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### *A POTPOURRI*

#### PREVENTING TRANSFERS OF CLOSELY-HELD

#### STOCK TO DIVORCING NON-FAMILY MEMBERS

Selecting a business or marriage partner is complicated. While some factors apply to both selection processes, many obviously do not. Few elect to engage in business with a spouse. Fewer still would engage in business with the spouse of a business partner. Closely-held business owners use buy-sell agreements to restrict transfers of ownership and to ensure a smooth transition of operations in the event of certain events, such as death, disability, or divorce.

Divorce presents a variety of issues that can impact business ownership. If the ownership interest was acquired independently before marriage or during marriage by gift or inheritance, for example, and without contribution of any marital funds, services or assets, it may constitute a non-marital asset, which is subject to division or transfer upon divorce. However, even if initially acquired before or outside of the marriage, the interest may be "transmuted" through subsequent contribution of marital funds, services or assets to the business, requiring a division or transfer upon divorce.

Illinois courts generally attempt to avoid dividing a business in divorce situations, especially where animosity between spouses would jeopardize ongoing operations. In such cases, courts attempt to *equitably* (as distinguished from *equally*) distribute marital assets by awarding the business interest to the spouse that is actively engaged in the business and offsetting that interest by allocating other marital assets, or by requiring cash payments, to the non-active spouse. This provides a "clean break" for the parties.

Such a distribution, however, may not be possible where other marital assets are insufficient or where there is no cash or any financing opportunities that would allow for payments to the non-active spouse. In such cases, the interest may be divided, possibly prolonging tension between the spouses, as well as other business owners, to the detriment of continuing operations of the business. A similar situation can arise in the event of death if a surviving spouse elects to renounce a will (and thereby take a share of marital assets being one-half, if there are no children, and one-third if there are children) that leaves the business to someone else, but this may be avoided through the use of living trusts which are not subject to renunciation.

A buy-sell agreement enables owners to restrict transfers and may impose purchase obligations on the company or other owners. Purchase obligations work well in the event of a death, providing a cash-out for the surviving spouse, but not in divorce, since the active spouse generally continues employment in the business and prefers to maintain an ownership interest. In addition, if a portion of a business interest is allocated to a non-active spouse, a court may decide that transfer restrictions in a buy-sell agreement are unenforceable as to such spouse or the company's transfer agent because neither was a party to the buy-sell agreement and neither agreed to the restrictions contained therein.

To maximize protection of business interests and to avoid potential disruption that could arise as a result of a divorce, a business owner must identify the source of interests as non-marital and avoid any post-acquisition contributions of any marital funds, services or assets. The interest should be contributed to a living trust and should be subject to a buy-sell agreement. Consideration should be given to asking the non-active spouse to be a party to the buy-sell agreement and subject to the transfer restrictions contained therein. A waiver of rights to the interest may be included in the buy-sell agreement, with an acknowledgment that marital rights will be funded through other identified assets in the event of a divorce. Such actions admittedly may be difficult or unpleasant to implement, and may not be acceptable to all owners or spouses.

These are sensitive issues that could damage a family and/or destroy a business. Counsel should be consulted at an early date to facilitate discussions and focus the parties' objectives.

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#### **EMAILS MAY CONSTITUTE A CONTRACT IF THERE IS OFFER AND ACCEPTANCE**

A recent opinion by the 7<sup>th</sup> Circuit Court of Appeals addressed the issue of whether an email constitutes a contract. In *PFT Roberson, Inc. v. Volvo Trucks North America, Inc.*, the court held that an email from one party to the other during contract negotiations which left many details open for discussion did not constitute a contract.

Roberson and Volvo discussed an arrangement for Roberson's purchase and maintenance of new Volvo trucks over a period of several years. The parties exchanged numerous draft contracts, none of which were signed. Roberson later brought suit against Volvo, however, alleging breach of contract. Roberson claimed that an email sent to Volvo entitled "confirmation of our agreement" constituted a contract between the parties. The email was a summary of the status of negotiations between the parties and identified numerous items on which the parties had yet to agree.

