

## BOB THOMPSON REMEMBERED

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American Academy of Matrimonial Lawyers, and other family law lawyers groups. When the first issue of *The Best Lawyers in America* was published, his name was there and it remained there every year thereafter until he retired in 1990.

Bob had a quick, imaginative and deeply analytical mind. He could cut through to the heart of a complicated issue very quickly and he had a knack for solving problems. His mediation talents were recognized long before the term “alternative dispute resolution” became popular, and he was frequently asked by lawyers in difficult cases to act as mediator to bring the parties together rather than to sunder them apart. He also sat as Judge Pro Tem in many cases and was hired in many other cases as a private judge to decide very thorny issues.

Bob was beloved not only by his personal family but also by his other family here at the firm. Bob mentored many of the younger lawyers and he could always be counted on for sound advice and for an insightful answer. We here at the firm are all better for having known him, for having worked with him, and for having been taught by him how to be excellent lawyers. We are grateful for his life and all that he bestowed on us, on his family and on the community in general.

## COMMONLY ASKED QUESTIONS

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Seller wants \$20 million for all stock of his Company because the future potential of the business is very promising – a new product being launched that appears to be a major winner. The Buyer, on the other hand, believes that since the Company has not demonstrated that it can deliver such high growth rates, the future is uncertain and can only justify paying \$10 million. The Buyer may then say, “I’ll pay you \$10 million now and if you achieve your sales and profit projections in the next five years, I will pay you 50% of the Company’s profits up to a maximum of \$10 million.” You then have an Earn Out.

An Earn Out is a key vehicle for sharing risk in mergers and acquisitions. The Earn Out is riskiest to the Seller because the price is tied to future earnings and is contingent on unforeseen events. But in return for accepting this risk, the Earn Out should provide the potential for a higher selling price than would otherwise be possible.

An Earn Out makes sense for the seller of a business that is on the verge of a major increase in sales and productivity. If the firm is still not produc-

ing much profit, a buyer would be reluctant to pay a great deal. However, if the firm delivers on its potential, the Earn Out offers the Seller some great upside potential.

Sometimes, the Earn Out may be the only way to sell a business that is heavily dependent on the Seller’s knowledge of proprietary technology or key customer relationships. The Earn Out could be used to motivate the Seller to stay around and manage the business to achieve the projected performance for his financial benefit as well as the Buyer’s.

*Denny S. Roja is a member of Carr, McClellan’s Corporate and General Business Group.*

## PITFALLS

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appointment or election occurs before the expiration of the two-year period. For bankruptcy cases filed before October 22, 1994, Ninth Circuit case law has recently made it clear that actions to avoid preferential transfers must be commenced two years from the date the bankruptcy case is filed, unless a Chapter 11 trustee is appointed or elected within that two-year period at which point it is two years from the date the Chapter 11 trustee was first appointed or elected.

Bankruptcy issues can be complex, especially those involving avoidable transfers. Questions regarding this issue may be directed to the Creditor’s Rights and Bankruptcy Department at Carr, McClellan.

*Moina C. Walsh is a member of Carr, McClellan’s Creditors’ Rights and Bankruptcy Group.*

## SUBLEASE SURVIVES

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provision in the Lease stating that it does. The *Chumash* decision illustrates the importance of including language in a sublease providing that sublessee has the right to cure lessee’s breach to protect sublessee’s right to possession under the sublease.

*Wendy L. MacIhwaine is a member of Carr, McClellan’s Real Estate Group.*

**NOTE: If you have any general questions that you would like answered in *Perspectives*, please direct your calls to Maritsa Chew at (415) 696-2589. We will try to address them in a future issue.**

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CARR, McCLELLAN, FOUNDED IN 1945, HAS OFFICES IN BURLINGAME AND SAN FRANCISCO. THE FIRM PROVIDES FULL-SERVICE LEGAL ADVICE TO MANY CLOSELY-HELD BUSINESSES AND MAJOR CORPORATIONS IN THE BAY AREA’S LEADING INDUSTRIES, AS WELL AS TO INVESTORS AND FAMILIES.

