, the trust can be irrevocable or revocable, the trust can have the trust protector with veto power, it can avoid probate, and the trust assets can be moved. The main disadvantages of foreign asset protection trusts are that sometimes U.S. judges will attempt to get around their protection and will hold the grantor in contempt for not transferring the assets back into U.S. jurisdiction.

It is imperative to be aware that there are no tax advantages to the FAPT and one of the major misuses of these trusts has been an attempt to avoid paying income tax on the

income earned. This is clearly illegal and not a valid reason for creating such a trust.

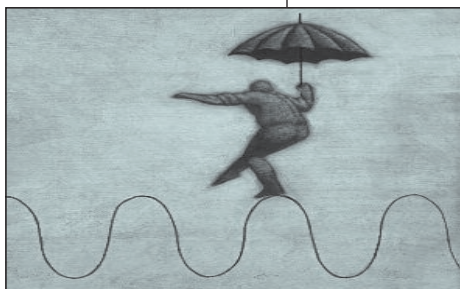
The best asset protection technique, in our opinion, is to create a combination of an entity and trust in which you create a U.S. limited partnership and maintain control over most of your assets in the U.S. Concurrently, you would create a foreign asset protection trust with a foreign co-trustee. It would initially be considered a U.S. trust but would contain what is known as a duress provision which would provide that, if an incident of duress occurred, you would resign as the general partner of the partnership. The trust, as limited partner of the partnership, could then transfer the balance of its assets into a foreign trust and the provisions for foreign trust protection would go into effect. You would resign as a trustee and would not have any ownership in it. Therefore, no judge could force you to transfer assets back, since you cannot control what you do not own. You would engage a foreign trust protector to help protect the assets.

Asset planning techniques have become somewhat more sophisticated and it is often important that such protection be taken. However, it cannot be stressed too strongly that these actions must be taken before any type of disaster or distress events occur. Once you are the subject of an action or once a claim has clearly accrued against you, it is too late to move assets. For more information on this topic, please feel free to contact our office. ■

The New Overtime Rules: Tempest In A Teapot

Recently the issue of "overtime" compensation became an issue in the Presidential Campaign - each side accusing the other of hurting the economy by the balance struck in newly revised Labor Department regulations governing the issue of who must be paid overtime. The truth is that while there has been some "tinkering" with the exemptions from overtime eligibility, existing law remains relatively unchanged. Only the 30-year-old salary standard has been transformed, thus increasing the pool of employees theoretically entitled to overtime. Even under the revised regulations both the "duties" test and the "salary level" test must be met, so just because one is theoretically eligible for overtime does not necessarily mean one will receive such extra compensation. Here are the details:

The FLSA [Fair Labor Standards Act] generally requires covered employers to pay employees at least the federal minimum wage for all hours worked, and overtime premium pay of time-and-one-half the regular rate of pay for all hours worked over 40 in a single workweek." 29 CFR Part 541. New regulations which took effect on August 23, 2004 essentially do two things: 1) increases the minimum weekly salary levels for which employers must pay minimum wage and overtime from \$155/wk to \$455/wk, and 2) further





develops and defines the “white collar” employee exemption setting forth those employees who are not covered by the minimum wage and overtime requirement.

In order for an employee to be subject to the “white collar” exceptions to overtime and minimum wage requirements the following tests must be met.

Executive Exemption:

- 1) The employee must be compensated on a salary basis at a rate not less than \$455 per week;
- 2) The employee’s primary duty must be managing the enterprise, or managing a customarily recognized department or subdivision of the enterprise;
- 3) The employee must customarily and regularly direct the work of at least two or more other full time employees or their equivalent; and
- 4) The employee must have the authority to hire or fire other employees, or the employee’s suggestion and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees must be given particular weight.

Administrative Exemption:

- 1) The employee must be compensated on a salary or fee basis at a rate not less than \$455 per week;
- 2) The employee’s primary duty must be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer’s customers; and
- 3) the employee’s primary duty must include the exercise of discretion and independent judgment with respect to matters of significance.

Professional Exemption:

- 1) The employee must be compensated on a salary or fee basis at a rate not less than \$455 per week;
- 2) The employee’s primary duty must be the performance of work requiring advanced knowledge, defined as work which is predominantly intellectual in character and which includes work requiring the consistent exercise of discretion and judgment;
- 3) The advanced knowledge must be in a field of science or learning; and
- 4) The advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction.

Creative Professional:

- 1) The employee must be compensated on a salary or fee basis at a rate not less than \$455 per week;
- 2) The employee’s primary duty must be the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.

Computer Employee Exemption

- 1) The employee must be compensated either on a salary or fee basis at a rate not less than \$455 per week or, if compensated on an hourly basis, at a rate not less than \$27.63; and
- 2) The employee must be employed as a computer systems analyst, computer programmer, software engineer or other similarly skilled worker in the computer field performing the duties described below;
 - 1) The application of systems analysis techniques and procedures including consulting with users to determine hardware, software or system functional specifications;
 - 2) The design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications;
 - 3) The design, documentation, testing, creation or modification of computer programs related to machine operating systems; or
 - 4) A combination of the aforementioned duties, the performance of which requires the same level of skills.

Outside Sales Exemption

- 1) The employee’s primary duty must be making sales (as defined in the FLSA), or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and
- 2) The employee must be customarily and regularly engaged away from the employer’s place or places of business.