Roberson argued the email constituted a contract, because the email did not state the agreement was subject to the items that had not yet been agreed. However, the court found that the email merely called for the negotiation of many open items, and was not an offer which could be accepted to form a contract. The court reasoned the email was not something to which Roberson could respond saying, "I accept." Rather, the email merely called for additional negotiations over key terms to the agreement instead of being an offer which could be accepted.

This case highlights the importance of creating a formal, written contract, even if negotiations are conducted over email. If a formal document setting forth offer and acceptance of certain terms does not exist, a court may not find the existence of a contract. If you have any questions regarding the enforceability of a contract or whether an email constitutes a contract, please contact a member of the firm.

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## **JOINT TENANCY OWNERSHIP: FRIEND AND FOE**

Joint tenancy ownership of assets is sometimes called “the poor man’s will.” Indeed, joint tenancy ownership can be a good substitute for a will in some circumstances. However, joint tenancy is far from a panacea for a comprehensive estate plan, and without careful consideration of the desired result, joint tenancy could result in some unintended consequences.

Joint tenancy is the ownership of an asset by one or more persons, each of whom is the equal owner of the undivided whole. The “estate planning” feature is that upon the death of one joint tenant, the surviving joint tenant becomes the owner of the asset. Because title to the asset passes by operation of law, a will or trust is not necessary to transfer title at death of an asset owned in joint tenancy.

Complications can result when a joint tenancy account is created in order to assist the account holder to pay his or her bills. So called “convenience” accounts often provide an opportunity for the purported “assistant” to help himself or herself to the funds in the account, whether before or after the death of the account holder. One problem is that the addition of a person as a joint tenant is presumed to be a gift, a presumption that can only be overcome by clear and convincing evidence by the party claiming that there was no gift. Thus, while a person may have intended that a bank account would pass as part of his or estate, the account will become the property of the surviving joint tenant unless it can be proven that the joint tenancy account was established solely for convenience. The better way to give another person access to an account for the convenience of the account owner is to give that person a durable power of attorney that will provide access to the account. The power of attorney will terminate upon the death of the principal, thereby terminating the agent’s access to the account.

Tax treatment of joint tenancy assets or accounts can also complicate matters. One result of the presumption that a gift is made upon the creation of a joint tenancy is that gift taxes may result. For example, the creation of a joint tenancy in real estate is an immediate gift (the reason being that the gift has been completed because the grantor cannot take the property back unless the grantee signs a deed conveying title). On the other hand, with respect to a bank account, a gift does not result unless the donee makes a withdrawal from the account and uses the funds for his or her own personal benefit, thereby completing the gift. In any event, careful record keeping is essential in order that tax issues can be identified and gift tax returns filed if necessary.

If a husband and wife own all their assets in joint tenancy, and their combined net worth exceeds the estate tax exclusion equivalent amount (\$2,000,000 per person in 2007), their estates may incur an otherwise avoidable estate tax. Consider the following example: husband and wife have a combined net worth of \$4,000,000. Upon the death of the first spouse, the surviving spouse will become the owner of all the assets. Upon the death of the second spouse, an estate tax will be due for all assets in excess of \$2,000,000. In our example, the federal estate tax on the estate of the second spouse to die would be \$780,000. Had the couple each held one-half of their assets in separate living trusts, rather than relying on joint tenancy to accomplish the transfer, the federal estate tax would have been avoided in its entirety.

While joint tenancy ownership can be beneficial, and may well be appropriate in certain circumstances, its use must be carefully planned to avoid any number of adverse consequences. Please do not hesitate to telephone us if you have any questions regarding joint tenancy or your estate plan generally.

