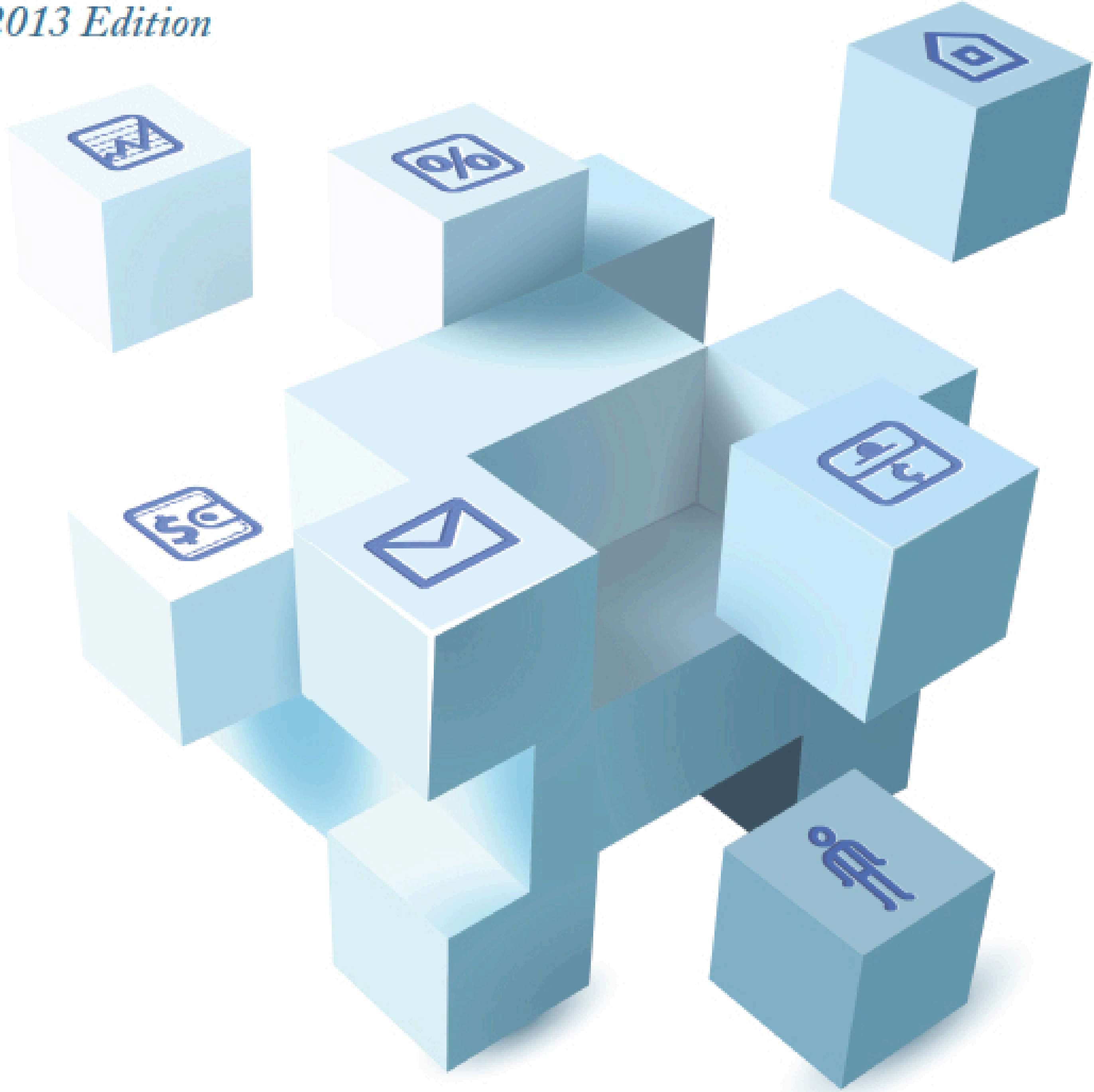
Legal Basics for Small Business

2013 Edition



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OHIO STATE BAR ASSOCIATION

Legal Basics for Small Business
2013 Edition

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The Ohio State Bar Association (OSBA) is pleased to offer *Legal Basics for Small Business*, designed especially for small business owners in Ohio who are looking for basic legal information. Presented in an easy-to-read question-answer format, this handbook is a compilation of individual articles written and edited by more than 140 Ohio lawyers who volunteered their time and effort.

While this text does not pretend to be comprehensive, and in no way replaces the texts provided by the Ohio Chamber of Commerce or the advice of an attorney, *Legal Basics for Small Business* provides an overview of some of the major issues you can expect to confront each day as you launch and seek to maintain your business. Remember, however, that the law is constantly changing, and some of the legal interpretations in this text may be misleading or erroneous. Before applying any of this information, readers are urged to seek advice from an attorney.

The OSBA invites your comments and suggestions to improve future editions of this publication. Please send your comments to: OSBA Public Relations, P.O. Box 16562, Columbus, OH 43216-6562.

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Business Start-Up

Chapter 1

How to Begin: Checklist for Forming an Ohio Corporation

1) Call the Ohio Secretary of State at (614)466-3910 or toll free at (877)767-3453 to determine if the proposed corporate name is acceptable. It is possible to email the Business Services Division from the Ohio Secretary of State's website at www.sos.state.oh.us/sos; click "business filings," and you can conduct your own search on the Ohio Secretary of State's website. The proposed name must be "distinguishable upon the records" of the secretary of state. A name is not considered to be distinguishable from another name if the only difference is:
   a) reversing of words (*e.g.*, Fast Copy, Copy Fast);
   b) use of Arabic numbers or Roman numerals (*e.g.*, Jim's Sales I, Jim's Sales II);
   c) use of possessives (*e.g.*, Thompson Auto Body, Thompson's Auto Body);
   d) phonetic spelling (*e.g.*, Quick, Kwik).

2) Determine availability of the proposed corporate name in any other states in which the business will operate.

3) File the articles of incorporation with the Ohio Secretary of State, Business Services Division, P.O. Box 670, Columbus, Ohio 43216. Expedited filing is permitted by paying an additional $100 fee and sending the articles and the fees to: Secretary of State, P.O. Box 1390, Columbus, Ohio 43216.
   a) You must use Secretary of State Form 532A.
      1) The name of the corporation must end with "Company," "Co.," "Corporation," "Corp.," "Incorporated," or "Inc."
      2) The articles must indicate the corporation's principal office—city, village or township and county.
      3) The articles must state the number of authorized shares that can be issued and their express terms. NOTE: The number of shares authorized determines the filing fee.
      4) If the corporation plans to have an initial stated capital, it must be included.
      5) You may appoint the initial board of directors in the articles.
      6) The articles must be signed by all incorporators.
   b) The Original Appointment of Agent is included in the Secretary of State Form 532A.
      1) The statutory agent must acknowledge and accept the appointment.
      2) The statutory agent's address must contain a street address and zip code. Post office boxes are not acceptable unless the statutory agent is an individual and checks a box to certify that he or she is an Ohio resident.
   c) The filing fee must be in the form of a check made payable to the secretary of state. The minimum fee for filing the articles is $125. This minimum fee permits the issuance of 1,500 shares. See *Ohio Revised Code* Section 111.16(A)(2) for the appropriate filing fee if more than 1,500 shares are to be issued. The filing forms and fee schedule on the Ohio Secretary of State website also contain a form to determine share-based fees.
   d) The Ohio Secretary of State's office will not return the articles after filing. Send a photocopy of the articles and retain the original articles. A scan of the filing will also be accessible on the website after processing.