However, regardless of the pay per (continued on page 4)

What We’re Up To



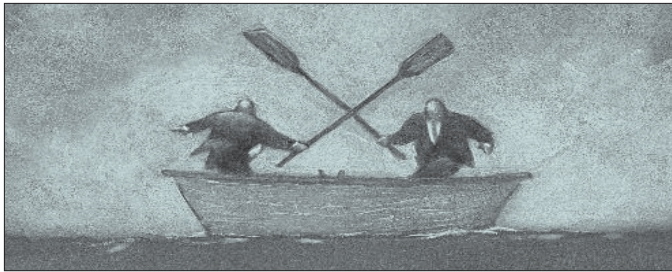
Robert Ganz is defending an assignee of a multi-million dollar contract with a state government against claims that it is responsible for its predecessor’s failures at performance. ■

Jed Wolkenbreit is assisting physician groups with developing new practice relationships with the Hospitals with which they were formerly associated on a staff basis. ■

Rick Friedman is involved in several pieces of construction-related litigation protecting an owner’s rights in contractor-subcontractor related disputes. ■

Dave Siegfeld has recently been involved in several estate planning projects and related disputes in which he has been able to bring together different factions of a family to resolve the ultimate disposition of their common decedent’s assets. ■

week, a new section 541.3(a) of the regulations states that exemptions do not apply to manual laborers or other “blue collar” workers who perform work involving repetitive operations with their hands or physical skill and energy. Thus, for example, non-management production-line employees and non-management employees in maintenance, construction and similar occupations such as carpenters, electricians, mechanics, plumbers, iron workers, craftsmen, operating engineers, longshoremen, construction workers and laborers have always been, and will continue to be, entitled to overtime pay. ■



Contract Law Update

Personal Liability for Corporate Actions.

A major reason for forming a corporation or limited liability company is to avoid personal liability. However, when you sign your name or otherwise act on behalf of a corporation, what you do and how you sign may determine whether you are personally liable. Two recent cases illustrate this point. In Rosen v. Watermill Development Corp., homeowners sued the corporate developer who constructed their homes alleging defective workmanship and breach of warranty. The Plaintiff also sued Gordon, President of the defendant Watermill Development Corp. The Appellate Division held that the Supreme Court should have dismissed the breach of contract cause of action against Gordon in his personal capacity because the evidence established that he entered into the contract of sale and signed the related documents in his corporate capacity as President of the corporation. The best evidence that you have signed a contract on behalf of a corporation or other entity is to be explicit in setting forth the name of the entity in the contract making clear that it is a corporation or limited liability company, and **signing** the document using your official corporate status (President, Treasurer, Managing Member, etc.).

If the business name on your letterhead or on your business checks does not indicate you are a corporation, **and** you sign without indicating your corporate title, a court could find you personally liable for breach of contract.

Does that mean that you cannot be held personally liable if your corporation is properly named and you sign in your corporate capacity? That depends on the nature of the liability. In Ideal Supply Corp. v. Fang, plaintiffs brought an action for breach of contract **and** fraud. They named the individual officers of the corporation based on their allegation that the individual officers participated in the fraudulent misrepresentations. The Court held that it was “well settled” that agents or officers of a corporation may be held **personally**

liable for their tortious acts committed in the performance of their corporate duties. A tortious act is a civil wrong (as distinguished from a breach of contract). There are a variety of business wrongs that constitute torts rather than a breach of contract.

When Does a Letter of Intent Constitute a Binding Contract?

Parties may enter into a Letter of Intent before they get to the actual contract. This is particularly common for commercial leases. The brokers will often prepare a Letter of Intent which will eventually be replaced by the commercial lease. The Letter of Intent may expressly state that it is not a binding contract. However, a recent case illustrates how a Letter of Intent can form the basis for a breach of contract.

In 180 Water Street Associates, L.P. v. Lehman Brothers Holdings, Inc., the Appellate Division was confronted with a Letter of Intent for a long-term lease. The Letter of Intent provided for a lease term of “approximately 20 years”. It also provided that the parties would negotiate in good faith and only with each other toward a final lease, and do so on an exclusive basis.

When the parties failed to enter into a lease, the landlord sued. The Court held that the Letter of Intent was not binding or enforceable as a lease. The Letter expressly disclaimed any binding effect, and the term “approximately 20 years” was too vague to be enforced as a lease.

However, the landlord claimed that the defendant was negotiating with other landlords from the very beginning. The Court held that this allegation was sufficient to state a claim for breach of the portion of the Letter of Intent that required the parties to negotiate in good faith and only with each other. Also, the Court gave a warning to the tenant that the Letter of Intent was sufficiently definite as to all material terms of a commercial lease, except for duration. Since the only remaining term was the length of the lease of “approximately 20 years”, the Court indicated that the 20-year bench mark would provide a basis for determining whether the negotiations were, in fact, conducted in good faith.

While a Letter of Intent can be a useful step prior to drafting the actual contract, the parties should expressly indicate that the Letter of Intent is not binding and shall not be construed as a contract. However, if the letter of intent contains a requirement that the parties negotiate in good faith and only with each other, it is important to note that the term “good faith” means just that. You cannot break off negotiations over a spurious or fictitious point. When a Court looks at the negotiations, it will look at the Letter of Intent to see how many issues were left to negotiate. In this case, there was apparently very little left to negotiate. ■



DISCLAIMER Actual resolution of legal issues depends upon many factors, including variations of facts and the application of such facts to state and federal statutory and common law. This Newsletter is not intended to provide legal advice on specific subjects, but rather to provide insight into legal developments and issues. The reader should always consult with legal counsel before taking action on matters covered by this Newsletter.