

Business Update

The Legal Newsletter For Maine's Small Business Community

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Another Effort to Amend the Bankruptcy Code

By Richard P. Olson

Last fall, both houses of congress passed different bills that would have radically altered the bankruptcy code, primarily in the area of consumer bankruptcy. The legislation went to a conference committee which was not successful in eliminating the differences between the bill before the end of the session and the legislation died.

The legislation, which was heavily supported by the credit card industry has been reintroduced and we can expect a new effort over the next year to substantially tighten the restriction on debtors in the areas of eligibility, exemptions and dischargability of certain kinds of consumer debts.

The current bankruptcy code is highly favorable to consumer debtors and 1998

was another record year in terms of the number of bankruptcy filings despite the otherwise strong economy.

Perkins & Perkins, P.A. have extensive experience in workout and bankruptcy for professional people who have undergone financial setbacks. One of the things we hear over and over again from our bankruptcy and workout clients is that they wished they had either begun workout negotiations or a bankruptcy much sooner than they did.

We cannot predict how the bankruptcy code may change over the next year; however, for some people it may be prudent to factor the possibility of changes in the bankruptcy in their plans.



The Business Specialists of Perkins & Perkins, P.A.
From upper left: Donald Perkins, Sr., David Perkins, Joleen Rice, Richard Olson.

Choice of Entity-Questions Continue

By Richard P. Olson

With the advent of the Limited Liability Company in Maine and changes in the corporate and individual tax rates, clients, lawyers and accountants continue to grapple with the questions of whether to form new businesses as LLC's, S-Corporations or C-Corporations. We do not automatically recommend one type of entity over another since each offers advantages and disadvantages.

For a period it appeared that the "entity of choice" in Maine might be the LLC; however, as tax law has developed and attorneys, accountants and their clients have developed more experience with the LLC form of business, the S-Corporation and C-Corporation forms have remained very popular choices. If the LLC has rendered anything form of business obsolete, that form would be the Limited Partnership. Additionally, I believe there is almost no one who is intentionally forming general partnerships.

In brief form the salient characteristics of the three most popular forms of business are as follows:

S-Corporation: Like all corporations, the S-Corporation has shareholders that own the equity of the business. The shareholders elect directors who manage the corporation and the directors engage one or more officers to handle the day to day operation of the business. The Corporate Veil protects the shareholders—they bear no individual liability for the debts or other liabilities of the corporation except to the extent that they contractually assume those liabilities (such as executing a personal guaranty).

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Perkins & Perkins Expands its Portland Offices

We have just completed a major renovation and expansion of our offices at 30 Milk Street in Portland. We have increased our space by adding the entire fourth floor to our existing fifth floor offices. The fifth floor will have an expanded reception area and there is new carpeting, paint, artwork and secretarial stations.

We have also upgraded all of our computers to Windows 98, added an internet connection through the superfast Roadrunner system and everyone in the office now has direct e-mail. You can now reach David, Richard and Joleen at these following addresses:

David Perkins: Dperkins@perkinspa.com
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Next in the technology sphere is our web page.

The S-Corporation, technically a corporation that elects to have itself taxed under Subchapter S of Internal Revenue Code Section 1361, has the following additional characteristics:

- Not more than 75 shareholders
- Not more than one class of share holders
- Only individual shareholders
- No non-resident shareholders
- Must elect Subchapter S status.
- Must use the calendar year as its tax year. The S-Corporation has the following tax characteristics:
 - Earnings of the corporation are not taxed at the corporate level—they pass-through the corporation and are taxed as income (or losses subject to passive loss rules) to the individual shareholders in a manner similar to the taxation of a sole proprietorship or partnership.
 - They need not use accrual method of accounting.

C-Corporation: The C-Corporation shares the same corporate governance characteristics as an S-Corporation. The C-Corporation has the following different tax characteristics:

- May use unlimited classes of stock.
- No limits on the persons or entities who may be shareholders.
- Need not use the calendar year as the tax year.
- Unlimited number of shareholders.
- Income does not pass through to the

shareholders, but is taxed at the corporate level. Thus if the corporation has taxable income, that income is taxed at the corporate level before any distributions can be made to shareholders. When the distributions are made to shareholders, those distributions are taxed again as income of the shareholders. This is known as double taxation.

LLC: The LLC is a hybrid entity designed to provide the ownership flexibility, liability protection and management virtues of a C-Corporation with the tax benefits of a partnership.

An LLC has members who are analogous to the shareholders of a corporation in that they own the equity of the business. In a member managed LLC, the members are further analogous to directors or partners in terms of their duties and responsibilities to the entity. In a manager managed LLC the members select one or more managers to manage the business and their role is more like that of a shareholder or limited partner.

In the LLC the rights and duties of the various parties are set forth in an operating agreement which is similar to a limited partnership agreement or a combination of by-laws and shareholders agreement.