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STRATEGIES  
FOR  
BUSINESS

## NON-DEDUCTIBLE PERSONAL INTEREST OR DEDUCTIBLE BUSINESS EXPENSE

*By Lage E. Andersen*

Section 163(h) of the Internal Revenue Code says that “personal interest” paid by a taxpayer other than a corporation is not deductible. The Legislative history of Section 163(h) says that “personal interest also generally includes interest on tax deficiencies.” Since 1986, the IRS has taken the position that any interest paid by an individual on a tax deficiency is not deductible. The Tax Court recently decided that because of the word “generally” in the legislative history, interest on a tax deficiency that is properly allocable to a trade or business is deductible “above the line” as a business expense. The taxpayers operated a business as sole proprietors and the tax arose because of a change from the cash method to the accrual method of accounting. The case is *Redlark v. Commissioner* 106 TC No.2, (1996). The IRS will probably appeal to the Ninth Circuit.

Advice:

1. If you paid interest on a tax deficiency that might be “allocable to a trade or business” and the period of limitation on filing a claim for refund is still open for the tax year that you paid the interest, file a protective claim for refund while this issue gets sorted out in the courts. A tax refund claim must be made by the later of (1) three years from the date the return was filed or (2) 2 years from the time the tax was paid.

2. If you paid interest on a tax deficiency in 1995 “allocable to a trade or business”, then deduct the interest on your tax return. To avoid a penalty if the Tax Court decision is reversed, you may want to file Form 8275-R and disclose the deduction to the IRS.

(further tax strategies on page 2)

## BOB THOMPSON REMEMBERED

Robert R. Thompson died on October 8, 1995, just as the last issue of *Perspectives* was going to press. The short death notice which we were able to squeeze into the last issue did not begin to do justice to Bob’s outstanding career with this firm and to the wonderful life he lived in this community.

Bob joined this firm in 1949 just after graduating from Stanford Law School. He was the fourth lawyer in the firm and immediately plunged into a general practice which included a lot of litigation, a lot of real estate, and a miscellany of other matters. He liked to call himself the “Utility Infielder” in the firm and for many years this was very true. Early on, his outstanding talents became very apparent. He was a superb litigator and an outstanding real estate lawyer. Those early years of his practice were very exciting as something new was happening on the Peninsula almost every day.

Bob and his wife, Doris, and their family (at that time, only two daughters) had settled in Millbrae and had become very active in the community. In the early 1950’s, Millbrae asked Bob to become its City Attorney, an assignment which he undertook with enthusiasm. Bob would work hard here at the office all day and then sit through long evening meetings of the City Council or Planning Commission and yet be ready to go again early the next morning. He was City Attorney when some of the most important issues facing Millbrae were being decided, including the development of the Mills Estates area and the location of what would ultimately become the 280 freeway.

Bob and Doris’ family grew with the birth of their first son in 1953 followed shortly thereafter by two more sons and finally, in 1960, by the sixth child, Robert Jr. As Bob’s family grew, so did his stature in the legal profession and in the community. He was elected President of the San Mateo County Bar Association, became active in the State Bar, gave many talks to lawyers and lay groups and wrote many articles for legal publications.

In the early 1960’s, he began to specialize in family law. And it was with that specialty that he became most closely identified. He developed a well-earned reputation as one of the leading family law lawyers in California, was active in the (continued on page 8)

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## NEW LAW - STATES CANNOT TAX PENSION INCOME OF FORMER RESIDENTS

On January 10, President Clinton signed a new law that stops a state from taxing the retirement income of a person who is not a resident of that state. This bill applies to payouts after 1995 from nine specified types of retirement arrangements:

1. Qualified pension plans, including 401(k) plans;
2. Simplified Employee Pensions (SEP);
3. 403(a) annuities;
4. 403(b) annuities;
5. IRAs;
6. Deferred compensation plans of governments and exempt organizations under §457;
7. Governmental retirement plans;
8. A 501(c)(18) trust; and
9. Non-qualified deferred compensation plans meeting certain requirements.

## TAXATION OF DAMAGES - A FOLLOW UP

In the last *Perspectives on Law*, we reviewed the taxation of payments for damages received because of personal injury or sickness. The House and Senate passed a tax bill last November that President Clinton vetoed. The tax bill included two major changes in this area:

1. All damages for non-physical injuries such as emotional distress would become taxable; and
2. All punitive damages would be included in taxable income.

It is uncertain whether (and when) these proposals will be enacted into law. Advice: For maximum tax advantage, settle lawsuits that involve claims for emotional distress as soon as possible.

The IRS says that punitive damages are not excludible from gross income because they are not intended to compensate for personal injuries. The courts are agreeing with the IRS's position. Advice: In settlement of a lawsuit, avoid allocations of payments to punitive damages.