4) Incorporators, or the directors if named in the articles, should start a corporate minute book by acknowledging the filing of the articles and including the original of the filed articles.
    a) Incorporators, or the directors if named in the articles, should authorize the issuance of shares.
    b) The investors should sign a *subscription agreement*, the agreement in which the investor agrees to buy the shares for a given price.
    c) The incorporators, or the directors if named in the articles, may set the value of non-cash assets in payment of the subscriptions.
    d) The incorporators, or the directors if named in the articles, accept the subscriptions.
    e) The incorporators must give notice of the first shareholders' meeting.

5) Consider electing a "Subchapter S" corporation status for federal and state tax purposes. See Sections 1362 <u>et</u> <u>seq</u>. of the *Internal Revenue Code*.
    a) Use IRS Form 2553. File with the Internal Revenue Service Center, Cincinnati, Ohio 45999, within the 16th day of the third month of the beginning of the tax year.
    b) Shareholders and the corporation must file a notice of the subchapter selection with the Ohio Department of Taxation.

6) If the business will operate under a name other than its corporate name, a fictitious name must be filed on Form 534A (Name Registration) with the Ohio Secretary of State, P.O. Box 670, Columbus, Ohio 43216. There is a $50 fee to file this form.

7) A trade name may be registered with the Ohio Secretary of State by completing Form 534A and sending it, along with a $50 filing fee, to the address provided above in item 6.

8) Make sure your business complies with the Ohio securities laws. The most common exemption from the Ohio registration requirements for small businesses is a small business equity investment to ten or fewer investors (*Ohio Revised Code* Section 1707.03[O]). To comply with this exemption, the subscription agreement must include statements that: 1) the purchaser is aware that no market may exist for resale of the securities; 2) the purchaser is aware of any restrictions on transfer of the securities; and 3) the purchaser declares that the purchase of equity is for investment purposes and not for redistribution. If there are non-Ohio investors, check with their resident state security regulator.

9) Make sure your business complies with federal securities laws. Registration is required unless an exemption is available. Following are the two most common exemptions for small businesses:
    a) Intrastate exemption (see Securities and Exchange Commission Rule 147);
    b) Private placement exemption (see Regulation D of the Securities and Exchange Commission).

10) Obtain the taxpayer identification number from the Internal Revenue Service. Submit Form SS-4. See the procedure set forth on the IRS website: www.irs.ustreas.gov. Note that any person filing a Form SS-4 other than a corporate officer must be designated as the Third Party Designee on the Form SS-4. To handle any other tax matters for the corporation, a person must also file Form 2848 with the IRS.
    a) By filing the Form SS-4, the corporation is automatically pre-enrolled in the Electronic Tax Payment System.
    b) By filing the form SS-4, the corporation will receive the IRS Circular E Employee's Tax Guide – Forms for Payroll.

11) Take the following action at the first shareholders' meeting or by written consent of all shareholders.
    a) Elect directors.
    b) If the directors named in the articles have not done so, the shareholders should adopt the code of regulations for the internal government of the corporation.
    c) Consider adopting a close corporation agreement (see *Ohio Revised Code* Section 1701.591).
    d) Set value for any non-cash payments by investors to the corporation.
    e) Consider adopting a shareholder's buy and sell agreement.
    f) Set the fiscal year for the corporation.

12) Take the following action at the first meeting of the board of directors or by written consent of all directors.
    a) Elect officers.
    b) Set up a bank account by adopting a bank-provided resolution.
    c) Consider adopting benefit plans.
    d) Consider adopting group term life insurance plan (see *Internal Revenue Code* Section 79).
    e) Consider adopting accident and health insurance plan (see *Internal Revenue Code* Section 105[b]).
    f) Consider adopting medical reimbursement plan (see *Internal Revenue Code* Section 105[b]).
    g) Consider adopting a death benefit plan (see *Internal Revenue Code* Section 101[b]).
    h) Consider adopting a Section 1244 plan. This allows the stockholders to take an ordinary tax loss rather than a capital loss if the business fails and the stockholders lose their investment (see *Internal Revenue Code* Section 1244).
    i) Adopt a resolution for leasing business space.
    j) Adopt a resolution for the purchase of any real estate.
    k) Set compensation of key employees.

13) Consider requiring key employees to execute employment agreements with covenants not to compete.

14) Issue stock certificates or transaction statements for paid shares.

15) Consider adopting policies about the following issues to protect the company, the directors and the executives:
    a) sexual harassment;
    b) non-discrimination;
    c) trade secret protection;
    d) company ethics (*e.g.*, corporate gifts, anti-kickbacks);
    e) email, computer and Internet use;
    f) compliance with environmental laws;
    g) compliance with the anti-trust laws;
    h) compliance with the worker safety rules;
    i) development of procedures to prevent hiring of illegal aliens; and
    j) political contributions.

16) Obtain the following posters to be placed conspicuously in the workplace:
    a) Ohio Civil Rights (contact the Ohio Civil Rights Commission, Education and Community Relations, 111 East Broad Street, 3rd Floor, Columbus, Ohio 43205-1371);
    b) Fair Labor Standards Act – Minimum Wage poster;
    c) Employee Polygraph Protection Act – poster advising employees of federal rights when confronted by a request from an employer to undergo a lie detector test;
    d) rights of employees under the Family and Medical Leave Act poster;
    e) posted notice of company's anti-discrimination policy and anti-harassment policy (sex, race, national origin, etc.);
    f) Federal Occupational Safety and Health Act (OSHA) poster (states the rights of employees under OSHA);
    g) Federal Equal Employment Opportunity Commission poster;
    h) Ohio Wage and Hour requirements poster (See website: www.com.ohio.gov/laws/docs/dico_2013MinimumWageposter.pdf).

17) Become an Ohio income tax withholding agent. File Form IT-1, Application for Registration as an Ohio Withholding Agent, with the Ohio Department of Taxation. See the Ohio Business Gateway for Electronic Filing (http://business.ohio.gov/efiling) or the Ohio Department of Taxation (http://business.ohio.gov).