At or near its formation an LLC elects whether to be taxed as a corporation or as a partnership.

Some of the tax characteristics of an LLC which elects to be taxed as a partnership are:

- Pass through to members of gains and losses.
- Members are likely to be subject to self employment tax on their share of income (subject to evolving regulations).
- Transfers of property (such as real estate) to the LLC from members and from the LLC to members are generally not taxable events.

Tax considerations do not always favor one entity over another and while the tax considerations are essential factors in any decision, people considering a new entity also need to consider governance issues.

The governance of corporations and the respective rights, duties and liabilities of directors, officers and shareholders have a long history and relatively well settled body of law which enable attorneys and clients to assess the legal risks of various courses of action. The law of LLC's is still very young and still evolving in ways, which are difficult to predict.

The state filing fees for LLC's are substantially higher than those for corporations; however those amounts are not usually significant in the long term. The legal and accounting costs for setting up simple LLCs are somewhat higher than for similar corporations.

In advising our clients we try to evaluate their business plans, their business styles and work with their tax professionals to help them choose the entity that we believe will work best for them in the long term.

Time to Refinance Your Business?

These are extraordinary times for maximizing the profitability of your business by reducing the cost of business loans.

By David J. Perkins

Within the Maine banking community, commercial bankers are in serious competition for customers. With low federal rates, banks are making good profits. As a result, banks presently want to expand their commercial loan portfolios.

The entry of banks like Citizens Bank to Maine has added an aggressive new source of capital for both commercial and real estate development loans. While former stellar lenders like Key Bank continue to miss many opportunities, Fleet Bank has re-energized its commercial lending department. Peoples

Heritage continues to demonstrate an aggressive approach to growing its commercial portfolio.

In the small or mid-sized bank category, Coastal Bank, in Southern Maine, and The First National Bank of Damariscotta, in the Mid-Coast, among others, are offering both aggressive terms and a more community based approach to lending.

With these developments, fixed interest rates in the range of 7-8% are now available to a wide range of Maine entrepreneurs.

The Maine capital market now offers non-recourse loans (no personal guarantee) for real estate holdings with sufficient equity, through firms like New England Realty. Even real estate projects or businesses with troubled pasts can access capital through firms like Pioneer Capital.

Even if you are happy with your existing bank, these developments provide you with substantial leverage to convince your lender to lower the cost of your borrowing.

There are dangers for the unwary. For instance, with these aggressive rates, banks are including substantial pre-payment penalties. Many loan quotes are also made on a variable basis, which could leave the borrower exposed with a change of economic conditions.

The real risk, though, is that you miss this historic opportunity to reduce the cost of your business debt!

Business Brokerage Services

There are times when the sale or purchase of a business or commercial real estate require specialized services that combine legal and business analysis and judgments. Perkins & Perkins, P.A. is available to provide legal business brokerage services to clients in connection with such sales or purchases—often with success-based, rather than hourly fees. If you are planning a sale involving complex issues, or are interested in acquiring a business in distress or in a "special situation", contact David Perkins or Richard Olson to discuss the services we provide in those areas.

Contracts – Building Blocks of Business

By Richard P. Olson

Contracts are not a very hot topic in the law. Criminal law, civil rights, defamation, sexual harassment and torts all have their place in the various newsmagazines, however we hardly ever see pundits discuss topics like indemnification clauses, integration clauses or choice of law provisions. Sure, there are a couple exceptions, the Car Test case and the CMP/FPL dispute being recent examples of local high profile contract cases, but the coverage is pretty limited.

You may be surprised to learn that contractual disputes account for the bulk of all civil litigation. There are tens of thousands of contract cases litigated every year. We have seen a number of contract dispute cases in this office during the past year and most could have been avoided or liability could have been sharply limited by (1) having a written contract signed by both parties and (2) following a few simple drafting principals.

You should never embark upon any business endeavor that has any significance or exposes the business to any significant liability without having a written contract in place.

You cannot prepare a contract that is foolproof or bulletproof. The most important elements of contract will always remain good faith and fair dealing; however, by taking the time to address a few basic issues you can sharply reduce your business exposure. A good (and fair) contract should not alienate customers or vendors. It should help the parties avoid conflict by properly reflecting and serving as a memorandum of their undertakings.

It is my view that each contract should, at a minimum, address the following:

Parties: Who are the parties to the contract? Are they corporations or individuals? Where is their office?

Term: What is the duration of the contract? When and how will the contract come to an end? Can parties terminate simply on notice after some period of time? Must it be written or oral? Regular mail or certified mail?

Duties of the Parties: What are the respective rights and obligations of the parties? Representations and Warranties: Has either party made any representation that the other is relying on, such as the capacity to perform the anticipate work?

Events of Default: What will constitute breach? It can be specific or general, depending on the party's trust and appetite for risk. Is substantial performance enough? Must there be a notice of the breach?