*Lage E. Andersen is a member of Carr, McClellan's Tax Group.*

## ESOP - A TAX ADVANTAGED VEHICLE FOR FINANCING AND LIQUIDITY

*By Denny S. Roja*

Picture the business owner with a classic dilemma. The owner is approaching retirement. He is beginning to think of ways of getting some money out of the business. A public offering of his stock is not feasible. The industry he is in is quite unglamorous. Its sales and earnings are growing steadily but unspectacularly. He really would rather not sell the company, preferring that it remain independent. Besides, he would rather pass it on to his many loyal workers. The solution - an Employee Stock Ownership Plan (ESOP).

An ESOP is many things to many people. It is a technique of corporate finance, a method of shielding taxes, a way of transferring ownership to employees, a key tool for motivating employees to achieve higher performance levels and a major path to liquidity for business owners - all rolled into one.

### **Financing Vehicle**

An ESOP can be used as a financing vehicle. As a technique of corporate finance, the ESOP can be used to raise new equity capital, to refinance outstanding debt or to acquire assets through leveraging with third party lenders. It is as close to "cheap" money as one can get. However, an ESOP is mandated by law to invest its contributions primarily in stock of the sponsoring employer.

It is also the only qualified employee benefit plan which is permitted to borrow funds on employer credit in order to acquire employer stock.

### **Tax Benefits**

Congress designed ESOPs to provide tax breaks for sellers, buyers, and the bankers who finance such deals. Its intent was to preserve economic stability within communities and encourage wider distribution of wealth.

## **ABOUT OUR PEOPLE**

### IN OUR PROFESSION . . .

#### STEVEN D. ANDERSON

The firm is pleased to announce the election of Steven D. Anderson to Director effective January 1, 1996.

Having begun his career in law by concentrating in the representation of closely-held businesses, Mr. Anderson counsels clients of all ages with the goal of matching the special needs of clients and their families with proper estate, trust law and gift tax planning documents and strategies.

Currently the President of the American Lung Association of San Francisco and San Mateo Counties, Mr. Anderson has long been active in many civic and charitable organizations. He is a graduate of University of California, Boalt Hall and received his undergraduate degree from the University of California, Berkeley, Magna cum laude.

Mr. Anderson recently passed the State Bar specialization exam for Estate Planning and Probate Law.

#### LAURENCE M. MAY

Real Estate Director, Laurence M. May began serving a four year term as a member of the publicly elected Hillsborough City School District Board of Trustees.

#### MOIRA C. WALSH

Moira Walsh, a Director in the firm's Creditor's Rights and Bankruptcy Group was appointed to the firm's Executive Committee.

#### W. GEORGE WAILES

W. George Wailes, a Director in the firm's Litigation Group, is currently serving on the San Mateo County Advisory Board for the Arthritis Foundation.

"THE CHUMASH DECISION ILLUSTRATES THE IMPORTANCE OF INCLUDING LANGUAGE IN A SUBLEASE PROVIDING THAT SUBLESSEE HAS THE RIGHT TO CURE LESSEE'S BREACH TO PROTECT SUBLESSEE'S RIGHT TO POSSESSION UNDER THE SUBLEASE."

He was recently appointed to the Bench/Bar and Community Relations Committees and as a Delegate to the State Bar Convention for the San Mateo County Bar Association.

Additionally, Mr. Wailes is serving as Co-Chair of the Hastings Trial Advocacy Program.

#### JAMES R. CODY

A Director in Carr, McClellan's Estate, Financial Planning and Probate Group, Mr. Cody was appointed in January, 1996 to a three year term as a member of the Board of Trustees of the Mills-Peninsula Hospital Foundation.

In June, Mr. Cody will become a member of the Board of Directors of the California Affiliate of the American Heart Association.

#### ELIZABETH A. FRANKLIN

Elizabeth A. Franklin, Director and Chair of the firm's Employment Law Group, was appointed to the Board of Directors of the Burlingame Chamber of Commerce. Additionally, Ms. Franklin is serving as Secretary/Treasurer to Queen's Bench and is serving another term as Chair of the Labor and Employment Law Section of the San Mateo County Bar Association.

#### LISA H. STALTERI

Lisa H. Stalteri was named Chairperson of the Real Estate Section of the San Mateo County Bar Association; was appointed to the Environmental Committee of the Probate and Estate Planning Section of the California Bar Association and was appointed to the Environmental Controls Subcommittee of the Business Section of the American Bar Association.

Ms. Stalteri is a Director in the firm's Real Estate Group.