18) File Form JFS 20100, Report to Determine Liability (Unemployment Compensation), with the Ohio Department of Job and Family Services, Contributions Section, P.O. Box 182404, Columbus, Ohio 43218-2404, or go to Ohio Business Gateway (http://business.ohio.gov) or the Ohio Office of Unemployment Compensation (www.jfs.ohio.gov/ouc).

19) File Form U-3 Application Coverage with the Ohio Bureau of Workers' Compensation. It is possible to apply online. See www.ohiobwc.com.

20) File the commercial activity tax registration Form CAT-1 with the Ohio Department of Taxation (www.tax.ohio.gov).

21) Obtain a vendor's license. This is needed for compliance with Ohio sales tax on goods and services. Use www.tax.ohio.gov/sales_and_use/license.aspx to obtain the account online.

22) File Form JFS 07048 with the Ohio New Hire Reporting Program by mail at P.O. Box 15309, Columbus, Ohio, 43215-0309, by FAX at (888)872-1611, or online at www.oh-newhire.com.

23) Obtain from local authorities the information and forms for local income tax compliance.

24) Information can be obtained from the following state agencies:
    a) 1st Stop Business Connection: (800)248-4040 or (614)466-4232 or http://business.ohio.gov/starting/);
    b) Ohio Secretary of State (614)466-3910;
    c) Ohio Department of Taxation: (888)405-4089;
    d) Ohio Department of Securities: (614)644-7381 or (877)767-3453.

–by Cleveland attorney Jason C. Blackford. Updated by Cleveland attorney Jack Kurant of Wachter Kurant LLC and Cleveland attorney Michele R. Yeh.

Know the Advantages and Disadvantages of C-Corporations, S-Corporations and Limited Liability Companies

Q: What is a C-corporation and what are the principal advantages and disadvantages of using one?

A: A C-corporation is typically a business organized as a corporation under state law and is subject to federal income tax under sub-chapter C of the *Internal Revenue Code*. A C-corporation is subject to federal corporate income tax on its taxable income, and its shareholders are subject to federal income tax on any dividends at a maximum 20 percent federal income tax rate (as of February 2013) if certain requirements are met. Otherwise, dividends are subject to federal income tax at the shareholder's ordinary income tax rate, a disadvantage. These two layers of tax are sometimes referred to as double taxation.

If the federal corporate income tax imposed on business profits is less than the individual income tax on those same profits, then a C-corporation may provide a modest federal income tax advantage. Currently, the first $50,000 of taxable income of a C-corporation is subject to a maximum federal income tax rate of 15 percent. If earnings of the business will be retained in the corporation and reinvested in the business, then using a C-corporation takes advantage of these lower federal tax rates. This advantage will be lost if the earnings are distributed by the C-corporation to shareholders as dividends to be taxed again at the shareholder level.

The principal non-tax advantage of any corporation is that the corporate form of doing business is familiar. Many statutes and administrative rules anticipate corporate structures, and there is a developed body of case law that helps set parameters for appropriate conduct for shareholders and directors.

State corporate law allows a corporation to have different classes of stock with varied distribution and voting rights, such as preferred stock or classes of stock with special rights and preferences. A C-corporation can generally use this flexibility without affecting its tax treatment.

Another disadvantage, aside from the double taxation that applies to C-corporations, is the "trapping" of losses in the corporation. C-corporation net operating losses are generally carried forward or back to offset income of the C-corporation; they cannot be used by shareholders to offset personal income.

Finally, in many states, the C-corporation is subject to a separate state franchise tax that does not apply to S-corporations or limited liability companies (LLCs). Ohio's franchise tax applies only to financial institutions and certain holding corporations. In the place of the franchise tax, Ohio has imposed a commercial activity tax (CAT) that applies to most businesses.

Q: What are the principal advantages and disadvantages of using an S-corporation?

A: An S-corporation is generally treated as a *flow-through* entity for federal income tax purposes; that is, income and losses of the S-corporation are reported on the shareholders' personal income tax returns. Thus, the chief advantage of an S-corporation is the ability to generally eliminate the federal entity-level income tax while using the corporate form of organization under state law that is generally familiar to business people and fits well with most statutes and regulations. Also, subject to applicable limitations, shareholders can use their pro rata share of an S-corporation's losses to offset other personal income. Employment taxes apply only to the portion of S-corporation income characterized as salary; S-corporation distributions are not subject to employment taxes such as FICA and FUTA.

A disadvantage of an S-corporation is its rigid requirements to qualify for and retain its S-corporation status. If any requirement is not satisfied, then the corporation will lose its status as an S-corporation and be subject to federal income tax as a C-corporation. For example, one requirement mandates that the S-corporation have only one class of stock, which generally means that all outstanding shares of stock must confer identical rights to distribution and liquidation proceeds. Also, the number of shareholders is generally limited to 100, and there are restrictions on who can be a shareholder. Only individuals who are not non-resident aliens for federal income tax purposes, estates, and certain trusts and tax-exempt entities can be S-corporation shareholders. Corporations and other entities, such as partnerships, cannot own S-corporation stock.

Q: What are the principal advantages and disadvantages of using a limited liability company?

A: The limited liability company, like a corporation, generally provides its owners with limited liability. Except in special circumstances, only the company, not its owners, is liable for the debts and obligations of the business.

The limited liability company, like the S-corporation, has *flow-through* taxation unless an election is made to treat the LLC as a C-corporation for federal income tax purposes. This means that the income and losses of the business are reported on the owners' personal income tax returns, and the LLC does not have any federal income tax liability. Unlike the S-corporation, the LLC can create different classes of interests, such as interests having a preference on liquidation and/or dividends, or with varied distribution rights. Also, LLC interests, unlike S-corporation stock, can be owned by any individual or entity without affecting the LLC's flow-through tax treatment.

The limited liability company is more flexible than a corporation and allows the members to be creative in developing a management structure. The LLC can be managed by a manager, its members, a board, or a combination of these elements. As a result, the LLC structure, as described in its operating agreement, can resemble the structure of a corporation, a partnership, or something in between.

A disadvantage of the LLC is that it is a relatively new form of entity. Ohio's LLC statute is just 20 years old, whereas Ohio's corporation law predates the codification of the *Ohio Revised Code* in 1955. There is less case law interpreting the LLC form of organization, and not all state statutes and regulations explain how an LLC should fit into their schemes.

Another disadvantage of the LLC is that self-employment taxes generally apply to a member's distributive share of trade or business income of the LLC, subject to certain exceptions.

Caution: This discussion assumes that the LLC is treated as a partnership for applicable income tax purposes, or, if there is only one owner, it is being disregarded (ignored) for applicable income tax purposes. Using IRS Form 8832, it is possible to elect that an LLC be subject to taxation as if it were a C-corporation or, by filing Form 2553, as an S-corporation.

Q: How do business owners choose from among these options?