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## PROHIBITION AGAINST WORKING FOR COMPETITOR

### FOUND UNENFORCEABLE

It is not unusual for employment agreements to contain a non-competition provision which, among other things, prohibits an employee from working for a competitor of the employer. The question then arises regarding whether such provision is enforceable. The recent case of *CertainTeed Corporation v. Williams* provides excellent guidance regarding the enforceability of such a provision.

Jerome Williams (“Williams”) was employed by CertainTeed Corporation (“CertainTeed”) as a Plant Engineer. When he was promoted to Assistant Plant Manager, Williams was required to execute a Noncompete Employment Agreement (“Noncompete Agreement”). The Noncompete Agreement, among other things, provided as follows:

I [Williams] shall not, without written consent signed by an officer of [CertainTeed], directly or indirectly (whether as owner, partner, consultant, employee or otherwise), at any time during the one year period following termination of my employment with [CertainTeed], [engaging] in or contribut[ing] my knowledge to any work or activity that involves a product, process, apparatus, service or development (i) which is then competitive with or similar to a product, process, apparatus, service or development on which I worked or (ii) with respect to which I had access to Confidential Information while at [CertainTeed] at any time during the period prior to such termination.

In determining whether such provision was enforceable, the court noted that a non-competition provision must protect a legitimate interest of the employer in order to be valid. Protection of trade secrets, confidential information, goodwill and unique or extraordinary skills are legitimate interests supporting such a provision. However, if the provisions are inserted into an agreement for some other purpose, such as eliminating or repressing competition or keeping the employee from competing so that the employer can gain an economic advantage, the covenant will not be enforced.

In ruling the above provision was unenforceable, the court found that the provision prohibited Williams from engaging in any competing business even when that competition did not involve the use of protected information. Thus, the provision was not protecting a legitimate interest of CertainTeed. The court went on to find, however, that the provision could be reformed so that it would be enforceable by striking subpart (i), which would then allow Williams to work for a competitor so long as he refrained from using or disclosing CertainTeed’s protected information.

So long as the non-competition provision protects an employer’s legitimate business interests, and is not a blanket prohibition against working for a competitor, the non-competition provision should be enforceable. This is a constantly changing area of the law. Employers should continuously review their non-competition agreements in view of new case law, and employees should contact us if they have questions about the present enforceability of non-competition agreements entered into sometime ago.

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**PERSONAL EXPENSES OF SHAREHOLDER PAID BY CORPORATION WITHOUT  
EXPECTATION OF REPAYMENT IS A CONSTRUCTIVE DIVIDEND**

Remember those television commercials around Christmas season that showcased a new Lexus with red holiday bow as a present? Those commercials must have been generated by a producer whose earlier career involved the practice of tax law, as exemplified by the following Tax Court case.

Mr. Wright was the sole shareholder and president of HJ Builders, a corporation engaged in residential construction and real estate development. On July 10, 2001, HJ Builders made a payment of \$12,155 to "Lexus." The Lexus was driven exclusively by Mrs. Wright, who was not a salaried employee of HJ Builders and was listed as a "housewife" on the Wrights' 2001 income tax return. No mileage logs were kept by Mrs. Wright or HJ Builders with respect to the Lexus.

Upon audit, the IRS issued notices of delinquency to the Wrights on the basis that the \$12,155 payment to Lexus by HJ Builders was for a personal vehicle and the payment was taxable as constructive dividend income to Mr. Wright. The notices also asserted negligence penalties under Internal Revenue Code Section 6662 with respect to the Wrights and HJ Builders.

Neither the Wrights nor HJ Builders presented any reliable evidence that the Lexus was a business asset. Although Mr. Wright testified that his wife used the Lexus exclusively for business, she did not appear at trial. Deductions related to passenger vehicles are not allowable unless the taxpayer substantiates by adequate records, or by sufficient evidence corroborating the taxpayer's own statement, the time, place, and business purpose of the vehicle's use.

