

CARLILE PATCHEN & MURPHY LLP

Attorneys at Law

Leadership through Understanding and Insight

SUMMER 2002

WORKPLACE ARBITRATIONS REVISITED

In recent years, many employers have re-required employee disputes to be resolved through arbitration rather than to be adjudicated in the courts or by government agencies. In a recent California case called *Circuit City Stores, Inc. v. Adams*, arbitration agreements in the employment setting were again upheld as being enforceable.

However, a subsequent United States Supreme Court decision has created uncertainty about the effectiveness of arbitration agreements. In *Equal Employment Opportunity Commission v. Waffle House Inc.*, the Court held that such agreements do not bar the Equal Employment Opportunity Commission (EEOC) from enforcement proceedings to obtain victim-specific judicial relief (for example, back pay, reinstatement and damages).

While it does not appear that the Court was attempting to abandon prior pro-arbitration decisions, this decision leaves questions as to the finality of a post-arbitration settlement agreement between an employer and an employee. It does not, however, undercut the validity of the arbitration process or the use of arbitration agreements in the workplace.

Practically speaking, employees may get two bites at the apple, one in arbitration and one through litigation initiated by the EEOC action. But the limited resources and past practices of the EEOC make this a remote possibility. Historically, the EEOC has filed suit in a very small percentage of cases.

After *Waffle House*, the effectiveness of arbitration agreements in avoiding EEOC investigations and lawsuits is somewhat diminished. It does not, however, mean that employers should abandon a well-designed workplace arbitration program.

Properly crafted agreements used in the proper circumstances may still continue to provide benefits to employers by avoiding jury trials and litigation costs.

The *Waffle House* decision is only one consideration in determining whether a company should adopt mandatory arbitration. While the informality of arbitration may be viewed as positive, it also can be a negative in situations where an employer needs the protection of formal discovery and evidence rules. Similarly, arbitration may provide the opportunity to get to a resolution faster and more economically, but such speed and efficiency may be viewed differently if the arbitration ruling results in an unappealable high-dollar award against the employer.

Employers who are interested in implementing arbitration agreements should proceed with caution and carefully consider the risks and benefits of these agreements. Only after careful consideration and consultation with counsel should such a program be implemented.

For more information on workplace arbitration programs, contact Kristine Hayes, Anne Larkin, Joëlle Khouzam, or your CPM attorney.

NEWS YOU CAN USE

S corporations are exempt from Ohio franchise tax; however, Ohio law requires an S corporation to file a notice of such election with the tax commissioner between January 1 and March 31 of each tax year that the election is in effect. Failure to do so may result in receiving notice from the Department of Taxation to cancel the corporation's charter, which would require reinstatement. Consult with your accounting advisor to insure that your notice has been filed with the Department of Taxation.

PRACTICAL CONSIDERATIONS FOR RESTRUCTURING THE THRIVING BUSINESS

Excerpted from an article by Michael A. Smith published in the North Coast Business Journal, April 2002.

Restructuring the entity form of a business can be driven by a number of factors such as liability, tax, or an attempt to create more flexibility. In some instances, a business may restructure or recapitalize without changing business form. A business that starts as a sole proprietorship might grow into a multi-employee, multi-investor concern, and an entity restructuring to a limited-liability entity form such as a corporation, limited liability company (LLC), or limited partnership can protect personal assets from legitimate business risks, such as the acts of their fellow-owners and employees.

In a sole proprietorship, the owner's personal assets are generally subject to the contract and tort liabilities of a business. Business income, loss, and tax credits are assessed directly to the proprietor's personal income tax. With an LLC or a limited partnership, the owner's personal assets are generally shielded from liability to the extent that they have not been contributed to the company, but the owner is taxed similarly to a sole proprietorship. A corporate entity shields owners' (shareholders') personal assets from company liability, similarly to an LLC or limited partnership. However, unless the corporation qualifies for election as a small business corporation and makes an "S" election, the corporation reports income, loss, and credits on its corporate tax return, and investors must then report gain on their personal tax returns when they receive dividends or guaranteed payments (salaries). When a corporation makes an "S-election", the shareholders report corpo-

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rate income, loss and credits on their returns, but the corporation does not generally file a separate return.