A: Most owners desire the protection of limited liability, and all of these options afford their owners limited liability from obligations and liabilities of the company. In choosing among the three entities, the facts and circumstances of each business must be considered. For many businesses that wish to avoid the double taxation of a C-corporation, but want flexibility in management and distributions, the LLC is an increasingly popular choice. Owners may also want to consider how to pass a business on to the next generation or the potential effect of a sale or other disposition of all or part of the business.

–by Cleveland-area attorneys Jack Kurant and Michele R. Yeh.

C-Corporations, S-Corporations and Limited Liability Companies Are Taxed Differently

Q: How are C-corporations, S-corporations, and Limited Liability Companies (LLCs) different for income tax purposes?

A: The taxable income of C-corporations is subject to a corporate-level federal income tax, and a shareholder-level tax is imposed on cash or other property that is distributed to shareholders as a dividend. Thus, the earnings of a C-corporation are potentially subject to two layers of federal income tax (*i.e.*, double taxation).

Both S-corporations and LLCs (taxed as partnerships for federal income tax purposes) generally are pass-through entities for federal income tax purposes. Income and deductions attributable to business operations of the entity are passed through to the owners in accordance with applicable law. The results of the entity's operations are reported on the owners' individual income tax returns and also reported on the entity's federal information tax return. The entity generally does not pay federal income taxes. However, even if the entity does not make any cash distributions to the owners, the owners still must pay federal income tax on the earnings of the business.

Caution: Certain publicly traded limited liability companies and LLCs that specifically elect to be taxed as corporations will be taxed as C-corporations. For purposes of the following discussion, LLCs will be assumed to be taxed as partnerships for federal income tax purposes.

Q: Does the choice of entity affect how owner-employees are treated for payroll tax purposes?

A: Yes. With either a C-corporation or S-corporation, only the amounts paid to the shareholder-employee as compensation are subject to payroll taxes. The compensation must be "reasonable," or the IRS may treat the excess compensation as a non-deductible dividend or distribution.

The different tax rules for C-corporations and S-corporations create different incentives in determining the amount of compensation paid to owner-employees. In a C-corporation, the tendency is to set salary/compensation at the higher end of the reasonable compensation range so that the corporation can deduct such payments to the shareholder and reduce the amount paid out as dividends, which are subject to double taxation. (Dividends are not deductible by the C-corporation.) Conversely, salary paid to an S-corporation shareholder-employee would more likely be set at the lower end of the reasonable compensation range and provide for a larger dividend distribution, which would mitigate payroll taxes on such distribution.

By comparison, an LLC owner-member does not receive a salary. All amounts reflected on the tax return of the owner-member who performs services for the business are generally subject to self-employment taxes.

Q: Can losses incurred by the entity be used to offset the owners' personal income?

A: In a C-corporation, the answer is no. Losses of the C-corporation can only be used by the corporation and, generally, are carried forward or back to offset corporate income.

Losses generally do pass through to shareholders of S-corporations and members of LLCs to offset their other personal income.

The amount of losses the S-corporation shareholder/LLC member can use, however, depends upon applicable tax rules and regulations, which depend, among other things, on the owner's tax "basis" in his or her stock or LLC interest, and in the case of S-corporations, certain debt instruments. Whether the losses can offset other income of the owner, such as wages or interest, depends again on applicable rules, notably whether the S-corporation shareholder/ LLC member is regularly active in the operation of the business.

In an LLC, a member's tax basis in the member's LLC interest will be increased in accordance with applicable law if the LLC borrows money, which will then generally provide the member with increased capacity to take additional losses on his or her tax returns.

A shareholder's basis in any indebtedness of the S-corporation to the shareholder increases the shareholder's capacity to report loss deductions. After the shareholder's stock basis has been reduced to zero, the basis in such indebtedness may be reduced (though not below zero) by deductions passed through to the shareholder-creditor.

–by Cleveland-area attorneys Jack Kurant and Michele R. Yeh.

The LLC: A Useful Business Entity

Since the 1994 enactment of legislation in Ohio that created the limited liability company (LLC), this form of business entity has become immensely popular. And for good reason. The LLC is a flexible and valuable tool for business owners.

The LLC is an entirely separate type of business entity. Although it is not a corporation or a partnership, it can share attributes of each. Like a corporation, the LLC will generally shield its owners (called "members") from the company's creditors. The LLC is similar to a partnership in that it can choose to be taxed as a partnership or, in the case of a single-member LLC, as a sole proprietorship. In either case, the LLC will not be a tax-paying entity. Instead, its net income and other tax items will flow through to the members and will be reported on their income tax returns. In this way, the LLC is similar to the Subchapter S-corporation (S-corp). If desired, the LLC can elect to be taxed as a traditional C-corporation.

Although the LLC is similar to the S-corp, the LLC is more flexible. With the LLC, there are no restrictions on the number or type of owners, and the LLC can have more than one class of ownership (similar to common and preferred stock). The LLC also bears similarities to the limited partnership. The great advantage of the LLC, however, is that there is no general partner with unlimited liability to the partnership's creditors. Furthermore, there are no restrictions on the ability of LLC members to participate in management of the business, unlike the limited partners in a limited partnership. The old general partnership structure is not a recommended structure in the era of the LLC.

With the passage of H.B. 48 in 2012, Ohio became a leading state in terms of the protections afforded an LLC when a member is experiencing creditor problems. The new legislation clarifies that the "sole and exclusive" remedy of a member's creditor is a "charging order" on the member's interest in the company. The charging order limits the creditors to the right to receive distributions to the debtor member if and when such distributions occur. The creditor cannot reach the entity's assets or otherwise disrupt its business operations.

Furthermore, in conjunction with family business succession planning, the LLC offers a flexible arrangement for the transfer of interests to the next generation. If properly planned and implemented, the arrangement can have tremendous benefits in terms of avoiding estate and gift taxes.

–by Michael J. Stegman, an attorney with the Cincinnati firm of Kohnen & Patton LLP.

Essential Elements for Operating Agreements of Limited Liability Companies

The limited liability company (LLC) is quickly becoming the business organization of choice for many small business owners. The growing popularity of LLCs is the result of their simplicity and flexibility. Limited liability companies are separate legal entities, like corporations, but are treated as pass-through entities for tax purposes, provided they have not elected with the IRS to be treated as taxable entities. The members are protected from personal liability for the company's debts. Profits and losses are passed directly through to the members, which avoids double taxation because the LLC does not pay income taxes itself.

An essential element to the efficient operation and governance of an LLC is the operating agreement. An Ohio LLC can be organized without a written operating agreement. However, if there is no written operating agreement, the provisions of Chapter 1705 of the *Ohio Revised Code* govern the relationship of the members and the operation of the LLC, and many of the statutory default rules leave open important issues.