HJ Builders and the Wrights claimed the payment to Lexus was not income to the Wrights because the Lexus vehicle was a business asset. No record of use of the Lexus was provided by either the Wrights or HJ Builders. The Tax Court thus concluded the \$12,155 payment to Lexus was a personal expense of the Wrights paid by HJ builders and thus a constructive dividend by HJ Builders to Mr. Wright, its sole shareholder.

When a corporation pays the personal expenses of a shareholder without expectation of repayment, it may have made a constructive dividend distribution which is taxable to the shareholder. Whether a constructive dividend exists turns on whether the distribution was primarily for the benefit of the shareholder.

Section 6662 imposes a 20-percent accuracy-related penalty on any underpayment of Federal income tax attributable to a taxpayer's substantial understatement of income tax or negligence or disregard of rules or regulations. Negligence includes any failure to make a reasonable attempt to comply with the provisions of the Internal Revenue Code. The evidence in this case was quite clear that neither HJ Builders nor the Wrights maintained adequate records to substantiate deductions, and that they acted carelessly, recklessly, or with intentional disregard of Internal Revenue Service rules or regulations.

If the Lexus was a Christmas gift from Mr. Wright to Mrs. Wright, it was a very, very expensive gift.

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## **“BEST KNOWLEDGE” REPRESENTATION DOES NOT IMPUTE A DUTY TO INVESTIGATE**

The representations and warranties are an integral part of all contracts. When the representations are made to the “best knowledge” of the maker, is there any duty for the maker to make a factual investigation to ascertain whether the representations are true? That question was the subject matter of a Delaware case involving the representations made in a lease.

Landlord executed a lease which stated: “Landlord represents and warrants to the best of its knowledge and belief . . . [the premises] are in compliance with all applicable federal, state, and local laws and rules.” The lease also stated the landlord was not aware of any defect, problem, law, regulation, order, rule, or other matter that, if known to tenant, might adversely affect tenant’s decision to enter into the lease. The tenant discovered there were numerous building code violations within the building and sued landlord for tenant’s damages, alleging that landlord breached its representations.

Because there were no material facts in dispute, landlord and tenant both filed motions for summary judgment. Landlord contended that statements made as being to its best knowledge were just that – its *actual* knowledge. Tenant’s position was that “best knowledge” meant that landlord must make an investigation of the facts. The court decided in favor of the landlord, holding that statements made to the “best knowledge” did not impose on the party making the representation a duty to make any inquiry as to the facts set forth in the representation. Thus, the maker of the representations does not bear the risk of defects that may in fact exist but which are not known to the maker.

The representations and warranties in a lease or any other contract are not to be made lightly. Such provisions must be carefully reviewed and negotiated, and the party making the representation must understand the nature of the representations and the possible consequences. If you have any questions regarding the representations or warranties or any other aspect of a lease or contract, please do not hesitate to call us.

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## **LIVING WILL OR HEALTH CARE POWER OF ATTORNEY?**

The Living Will expresses an individual’s intent on the date it is signed; it does not allow another individual to make a different decision based upon medical information at a different time. The Living Will only becomes operative when death is imminent and the application of death delaying procedures serves only to prolong the dying process.

The Health Care Power of Attorney is the appointment of an individual by a principal to act as agent in the event the principal is no longer able to act for himself or herself. The agent makes decisions the principal cannot make, including the decision to terminate life sustaining treatment. The agent can thus discuss medical issues with medical providers at any time while the power is effective. The principal also has the power to limit the decision-making authority of the agent in the Power of Attorney.

The Health Care Power of Attorney is thus generally regarded as a more desirable estate planning strategy.

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## WHAT IS A CONTRACTOR'S OBLIGATION TO INDEMNIFY OTHERS?

Many, if not all, construction contracts contain provisions which require a contractor to indemnify the owner and/or the other contractors on the project from the damages arising out of an injury to a person or property due to the acts or omissions of the contractor. In the recent case of *Blackshire v. Banfield*, the court addressed the issue of whether the indemnification clause of a contract required a contractor to indemnify an owner whose negligence contributed to a personal injury.