#### DENNY S. ROJA

Denny S. Roja, a member of the Corporate and General Business Group, addressed the First Pan Pacific Microelectronics Symposium in Honolulu, Hawaii on February 8, 1996. He spoke on the topic of mergers and acquisitions and strategic alliances for technology companies.

holder to transfer assets to a trust inadvertently left out of the trust at the time of its creation.

The law of agency (and not the law of trusts) defines an agent's authority under a durable power. Anyone may be appointed as an agent, and persons so appointed have a fiduciary duty to diligently serve the principal. It is important to remember that an agent may only make gifts on behalf of a principal if the power to make such gifts is specifically mentioned in the durable power.

The estate and gift tax implications of a durable power from the agent's perspective must also be considered, since by giving an agent unfettered authority to manage the principal's assets, the assets may be included in the agent's estate for estate tax purposes, and thus subject to double taxation. This important aspect of durable powers is often ignored.

Durable powers for property management should not be confused with Powers of Attorney for Health Care Decisions (also often called "living wills") which pertain solely to personal health and life support decisions. (A discussion of health care powers is beyond the scope of this article.)

Under a property management power, two or more persons may be named as agents, and may act either jointly or severally depending on the terms of the power.

Because the agent under a Power of Attorney has the authority to act on behalf of the principal without supervision by a court or anyone else, and because the acts of the agent are binding upon the principal, it is essential to give careful thought to the selection of the agent; not only should the agent be a trustworthy person, but he or she should also be someone who has the experience and expertise to handle the assets of the principal. Powers of attorney for property management are extremely important documents and should never be created without careful thought and consideration.

*Steven D. Anderson is a member of Carr, McClellan's Estate, Financial Planning, and Probate Group.*

## REAL ESTATE

### SUBLEASE SURVIVES TERMINATION OF MASTER LEASE

*By Wendy L. MacIlwaine*

A recent California Court of appeals decision reaffirms a subleasee's right to continue its sublease even after the master lease has been terminated. In Chumash Hill Properties, Inc., v. Peram (1995) (39 Cal.App.4th 1226), the sublessor defaultee under a master lease by failing to pay rent. The sublessor then filed for Chapter 11 bankruptcy and rejected the master lease causing its termination. The master lessor Peram, shortly thereafter served Chumash Hill Properties, the sublessee, with a 30-day notice to quit the premises.

Pursuant to the language of the master lease, Chumash, if not in default under its sublease, had the right to notice and an opportunity to cure sublessor's breach after receiving notice of that breach. Also, if sublessor's breach is not curable, or if Chumash cures sublessor's breach, Chumash's use and possession of the property cannot be disturbed by Peram.

Chumash never received notice of sublessor's default and therefore did not have the opportunity to cure the default. Sublessor's subsequent rejection of the master lease in bankruptcy proceedings was a noncurable default. Therefore, because Peram never sent Chumash notice of sublessor's default, and because sublessor's rejection of the master lease in bankruptcy court was a noncurable default, Chumash was entitled to retain possession of the Premises.

In the Chumash decision, the court reaffirmed the position long held under California law that a Lessee's surrender of a master lease will not terminate a sublessee's sublease without a  
*(continued on page 8)*

Under the right circumstances, ESOPs offer benefits that companies and entrepreneurs cannot get anywhere else. Since contributions to an ESOP are fully tax-deductible, an employer can fund both the principal and the interest payments on an ESOP's debt service obligations with pre-tax dollars. An employee is not taxed on contributions to and income earned, e.g. cash dividends, by his ESOP account until his benefits are actually received.

The selling owner, on the other hand, is exempt from the capital gains tax provided that proceeds of the sale are invested in domestic corporate securities within a year.

#### Employee Ownership

Research has shown that most employees take ownership seriously. When treated like owners, they tend to respond accordingly and the company's performance benefits. They have been shown to raise the expectations of employees and the experience can be very positive.

#### Employee Benefit

An ESOP is an employee benefit plan which is qualified for tax-favored treatment under the Internal Revenue Code. As a benefit plan, ESOPs are governed by many of the same restrictive laws that govern other qualified deferred compensation plans. An ESOP, like most employee benefit plans, is generally designed to benefit employees who remain with the employer the longest as ownership interest are usually based on number of years of employment.

#### Path to Liquidity

Perhaps the dominant reason for implementing an ESOP in a company is liquidity. Owners of small, privately held companies usually install an ESOP to create some form of internal market for their stock. To some well-established, profitable private firms, the ESOP provides a way of cashing out without going public or selling the company.