An operating agreement should provide sufficient detail to serve as a road map for the members with respect to LLC governance and operation. This is all the more important since LLCs are a relatively new form of entity in Ohio and the parties involved and the public at large likely will have very little experience in dealing with LLCs than with other forms of business entities. The initial drafting of the operating agreement is very important because a well-drafted agreement will reduce the potential for disputes between the LLC members and managers in the future. Every LLC operating agreement should address these essential elements:

Contributions of the members. Many statutory rights of the members are based on the value of their capital contributions, so it is vitally important that this information is recorded in the operating agreement. If contributions will be in a form other than cash (such as services), it is important that the members explain the form and value of such non-cash capital contributions.

Transferability of membership interests and admission of new members. The operating agreement should describe the restrictions on the transferability of membership interests and explain the rules governing transfers and the admission of new members.

Withdrawal rights. LLC members' rights for withdrawing from the LLC, as well as the terms and conditions governing withdrawal, must be addressed in the operating agreement.

Death, bankruptcy or divorce of a member. It is important that the members specify what will happen to their membership interests in the event of a death, bankruptcy, or divorce of a member. Otherwise, there may be a number of undesirable possible outcomes. For example, an heir of a deceased member, a divorced member's ex-wife, or a creditor of a member may become a member of the LLC.

Allocation of profits, losses and distributions. It is often desirable to allocate profits, losses and distributions in a manner other than based on the value of the capital contributions of each member. By addressing these issues in the operating agreement, the members can ensure fair allocations to the members.

Management and Voting Rights. It is important to indicate whether the LLC will be managed by its members or by elected managers. If managers are elected, the operating agreement should specify which actions managers may take on behalf of the LLC (such as day-to-day business activities) and which actions require the approval of the members (such as material financing or business acquisition transactions). The operating agreement also should specify whether the members' voting rights are per capita, pro-rata based on capital contributions, or determined in some other manner.

Indemnification. The operating agreement should outline the terms and conditions regarding indemnification by the LLC of the members and managers.

Confidentiality. The operating agreement should address restrictions on a member's rights to use or disclose the LLC's confidential information.

Covenants not to compete. The operating agreement should address any restrictions on a member's right to compete with the LLC's business or pursue opportunities that should first be made available to the LLC. Ohio case law involving LLCs, although still limited, has established that the common law fiduciary duties of the members can be modified or eliminated by the terms of the operating agreement.

Also, certain provisions of the Ohio LLC statute cannot be modified by the operating agreement, but may be clarified by the operating agreement, including the following:

- Duty of Loyalty – The operating agreement may identify activities that do not violate the duty of loyalty. Also, the agreement can provide for procedures to address possible exceptions to the duty of loyalty.
- Duty of Care – The operating agreement may prescribe the standards by which the duty of care will be measured.
- Obligation of Good Faith and Fair Dealing – The operating agreement may prescribe the standards by which the performance of this obligation will be measured.
- Manager Duties – The operating agreement may describe, in writing, the standards by which performance will be measured and identify activities that do not violate the manager's duties.

–by D. David Carroll and Adam J. Biehl of the Columbus law firm, Bailey Cavalieri, LLC.

Letters of Intent: To Do or Not To Do

Business people involved in mergers, acquisitions and divestitures love them; their lawyers dislike and fear them. What are they? They are letters of intent.

The legal issue with a letter of intent has to do with whether the letter is a legally binding document or just an expression of the parties' intent to try to make a deal. When drafted by the inexperienced, a letter of intent that was only meant to be an expression of ideas about a possible future agreement can produce costly litigation. Further, a court may decide that the seemingly nonbinding letter of intent is a wholly or partially legally binding contract.

Business people are often drawn to letters of intent because they feel that putting something on paper makes a deal more likely to happen. A party may erroneously believe that the letter of intent morally commits the other side, while counting on the "nonbinding" nature of the letter to avoid making its own firm commitment.

Over the years, a lot of litigation has involved the binding effect of letters of intent. Even some letters of intent that specifically say they are not binding are held by a court to be binding in whole or in part, or to have an effect on related issues being litigated for a variety of reasons. Lawyers tend to dislike letters of intent because they understand the litigation risks and the uncertainty even when the letter says, "This is not a legally binding document."

Nevertheless, a properly written letter of intent dealing with the merger acquisition or divestiture of a business sometimes serves a useful purpose. Such a letter is usually partially binding and partially non-binding. The usual binding provisions concern the preservation of confidentiality, exclusivity of negotiations, expense allocation and due diligence procedures. During a buyer's due diligence, the parties negotiate the definitive purchase/sale agreement containing details of the transaction, such as the exact purchase price, price adjustments and payment terms, representations and warranties, closing contingencies and a host of other matters that need to be covered as facts become known through due diligence.

The bottom line is this: if you decide to use a letter of intent for any transaction, use it carefully and with help from experienced counsel.

–by Charles R. Schaefer, an attorney with the Cleveland firm of Walter Haverfield LLP.

Internal Governance – Codes of Regulations and Bylaws

A corporation's code of regulations regulates and governs the internal affairs of a corporation and the relationship among the corporation and its shareholders, directors and officers. The code is essentially a contract among those constituents and it addresses the governance and management of the corporation. A code of regulations is an extremely important tool for avoiding conflict. Governance and management issues that seem insignificant may become stumbling blocks if regulations are not in place to address them.

Some of the more important aspects of a code of regulations include:

- the time and place of shareholders' meetings and the manner in which meetings may be called, notice, quorum and voting requirements for meetings, and procedures for taking action without a meeting;
- the number, classification, terms and manner of fixing compensation for directors;
- the time and place of directors' meetings and the manner in which meetings may be called, notice, quorum and voting requirements for meetings, and procedures for taking action without a meeting;
- the appointment and authority of board committees;
- the titles, duties, authority, term of office and manner of fixing compensation for corporate officers;
- the rights of officers and directors to be indemnified by the corporation; and
- procedures that spell out how the code of regulations is amended by the shareholders.

In light of our country's experience with terrorism and war, it has never been more important for businesses to address emergency regulations. In Ohio, a corporation's emergency regulations are effective during times when the governor has declared a state of emergency, for example, after attacks upon the United States and natural disasters in general. In such situations, emergency regulations allow the corporation to continue operations, even if it would not have authority to do so under normal conditions. In the corporate setting, emergency regulations may allow any director to call a meeting. Further, the normal quorum requirements can be abandoned, when necessary, in favor of emergency quorums that may consist of any director or directors who appear at the meeting. Such emergency meetings and board actions can allow the business to move forward in even the most trying times.

Bylaws

Unlike a corporation's code of regulations, corporate bylaws are internal rules enacted by the board of directors. Bylaws are less common than codes of regulations and are likely only necessary, if at all, for corporations with large and active boards of directors. While bylaws must be consistent with a corporation's articles of incorporation and code of regulations, they have another purpose: to address the authority and internal governance of the corporation's board of directors. In Ohio, bylaws are often confused with codes of regulations because Ohio's code of regulations is referred to as the *bylaws* in a number of other states.