In *Blackshire*, Southern Illinois Power Cooperative ("SIPC") sought indemnity, including indemnity for SIPC's own negligence, for damages arising from a serious injury to an employee of Keith Martin, Inc. ("Martin") pursuant to Martin's contract with SIPC for electrical work at a power station owned by SIPC. It was undisputed that SIPC's own negligence contributed to the injury of the Martin employee.

The indemnity provision in Martin's contract with SIPC provided as follows:

Contractor shall defend and indemnify and save Owner and all of Owner's employees harmless from any and all claims, losses, damages, demands, suits, actions, payments, judgments, costs, and expenses, including attorneys' fees, arising or alleged to arise from personal injuries, including death or damage to property, occurring during the performance of the work and due to the negligent acts or omissions of the Contractor.

SIPC argued that if it is determined that Martin was guilty of *any* negligence which proximately caused injury to the employee, no matter how small compared to the negligence of SIPC, Martin must completely indemnify SIPC. Martin argued that the language of the contract limited Martin's indemnity obligations to a percentage equal to Martin's own negligence and did not extend to include indemnification for SIPC's own negligence.

In determining whether Martin would be required to indemnify SIPC, the court noted that in order for an indemnity provision to require the indemnification of the indemnitee's own negligence, the provision must provide for such indemnification in clear and explicit language. If there is no clear and explicit language, no such indemnification will be found.

In applying these principles to the indemnification provision in the *Blackshire* case, the court ruled the provision in the Martin contract limited Martin's indemnity to damages "due to the negligent acts or omissions of the Contractor." Such language did not extend the indemnification to negligent acts or omissions of the Owner. Rather, the provision only required the contractor to be responsible for the damages attributable to its own negligence. Thus, Martin would not be required to indemnify SIPC for SIPC's own negligence.

Indemnity provisions are material provisions of construction contracts. Contractors will seek to limit the scope of their indemnification to damages arising from personal injuries or damage to property arising from the negligent acts or omissions of the contractor. Owners may seek to expand the contractor's indemnification to cover damages arising from personal injuries or damage to property arising from the

negligent acts or omissions of any party on the job site since it is the contractor's responsibility to supervise the project, including safety procedures. Thus, it is important that both the contractor and the owner review indemnity provisions carefully to ensure that they have agreed upon the scope of the indemnity to be provided.

If you have a question about an indemnity provision in a construction contract, please telephone a member of the firm.

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From *The Lawyer Joke Book*:

One day a lawyer died and went to heaven.

When he arrived at the Pearly Gates, St. Peter asked him, "Who were you?"

The man told him, "I was a New York City divorce lawyer."

St. Peter studied the man suspiciously, and said, "We do have our standards here, you know. What exactly have you done to earn eternal happiness?"

The lawyer thought about it at great length and searched his mind for one good deed. Finally, he recalled an incident. "As a matter of fact, the other day I saw a bum on the street, and I gave him a quarter," he said, beaming.

St. Peter, nodding grimly, looked over to his assistant Gabriel and asked, "Is that in the records?"

Gabriel nodded his head in assent. Peter then said, "Well, that's not very impressive, nor is it enough. I'm sorry," he said, and turned to close the gate.

"Wait, wait, there's more!" shouted the man.

"The other night, I was walking home from the theater, and I tripped over a homeless boy. I stopped and gave him a quarter."

Peter again asked his assistant for confirmation, and again Gabriel checked the records and found it to be true. "Is there anything else?" Peter asked.

The lawyer thought hard and finally said, "No. Not that I can think of."

St. Peter contemplated him for a long moment, then asked Gabriel, "Well, what do you think we should do?"

Gabriel glanced at the lawyer disgustedly and said, "I say we give him back his half a buck and tell him to go to hell."

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