Remedies on Default: After a default what are the parties' rights? Will breach excuse performance? Will all payments become due? Will there be liquidated damages? Does the prevailing party obtain costs of collection of its damages?

Indemnification clauses: These clauses obligate one party or the other to defend and pay the liabilities of the other that arise from their conduct rather than the conduct of the party being sued. They provide essential protection from the torts of the other party.

Insurance/Bonding: Does either party have appropriate insurance to protect against the risks of the undertaking? Are you named as a co-insured to insure your protection? Did you see the insurance binder?

Choice of Law/Venue/Dispute Resolution Provisions: In the current legal environment litigation is very expensive, very uncertain and very slow. Many parties want to minimize those problems by submitting disputes to binding arbitration. Choice of law provisions determine which state law applies. If you negotiate that contract over the phone and activity takes place in California, you could end up having California law apply. Venue provisions also protect you from being hailed into court on the other side of the country. They state that where the disputes will be resolved. Normally, Maine parties prefer the Maine courts.

Integration Clauses: These clauses state the contract represents the complete agreement between the parties and that there are none of those oral representa-

tions or agreements that cause so many problems. They also state that the contract cannot be modified orally, thus providing some protection from future oral promise claims.

Signature: I am continually surprised at the number of contracts that never manage to get signed by one or both of the parties. If it is not signed it might have some evidentiary value as a reflection of the parties' intent in connection with their oral agreements, but it is not necessarily going to carry the day. The contract should be witnessed by non-parties and notarization, while not required, can be significant if there is a dispute regarding the execution.

Duplicate Originals: Each party should sign an original and each should retain an original. Yes, people do dispute signature existence and authenticity. In those contexts, an original is very valuable. Check your existing contracts to make sure they contain these provisions and make sure future contracts do and you will enhance both your business relationships and minimize your business exposure.

Does Your Lease Protect You?

By David J. Perkins

With strong demand for commercial space, this is a good time to be a commercial landlord in Southern Maine. It's also a good time to make sure your leases protect you for both good and bad times.

Too often, we find that new clients have not used appropriate leases.

For example, we recently represented a landlord in an action where the landlord was owed substantial back rent from a former tenant and the tenant claimed he was forced to leave due to excessive noise and odors. The good news is that our client won on all claims after a full trial. The bad news is that the client's lease did not call for the landlord to receive attorney's fees and costs in the event of default by tenant. If the appropriate lan-

guage had been in place, the tenant would probably never have contested the matter.

Here are a few suggestions to ensure that your commercial lease protects your interests:

- **Fixtures:** A tenant retains ownership of the personal property that goes into leasehold. However, when the personal property is attached to the real estate, the personal property becomes a “fix- ture.” Generally, the landlord wants to own the fixtures or at least control the damage done by the removal of the fixture by the tenant.
- **Taxes:** With a triple net lease, the tenant pays the taxes. If your tenant has required that the tax obligation remain with the landlord, you may want to consider a provision requiring the tenant to pay any increase in real estate taxes over the first, base year. You also want to specify that the Tenant will pay all personal property taxes due to the municipality.
- **Estoppel and Subordination:** When a commercial landlord refinances, the bank

routinely requires that an estoppel and subordination agreement be signed by all tenants. The agreements basically state that the tenant will not interfere with the bank exercising any of its rights and that rent will be paid to the bank in the event of a default. In many cases, tenants are nervous about signing lengthy and com- plicated estoppel and subordination agreements. The answer is to have a pro- vision in the lease that requires the ten- ant to promptly execute these agree- ments. Also, the landlord should have the tenant’s power of attorney to sign the agreement if the tenant refuses.

- **Indemnification/Insurance/Shifting of Risk:** Wherever possible, the Landlord wants to shift liability and risk to the tenant. Insurance clauses should provide that Tenant’s carry adequate insurance for risks associated with their business and the Landlord should be covered as well. Certificates of insurance should be provided to the Landlord. The Tenant’s insurer should also be required to notify Landlord in writing if the insur- ance is cancelled. The lease can also

have provisions protecting Landlord from unexpected events like bursting of pipes or environmental hazards from other parties.

- **CAMS:** With leases involving charges to tenants for common area expenses, the lease should provide a broad and detailed definition of expenses that can be charged to the tenant. For example, with larger commercial leases, the Landlord’s management expense can reasonably be charged entirely to the tenants.
- **Default Provisions:** The lease should provide an expansive definition of dam- ages allowed to Landlord in the event of default. For example, the Landlord should recover any brokerage commis- sions or improvement costs he has to pay in the process of re-letting the property. Attorney fee and late fee provisions are critical. Also, mandatory arbitration may be useful for landlords who want to avoid protracted disputes.

If you are a commercial tenant, we have similar advice. See us now to make sure your lease interests are protected.



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