In many instances, a corporation's board members are entirely unfamiliar with the state law governing corporations. Therefore, it is common for a corporation's bylaws to include summaries of the relevant statutes affecting the rights, authority and duties of the directors. For example, bylaws often will recite the specific provision of state law regarding the general authority of the directors. Bylaws also may address how to obtain a quorum of directors, how to take action without having a meeting, and how to remove directors and fill vacancies on the board.

–by D. David Carroll and Jameel S. Turner of the Columbus law firm, Bailey Cavalieri, LLC, and Todd J. Samples of Alliance Data Systems in Columbus. Updated by Adam Biehl and Jameel S. Turner, both of Bailey Cavalieri LLC.

Franchise Laws Protect Investors

Q: I am interested in buying a franchise. Are there laws that protect me in this situation?

A: The Federal Trade Commission (FTC) has a rule that requires a franchisor to provide detailed written disclosures to prospective franchisees. The franchisor must deliver these disclosures at least 14 calendar days before you sign any binding agreement with, and pay any money to, the franchisor. Ohio also has a law that protects franchises as discussed below.

Q: What type of information must the franchisor provide?

A: There are more than 20 categories of information covered by the FTC rule. This includes history of the franchisor, fees the franchisee will owe, the investment required to start the business, training, the franchisee's obligations, the franchisor's obligations, termination, transfer, dispute resolution and other matters.

Q: Does the FTC check the accuracy of the franchisor's disclosures?

A: No. The FTC makes no review of the written disclosures. You will need to study the disclosures carefully. You also should consult with an advisor, such as your lawyer.

Q: What can I do to gather more information?

A: The written disclosures must list current franchisees and persons who ceased to be franchisees within the past year. You definitely should contact both current and former franchisees to obtain information and to benefit from their experiences.

Q: Does the FTC regulate the terms of the franchise relationship?

A: No. The FTC does require the franchisor to provide the franchise agreement along with the detailed disclosures, but the FTC does not review the agreements. Because the franchise agreement will govern your franchise, you should study it carefully with an advisor.

Q: Can I rely on oral promises made by the franchisor?

A: No. Nearly every franchise agreement states that it is the entire agreement and there are no other promises or agreements.

Q: How, then, can I make certain I have the benefit of oral promises?

A: You will need to negotiate the franchise agreement with the franchisor. You should insist that the franchisor include in the franchise agreement all promises that are important to you.

Q: Are there other documents I should review?

A: Nearly all franchisors have an operating manual. The franchise agreement usually requires the franchisee to do what is in the operating manual. Before buying a franchise, you should obtain and review the operating manual.

Q: Does Ohio have a law to protect me in buying a franchise?

A: Yes. The Ohio Business Opportunity Plan Law applies to many, but not all, sales of franchises in Ohio. The law prohibits misrepresentations, requires presale disclosures to the franchisee and provides for the right to cancel during the five-day "cooling off" period following the signing of the franchise agreement.

> Most importantly, unlike the FTC rule, the Ohio law provides franchisees with the right to sue for damages (that may be tripled), attorney's fees and other relief. An Ohio franchisee who believes the franchisor did not comply with the Ohio law or did not comply with the FTC disclosure requirements may wish to consult an attorney concerning the Ohio Business Opportunity Plan Law.

–by G. Jack Donson Jr. and Margaret A. Lawson, both partners in the Cincinnati firm of Taft, Stettinius & Hollister, LLP.

Buyer Beware: The Steps to Purchasing a Business

If you are looking to buy or acquire a business, you will need patience, honed detective skills, legal and accounting advisors, and attention to every detail. The process of buying a business is a negotiation between the seller and the buyer. Both are looking out for their own interests, as well as the future of the business—but for very different reasons.

As the potential buyer, it's important for you to consider the seller's motivation to sell: is it retirement or lack of successor management? Perhaps the seller foresees changes in the market place and has an aversion to putting more capital at risk? Knowing the reasons for the sale will help a buyer prepare an offer, including whether to purchase the assets of the business or the stock.

As the buyer and seller negotiate through the sale, several key documents must be prepared and considered prior to the definitive agreement, including:

Confidentiality agreement: In order to receive basic information about seller, generally a buyer signs a document agreeing to use the information revealed only for the purpose of considering buying the business. Particularly, if the potential buyer is a competitor of the seller, this agreement may also preclude the buyer from hiring the seller's employees for a period of time, if the sale does not occur.

Letter of intent (LOI): This document is generally a non-binding offer for the business. Sellers prefer a more detailed LOI, as their greatest leverage is before its execution. Many times, sellers can be talking to multiple potential buyers prior to execution of a letter of intent. The signed LOI generally contains a provision giving the potential buyer exclusivity on negotiations for a 60- to 90-day period. Generally, buyers prefer a short LOI because they wish to delay negotiating difficult issues such as risk allocation and seller's indemnification obligations until a definitive agreement is made. Even so, it is becoming more common for buyers to insist that the seller provide a longer LOI to flush out the important issues so that negotiations can be terminated before extensive legal costs and time are expended on problems that cannot be resolved. Once a letter of intent is executed, key personnel are often told about the potential sale as well as the identity of the buyer who is involved in the due diligence (discussed below). If a potential sale is disclosed but the sale subsequently falls through, it can cause morale problems for the seller's employees. Also, the seller's reputation may be damaged if the sale falls through. Therefore, it is in the seller's best interest to resolve as many details as possible in the letter of intent. Just as the buyer wants to know if there are roadblocks to the sale, the seller will also want to know about any potential problems as soon as possible to reduce legal fees and time commitment to a failed transaction.

Due diligence: Following execution of the confidentiality agreement, the buyer conducts preliminary due diligence—an analysis of seller's business and financial results—and compiles the information into a document. The analysis at this stage establishes the potential price and determines whether the buyer remains interested. After the letter of intent is executed, the buyer completes due diligence, which may include talking to key customers, suppliers and personnel. Due diligence is designed to give the buyer a full understanding of the risks and liabilities of the business. Many times, the buyer revises the bid based on information generated during the due diligence process.

As a buyer, you need to ask yourself what key assets you want to acquire in the purchase of the business: patents or licenses, key customer contracts or supply agreements, equipment or personnel. If the documents are drafted to accomplish the purchase of the key elements of the business and to allocate the risks for past and future events in a manner you, as the buyer, understand and accept, the purchase is being done correctly. Finalize the deal.

–by Michael A. Ellis, an attorney with the Cleveland office of Porter Wright Morris & Arthur LLP.