In a thriving economy, factors other than liability also bear on the decision to restructure a growing business. The business may need to increase capital to accommodate the requirements of a lender. It might encounter a significant change in the size or scope of its operations, for example, in response to successful e-commerce opportunities. Investors might simply desire more flexibility, without running afoul of securities laws and regulations.

Tax considerations are also crucial in entity selection or restructuring: federal and state tax treatment of the new entity form might make the present form less attractive, as is sometimes the case when the sole owner of a single-member LLC encounters substantial earnings subject to federal employment taxes. Some taxes might be avoided in future tax years by restructuring the entity as an S-corporation.

Suppose the owner of a business has been operating the business as a corporation for 15 years, and the company is presently worth \$5 million. Over the last two years, the company has substantially increased in value, partly due to the marketing efforts of two key employees. The owner wishes to reward these key employees with ownership in the company to encourage further growth. However, she does not wish to give away too much of her company. Also, giving employees common stock based on the existing value of the business could have a significant adverse tax impact on the employee-shareholders, who might have to include the fair market value of the stock as personal income.

The company might consider restructuring its corporate form by creating two classes of stock. The owner would be issued preferred stock, with a value of \$5 million (the total fair market value of the company) while the two key employees and the owner would hold common stock. The owner would receive the first \$5 million on the sale or liquidation of the business, and she and the key employees would share ratably in the value above \$5 million. And since the preferred stock is worth the same amount as the total value of the company, there should generally be mini-

mal tax to the employees upon receipt of their shares. The owner would thereby receive compensation for her efforts in developing the company during its first 15 years, and the key employees and the owner would be rewarded for the growth of the business after the restructuring.

The effectiveness of such a restructuring to minimize tax depends on the valuation of the company at the time the employees receive the stock. The IRS might subjectively appraise the company's value higher than the value allocated to the preferred stock. To further minimize the value of the key employees' common stock, the company could create voting and non-voting classes of common stock in addition to the preferred stock received by the owner. The owner would receive the voting common stock and the key employees would receive the non-voting stock. As voting stock is generally more valuable than non-voting stock, if the IRS allocates pre-transaction value to the common stock, the key employees could argue that the owner's common stock should be allocated more tax on that value.

The creation of two classes of stock is not always possible, particularly where the existing corporation is required to maintain only one class of stock, as is the case with the "S" corporation. In such cases, other forms of compensation, such as a "phantom" stock plan, might be more desirable. Under a typical phantom stock plan, the employer corporation rewards key employees in the form of hypothetical, rather than actual, shares of stock. This "phantom" stock is credited to the employees, as are all dividends and stock splits attributable to these shares. Employee tax is deferred until they are entitled to receive money in accordance with the plan. These are, however, primarily compensation planning tools rather than entity restructuring strategies.

Business owners should give careful consideration to the method of restructuring. Various forms of tax-free reorganization exist for most limited liability entities. Tax and other considerations dictate whether the reorganization takes the form of an acquisition, merger, start-up or other form.

For more information on whether, when and how to restructure your entity, please call Mike Smith, Dick Patchen, Dick Bibart, Steve Enz, or your CPM attorney.

TRIBUTE TO LAURENCE E. STURTZ



Laurence E. Sturtz

The Firm would like to express its appreciation to Laurence E. Sturtz, a long-time member and former chair of CPM's Litigation practice group, who retired in May. Larry's career included success in both the boardroom and the courtroom. Immediately prior to joining CPM in 1988, Larry served as general counsel, president and Chairman of the Board of a public company which he successfully restructured. This followed years of private practice as an accomplished litigator, during which Larry developed a national reputation in the defense of first amendment rights cases. Over his years in practice, he has represented businesses of all sizes, as well as municipalities and individuals. He has also served as an arbitrator and volunteer mediator to the courts.