As a tool of corporate finance, it possesses significant flexibility and in recent years, companies have increasingly used ESOP financing to accomplish a wide variety of corporate

## CONGRESS

DESIGNED  
ESOPs TO  
PROVIDE TAX  
BREAKS FOR  
SELLERS,  
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objectives, including mergers and acquisitions.

The economic advantages of an ESOP are most prominent in the buy-out of an owner or major shareholders. Using the ESOP to buy the shares of principal shareholders is preferred over direct redemption by the company. The company's contribution to the ESOP is tax-deductible so that the stock purchase is accomplished with pre-tax dollars, thus conserving the company's cash and net worth. Selling shareholders receive capital gains treatment on the sale of their stock to an ESOP. Conversely, having the shares redeemed results in a distribution that is generally treated as a dividend to the selling shareholder.

#### How does it work?

After an ESOP is formed, it takes out a loan to purchase the owner's stock. The company contributes a portion of its pre-tax profit to the ESOP which gradually pays off the principal and the interest on the debt, allocating the paid-for shares to the employees' accounts. The IRS considers half the interest income the lender earns on the ESOP loan to be taxable so that the lender can charge the ESOP a lower interest rate.

Initially, the owner would sell 30% to 50% of his stock to the ESOP, depending on the company's ability to finance out of cash flow or collateralize with bank debt. A third party valuation establishes price. Over time, the owner sells his remaining shares to the ESOP.

Upon retirement, death, disability or termination, the employee's account is distributed to him or his beneficiary in shares of stock or in cash. However, to avoid having much stock being owned by outsiders or former employees, an ESOP may tend to make distributions solely in cash, provided the company's bylaws allow it.

#### Is an ESOP for your company?

For all its apparent advantages, an ESOP is not for everyone. For every ESOP that works, there is one that doesn't. The key is to know when it is appropriate and when it is not. Certain practical guidelines must be observed:

• For one, they can be expensive. To set it up would cost in the \$20,000 range. Total fees can run up to \$100,000 including legal, appraisal, and financial consulting. Unless a company is able to afford the costs and take full advantage of the tax breaks, it usually does not pay to have one.

• An ESOP is for profitable, well-established companies. Those with major financial difficulties should not consider an ESOP, nor can tiny businesses or startups or companies in decline. Assets should be largely unencumbered and cash flow must be strong so the debt can be serviced.

• An ESOP must be carefully planned and taken seriously. The plans are expensive and cumbersome and if inadequate attention is given, they can backfire.

• Companies in which key management is not expected to remain after the owner leaves are not suitable for an ESOP buy out. A strong management team is needed to keep the company afloat as it pays down the ESOP debt.

• Businesses with high employee turnover are likewise unsuitable because of the need to buy out the stock of departing employees thus necessitating cash outlays. In addition, the paperwork associated with frequently buying back stock of departing employees can be overwhelming.

• There can't be too many employees near retirement age because ESOPs must reserve funds for buy out of fully vested employees.

• The Company must have a certain number of employees and they must have high wages because the company's annual contribution to the ESOP is limited to 25% of the total payroll. Experts believe that an ESOP is not cost effective until the company has about 20 employees.

• The selling owner or shareholder is generally required by the bank to personally guarantee a portion of the debt. This requirement may not be an issue if the shareholder is convinced that the company remains financially viable and the ESOP will truly motivate employees.

For the healthy company, with strong potential for future earnings and cash flow, an enlightened owner and motivated employees, the benefits of an ESOP can be enormous indeed.

*Denny S. Roja is a member of Carr, McClellan's Corporate and General Business Group.*

## COMMONLY ASKED QUESTIONS REGARDING THE MERGER OR SALE OF A COMPANY

*By Denny S. Roja*

From time to time, clients and prospective clients ask us questions that are important to them in solving day-to-day business and personal problems. Following are two questions in the area of a merger or sale of a company.

Q. In selling my Company, what are the different ways by which the transaction can be structured?

A. One of the most important decisions in an acquisition is how you structure it. The acquisition structure controls what the Buyer buys. There are three basic structures:

1. A merger
2. A purchase of stock
3. A purchase of assets

A merger is the simplest mechanism for acquiring another company. In a merger whereby one company is merging with another company, the two companies unite – that is, put their assets and liabilities together and by operation of law, they are married. One entity survives and receives all the assets and liabilities of the non-surviving one, including unknown liabilities. The merger is accomplished by the exchange of shares by the shareholders of each company. There is one key rule to be allowed as a merger – at least 50% of the consideration must be in stock.