Buying A Small Business? Do Your Homework

In today's economic climate, a number of experienced and highly educated professionals are facing an unplanned career change. Many see this as an opportunity to pursue the dream of entrepreneurship by purchasing a small business. If you are one of these, make sure you do your homework. While you personally need to determine what type of business you will buy, and whether you have the necessary skills and passion to make it succeed, you will also need to consider less exciting technical issues. Here's your assignment:

1) **Get real financials**. The number one thing you should do before buying a business is to verify its financial performance. Don't rely on the seller alone for this. While you can start with seller-prepared numbers, don't stop there. Request tax returns and financials prepared by a third-party accountant. Then have it all reviewed by an accountant you know and trust.

2) **Make sure the business can be sold free and clear of liens and claims**. Many businesses finance operations, inventory or real estate. This can mean that security interests may encumber the business's assets. Make sure you have conducted all of the necessary searches, *e.g.*, for liens and mortgages. Sometimes a small business has been in litigation and is subject to a court judgment, so you should conduct a litigation search as well. If it turns out your seller owes a bank or other creditor, make sure any creditor is paid before you take title to any part of the business, or you may be buying a liability.

3) **Only buy what you want**. You should only buy assets such as inventory, real property, equipment, customer lists, intellectual property and receivables, and avoid assuming liabilities. Assuming some liabilities may be unavoidable, depending on the transaction. For example, if the business is operated on leased premises, you'll have to assume a lease. If there are existing employees, you'll need to decide whether to retain them. There are significant legal issues associated with retaining existing employees, so make sure to consult a human resources professional and legal counsel.

4) **Confirm government approval**. Even in our free market economy, all businesses are regulated to some degree. Make sure the one you are buying is in compliance with all applicable local, state and federal laws and regulations. This includes zoning laws, building codes, tax laws, occupational licenses and other relevant regulations.

5) **Have a plan**. Even if you're buying a business with a history of success and an excellent business model, you must make your own plan. The most important part of the plan is your budget. Preparing a budget based in part on your financial due diligence will give you more realistic financial expectations and help control expenses. Perhaps most notably, a written plan, budget and *pro forma* financial statements will help you persuade a lender to extend you credit.

This is just a brief summary of the due diligence items you will need to complete before buying a business. Doing your homework first will greatly increase the likelihood of your success in your new business venture.

–by Patrick Hughes, an attorney with the law firm of Dressman Benzinger & LaVelle, P.S.C.

The Business Acquisition Checklist

One important way a small business can grow is by merging with or acquiring another company. An owner considering a merger or acquisition should take as many of the following steps as possible to evaluate the target company before deciding whether or not to proceed.

- ✓ Review financial statements for the previous five years or longer if possible. Note items that should be recast or restated.
- ✓ Prepare a comparative and ratio analysis of the financial information to identify significant trends, potential problems and opportunities.
- ✓ Review copies of federal, state and local tax returns for the previous five years.
- ✓ Determine if all payroll, sales, excise, and other miscellaneous taxes have been paid.
- ✓ Review the business minute book.
- ✓ Ask for any asset and business appraisals.
- ✓ Review the depreciation schedule in detail, giving attention to the original cost, age and condition of the assets.
- ✓ Prepare a detailed list of products and services the company offers.
- ✓ Prepare a list of major customers by name, volume and product.
- ✓ Determine if the seller has any patents, trademarks or licenses that need to be acquired.
- ✓ Review all leases.
- ✓ Prepare an organizational chart.
- ✓ Give consideration to the economy of the community where the business is located.
- ✓ Prepare a list of major suppliers.
- ✓ Determine which assets are mortgaged or pledged and review the loan documents.
- ✓ Determine if the key individuals are willing to sign a non-competition agreement.
- ✓ Review local zoning restrictions.
- ✓ Determine if the company is subject to any governmental regulations or restrictions.
- ✓ Inquire about any existing lawsuits and any contingent liabilities, such as environmental liabilities.
- ✓ Review all employee fringe benefit plans.
- ✓ Determine if there are any employment contracts with key personnel.
- ✓ Obtain copies of all union contracts.
- ✓ Look for win-win opportunities throughout the negotiation process.
- ✓ Determine if there are any tax audits and review the results of the audits.
- ✓ Seek advice from competent professionals.
- ✓ Consider the synergistic effect of the prospective sale on both the buying and selling businesses. Consider recasting the financial information to take this effect into account.
- ✓ Prepare or review forecast, budgets and business plan.
- ✓ Compute an acceptable range of value for the company and an appropriate offering price.
- ✓ Determine how the offering price should be allocated among the various assets to get the best tax benefits.

–by Bruce D. Bernard, Esq., tax strategist with Bernard Law, LLC in Worthington.

Marriage Plans Affect Business

Q: I am a business owner and plan to marry. Is there anything I can do to protect my business interests before I marry?

A: Yes. Consult an attorney about drafting a prenuptial agreement for you and your future spouse to sign in advance of the wedding. In such an agreement, you can state in advance of the marriage who will be entitled to your business interests in the event that your marriage should end or in the event of your death. For example, you might want to stipulate that your future spouse would not be entitled to any business interest that you now own, or any appreciation of a business interest you now own, and/or any business interest you might acquire later.

If such an agreement is in place and you later divorce or die, a court would follow the terms of the prenuptial agreement in distributing the value of your business interests. (By contrast, courts are sometimes not obligated to follow the terms of the prenuptial agreement regarding spousal support awards and can reassess spousal support at the time of the divorce.)

Q: If we decide not to make a prenuptial agreement and later divorce, what would happen to my current ownership interest in my business?

A: The value of the interest that you accumulated in your business before the marriage would be considered your own separate property and generally would be awarded to you and not your spouse. However, if the business interest that you owned before the marriage appreciates after the marriage, or if you acquire a new business interest after the marriage, then these interests may be considered “marital property” and your spouse generally may be entitled to receive one-half of the value.

Q: If we decide not to make a prenuptial agreement and I die before my spouse, what would happen to my ownership interest in the business?

A: Without a prenuptial agreement, your spouse may be entitled to receive some portion of the value of your interest in the business. For example, if you wrote a will leaving the entire interest to your children by a previous marriage, your spouse has the right to *elect against the will* and automatically take a portion of the share that was left to your children. If you die without a will, state statutes provide that your spouse would still be entitled to a share of your interest. (If you have no children and die without a will and without a prenuptial agreement, your spouse generally would be entitled to inherit all of your interest.)

Q: I just became engaged and I’m planning to marry in about six months. I hate to wreck my romance and would rather wait until all the wedding details are out of the way before working out a prenuptial agreement. Is there any hurry?

A: The biggest mistake that most people make regarding prenuptial agreements is waiting too long to consult an experienced domestic relations attorney, then trying to negotiate an agreement too close to the wedding. The circumstances surrounding the signing of a prenuptial agreement must follow a fair procedure or the agreement may be unenforceable. In determining whether to uphold a prenuptial agreement, courts look at how much time both spouses had to consider the agreement, whether both spouses understood the agreement, whether both spouses had counsel, and whether there was full financial disclosure.