More recently, Larry became known for his representation of high-profile lottery winners, including Columbus' "Lucky 13" winners in 1998. In that regard, he has been interviewed by countless national TV and radio stations, and media publications such as *Money* magazine. Larry was recently featured on WTBN radio's "Steve Cannon" talk show to discuss advice to lottery winners.

Larry has been a long-time and avid supporter of organizations which care for the homeless and underserved. He will continue to chair the Board of the Faith Mission, central Ohio's largest homeless shelter, and to serve on the Executive Committee of the Board of Lutheran Social Services, which owns and operates the Faith Mission and Faith on Eighth. He is co-chair for Recreation Unlimited's an-

nual Celebrity Waiters Luncheon, which raises funds for summer camp for handicapped persons. He serves as a trustee of the Discovery District Development Corporation, and is also an author and lecturer on topics affecting businesses. Larry and his wife, Maureen, will be enjoying time with their children and grandchildren, as well as sailing and traveling. Thanks, Larry, for your wonderful contribution to our firm and our community!

IS YOUR COMPANY'S RETIREMENT PLAN IRS COMPLIANT?

The simple mention of the Internal Revenue Service often conjures up thoughts of audits and strangers in dark suits raking through your documents. With the changing employment landscape, many companies find themselves having made mistakes in the calculation of plan contributions, or having a retirement program that is not in compliance with IRS rules.

Previously, self-discovery of such defects led to many dilemmas for employers, and there was little motivation for the company to voluntarily correct the mistakes and face the wrath of employees. Recently, the IRS has allowed greater latitude in a company's voluntary compliance. In effect, the IRS now allows companies to check their own plans and submit unsupervised corrections in certain instances. And, although the IRS will still collect its due, a company-generated correction is encouraged by smaller penalties, which often allows for a substantial savings to the company. The IRS has published guidelines that provide both qualified plans and "fix-it" strategies which it considers to be safe harbors. These safe harbors are strategies that may allow the defects to be corrected, a lower sanction to be calculated, and payments to be made without an audit. This comes as a result of an IRS pilot program to encourage voluntary corrections.

For more information on retirement plans and regulatory compliance, please contact Bob Barnett, Dick Patchen or your CPM attorney.

Who Took My Identity?

We've all heard the stranger-than-fiction tales of sorting through trash to find Social Security numbers, blank credit-card applications, canceled checks, and the like. But the crime of identity theft has gained notoriety and hit close to home for many people we know. How can you protect yourself, and what should you do if it happens to you?

First, be proactive by using a shredder to dispose of all unsolicited applications or mail which contains identifying information. Frequently, even what appears to be junk mail can contain identifying information.

Second, do not leave mail unattended. If you are going on vacation, have your mail held at the post office or have a neighbor empty your mailbox daily. Do not leave outbound mail in your box if it contains bill payments or personal information. If you are expecting a box of checks, pick them up from the local bank branch instead of having them sent to your home.

Third, demand security when ordering or paying for products online. Does the company you are dealing with identify itself as one that does not sell your information, and that insures secure transactions? Keep hard copies of orders and confirmation pages.

A recently discovered scam attempts to secure personal information by sending e-mails indicating that your Internet service provider needs to update its information files, or that the credit card you provided for payment has expired. Verify such inquiries directly with your ISP before releasing information over the Internet.

If you become the victim of identity theft, it is imperative to contact the three major credit reporting bureaus promptly (Trans Union, Experian and Equifax), so that fraud alerts can be placed on your accounts. Next, you should file a complaint with the Federal Trade Commission. You should also promptly call banks and credit card companies. It is helpful to keep a copy of all credit cards, front and back, so that you have the 800 numbers handy when you need them. Most major credit cards will limit your personal losses to nominal sums. Local law enforcement should also be contacted to make a report of the crime; be sure to request a copy of the report. You should also contact the Social Security Administration's fraud line at 1-800-269-0271.