A stock purchase is typically used when there are few shareholders of the Seller. The Buyer simply acquires the stock of the Seller from the shareholders. The Seller then becomes a subsidiary of the Buyer.

An asset purchase is one in which the Buyer simply buys certain or all of the assets and assumes some of all known liabilities of the Seller. He can pick and choose. The advantage for the Buyer is that he does not take over any unknown liabilities. Since individual assets are being bought, this tends to be complicated and messy.

The deal structure and form of consideration used determine whether the transaction is taxable or non-taxable to the company and to the selling shareholders. Cash usually triggers taxes. Stock generally does not. Debt is tax deferred until paid.

Q. In the context of a merger or acquisition, what does the term Earn Out mean?

A. If the Seller and the Buyer are far apart in their respective valuations, then an "Earn Out" may be a good way of bridging the gap. Let's say the  
*(continued on page 8)*

## AVOIDING BANKRUPTCY PITFALLS

*By Moira C. Walsh*

Whether you are an individual or a business, the chances of having some involvement in a bankruptcy case have increased dramatically in the last few years. Unfortunately, in today's economic climate, it seems that every organization has had at least one experience filing a proof of claim in a bankruptcy case or even receiving a demand for turnover of a preferential transfer. Whether you are a debtor or a creditor, bankruptcy is hardly a pleasant experience. However, knowledge and resources can be a great benefit when you find yourself owed money from a debtor in bankruptcy.

Demands for turnover of preferential transfers are more and more common. Generally, a preferential transfer is a payment or transfer made by a debtor to a creditor, based on a past due debt, made in the 90-day period prior to the debtor's bankruptcy, which caused the creditor to receive more than such creditor would have received if the debtor had been in bankruptcy at the time or if the transfer had not been made at all.

Preferential transfers are *avoidable*, meaning that a bankruptcy trustee or debtor-in-possession can commence an action against you for the turnover of any payments or transfers that you received from the debtor in the 90-day period prior to the debtor's bankruptcy filing. The idea is that there were other creditors that did not get paid in that 90-day period, and that if you got paid, you were preferred over other creditors, and thus should return the payment so that it can go into the pot from which all creditors can get paid. There are ways you can protect yourself from receiving an *avoidable* preference. Receiving payment for goods on a C.O.D. basis is an example. Further, Bankruptcy law provides certain defenses to the *avoidability* of a preferential transfer. These include the new value defense, contemporaneous exchange defense, and the ordinary course of business defense. You should also be aware that recently, case law and amendments to the Bankruptcy Code have fine-tuned the time period in which the bankruptcy trustee or debtor-in-possession can commence an action to *avoid* a preference. For those bankruptcy cases filed after October 22, 1994, actions to *avoid* preferential transfers must be commenced within two years from the date the bankruptcy case is filed, or one year after the appointment or election of the first trustee in a bankruptcy case, if such  
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FAMILIES  
&  
INDIVIDUALS

## USING DURABLE POWERS OF ATTORNEY AS PLANNING TOOLS

*By Steven D. Anderson*

Structuring the grant of authority to manage assets in the owner's absence or disability is an important aspect of estate planning. A durable power of attorney for property management allows the creator of the power (the "principal") to designate an agent to act on the principal's behalf with respect to asset management decisions.

Durable powers can be structured to be effective immediately, or to come into effect on the subsequent incapacity of the principal (a "springing power"). In the case of a springing power, certifications by one or more of the principal's physicians is often required to document the principal's incapacity.

Although third parties such as banking institutions and title companies are often reluctant to accept the authority of an agent acting under a durable power of attorney, under recently enacted California legislation, third parties are liable for attorneys' and court fees and costs associated with enforcement of statutory form powers if such parties unreasonably refuse to accept an agent's authority. Thus, the California legislature has strengthened the effectiveness of durable powers.

Under a durable power of attorney, the authority of an agent extends over a broad array of transactions, including not only payments on behalf of the principal, but purchases and sales of assets, refinancing, handling litigation, and even gifts of the principal's assets. Powers of attorney may also be narrowly tailored to grant authority to an agent to act only with respect to specific properties or transactions; such powers are commonly referred to as "special" or "limited" powers of attorney.

Because a durable power of attorney expires upon the death of the principal, such powers may not be used by the agent following the principal's death to effect post-death transfers of the principal's assets. During the principal's lifetime, however, a durable power is an effective way to allow another person to manage the principal's assets, thus avoiding a conservatorship, or the need to create a trust.

In addition to use as "trust substitutes," durable powers are often used in coordination with the creation of a living trust, and may allow the power

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