The enforcement of laws against identity thieves varies, and often rests on the credit-card companies' desire to prosecute. But the feeling of having one's person or privacy violated by a criminal is much more difficult to reconcile than re-establishing one's credit. For more information about identity theft and notifying authorities, visit the Federal Trade Commission's website at <http://www.consumer.gov/idtheft/>

PEOPLE ON THE MOVE

The Firm welcomes Columbus native Necol Russell-Washington, who recently joined the Litigation group. Necol, a graduate of Ohio State University law school, received her



Necol Russell-Washington undergraduate degree in Business Management from Franklin University and also has a degree in Computer Science. Before coming to CPM, she worked as a staff attorney in the Franklin County Domestic Relations and Juvenile Branch for Judges Yvette McGee Brown and Kim A. Browne. Prior to attending law school, she was a Corporate Trust Officer for Bank One and served as a sergeant in the U.S. Army Reserve. She is currently also an adjunct faculty member at Wilberforce University. Welcome, Necol!

Joe Patchen was recognized as an Outstanding Volunteer by FIRSTLink during National Volunteer Week. Joe is a member of FIRSTLink's Board of Trustees and is active in several other central Ohio non-profit organizations.

Ritchey Hollenbaugh and Anne Larkin were also recognized for their volunteer efforts by the Southern District court. They have served as volunteer mediators to the Settlement Week efforts provided by the federal court.

Leon Friedberg recently spoke to the Ohio Recorders' Association on the new requirements for real-estate transfer documents, changes in the notary-public law, and the new Ohio electronic-transaction and e-signature laws.

Lori Muetzel, Firm administrator, was elected President of the Columbus chapter of the Association of Legal Administrators.

Jane Higgins, a member of the Firm's Estate Planning practice group, was a speaker at a recent program at the Athletic Club, entitled Estate Planning for the Small to Mid-Sized Estate.

Tim Long recently gave a presentation at the Ohio Association of Cemetery Superintendents & Officials' Mid-Year Conference, discussing criminal charges brought against a crematory owner in Georgia and consumer protections available under Ohio laws.

Dave Ferris recently represented a local company and a trade association before the U. S. Supreme Court in an appeal filed by the opposing side.

Joëlle Khouzam will be a presenter at a seminar on writing employee handbooks on August 13. For a brochure, call Joëlle at 628-0811 or register by calling Lorman Education Services at (715) 833-3940.

Kristine Hayes was recently appointed to serve on the Westminster-Thurber Retirement Community Board of Trustees and as a member of its Human Resources Committee. Kristine will also be a co-presenter with Dennis Concilla at a seminar entitled "Covenants Not to Compete in Ohio" on August 20, where she will discuss negotiating and drafting agreements, and Dennis will discuss non-compete litigation.

FIRM PRACTICE AREAS

BUSINESS

- Business Organization
- Contracts
- Employment
- Transportation
- Telecommunications
- Public Utility
- Government Relations
- Intellectual Property
- International
- Non-Profit Organizations
- Taxation
- Litigation

REAL ESTATE & LAND DEVELOPMENT

- Affordable Housing
- Construction Law
- Leasing
- Title Insurance
- Purchase and Sales
- Taxation
- Litigation

PERSONAL

- Estate Planning
- Probate Administration
- Family Law
- Taxation
- Litigation

FINANCE

- Public Finance: Bond Counsel Services
- Public Finance: Underwriter Representation
- Securities
- Banking
- Broker Dealer
- Taxation
- Litigation

CREDITORS

- Loan Documentation
- Work-Outs
- Commercial Collections
- Bankruptcies & Foreclosures
- Retail Collections
- Bankruptcy Claims
- Taxation
- Litigation

The Report is published four times a year as a service to business owners and professionals. The information contained in The Report is not intended to be and should not be construed as legal advice. Readers should consult their professional advisors to discuss specific issues and applicability

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