–by Laura S. Zeldin, Esq. Updated by Pamela J. MacAdams, a partner in the Cleveland firm, Morganstern, MacAdams & DeVito Co., LPA.

Divorce Affects Business

Q: I am married and I currently own a business. If my marriage should end, how might my ownership interest in my business be affected?

A: If your marriage ends and you acquired your business interest during the marriage, the value of your interest would be considered *marital property* under Ohio law. Marital property is divided according to an *equitable distribution* analysis. Generally, your spouse may be entitled to receive 50 percent of the value of your business interest unless it is determined that an absolutely equal division would be inequitable (unfair).

Q: If I divorce, what will happen to my ownership interest in my business if all or part of my interest in the business was acquired before the marriage?

A: The value of the interest in your business accumulated before marriage would be considered your own *separate property* and generally would be awarded to you and not your spouse. If, however, the business interest that you owned before marriage has appreciated (grown in value) during the marriage, then the value of appreciation may be considered marital property and be subject to a 50/50 division unless the court finds that such a division would be inequitable. In some courts, this depends upon proof of any marital contribution of monies or labor to the business during the marriage.

Q: Is it possible that my spouse will receive part of my pension, retirement and other business benefits if I divorce?

A: Yes. The value of pension and retirement plans accumulated during the marriage is also considered marital property and is subject to equitable distribution. Generally, your spouse may be entitled to one half the value of the pension accumulated during the marriage unless it is determined that an absolutely equal division would be inequitable.

Q: Does the equitable distribution property analysis with the 50/50 starting point still apply even though the business interest is in my name and my spouse did not work in or have any connection with the business?

A: Yes. The equitable distribution formula applies even if your spouse has no connection to your business, assuming the business was started or acquired during the marriage. In Ohio, marriage is viewed as an economic partnership and both spouses are considered to have contributed equally to marital property that is produced or acquired by either one of them during the marriage. Marital property can be titled in the name of either spouse or both. The fact that the business interest is in your name is not the deciding factor in determining whether the property is marital or separate.

Q: Does equitable distribution mean that the court presumes my spouse is entitled to own half of my business interest after the marriage ends and will also be entitled to be involved in my business?

A: No. After the marriage ends, your spouse is entitled to half of the *value* of your interest in the business—not necessarily half of the business interest itself. However, if both spouses were actively involved in the business, Ohio law does not *require* one of them to stop being involved simply because the marriage has ended. Commonly, however, the court will seek to separate spouses in business as well as marriage by dividing assets such that only one spouse stays with the business.

Q: After deciding to separate, my spouse and I reached an agreement to distribute the value of the business interest (as well as our other marital property) that is different from the equitable distribution formula. Will the court accept and adopt our agreement?

A: The court will probably adopt your agreement if you and your spouse have fully disclosed all of your assets, and you and your spouse state that you have had the chance to find out about all financial matters, including the value of your assets.

However, after the court accepts an agreement made by both parties and grants your divorce, the agreement will not be set aside later just because one of the parties comes to feel it is a bad deal. Therefore, it is extremely important that both spouses at least consult an attorney to review their agreement and determine whether a spouse is receiving more or less than a court might award. Sometimes the court will reject an inequitable distribution if it is not convinced that each spouse had the benefit of legal counsel.

Q: What about the debts my business has? Will these be divided between my spouse and me?

A: Debts must also be distributed when a marriage ends and can be classified as *separate* and *marital*. Usually, debts related to a marital property business interest will have been factored into the net value of the business interest that is being distributed. Also, any ongoing responsibility for the debts of the business will generally remain with the spouse who continues to participate in the business. If, however, the business is a sole proprietorship and the spouses have filed joint tax returns in the past, the non-owner spouse who will no longer keep an interest in the business should make sure that the divorce paperwork contains language to protect himself or herself from any future tax liabilities related to past joint tax returns. If the business debt is jointly incurred, the spouse not keeping the business will also want strong language protecting him or her from collection of such debt by providing for recourse against the non-paying spouse if a creditor collects against the non-owner spouse after divorce.

Q: My spouse was not interested in finances and business during the marriage, so do I have to show my spouse my business and financial records now that the marriage is ending?

A: Yes. Full financial disclosure is required. If your spouse asks for your financial records and information, and you do not provide the information voluntarily, then your spouse has the right to obtain the financial records through a formal *discovery* process, which may involve *interrogatories* (formal written questions and answers) or *depositions* (*under oath* verbal questions asked outside the courtroom), or official requests asking you to produce the documents. Your records may even be subpoenaed (the court would issue an order commanding you to bring the records).

–by Laura S. Zeldin, Esq. Updated by Pamela J. MacAdams, a partner in the Cleveland firm, Morganstern, MacAdams & DeVito Co., LPA.

Incorporation Limits Liability

Q: ***I own a small business, which has two employees. Am I legally responsible if one of my employees is negligent?***

A: Yes. The legal doctrine of *respondeat superior* imposes vicarious liability on an employer for the negligent conduct of its employees committed within the scope of the employee's duties—even when the employer is not directly involved in the acts of misconduct. For example, an employer may be required to pay monetary damages for injuries caused to a third party in a motor vehicle accident when the employee is making a delivery to a customer. The employer, however, will not be liable for injuries caused by an employee who stops at a bar on the way home from work, has several drinks, and then causes a motor vehicle accident while driving home. Under those circumstances, the employee would not be acting within the scope of his or her employment, and the employer would not be vicariously liable for the employee's misconduct.

Q: ***What can I do to protect my personal assets against vicarious liability for my employee's negligence?***

A: A small business owner should always maintain a general commercial liability insurance policy for the business. In addition, the owner should also obtain automobile, malpractice or *errors and omissions* insurance policies when appropriate. Apart from insurance coverage, a small business owner should consider forming a legal entity for the business. Formation of a legal entity, such as a corporation, will expose only the corporate assets, as opposed to the personal assets of the owner, to liability in the event that an employee negligently injures another person.

Q: ***What steps must I take if I want to form a legal entity for my business?***

A: There are several different types of entities to consider for a small business. The most common and the easiest to form is called a limited liability company (LLC). An LLC is created by filing a document called *articles of organization* with the Ohio Secretary of State. Management of an LLC occurs through its members. Many LLCs have a document called an operating agreement, which defines how the LLC is to be managed and how the financial aspects of the LLC are to be organized. An operating agreement, however, cannot vary or restrict the rights and duties of the members of an LLC, including the right of access to books and records, the duty of loyalty owed among members of an LLC, or the duty of cared owed by members to each other and to the LLC, and the duties of a manager, among others.

Another option is a corporation. A corporation is created by filing a document called *articles of incorporation* with the Ohio Secretary of State. Articles of incorporation must include the name of the corporation and a statutory agent must be appointed. A statutory agent is a person who resides in the same county as the corporation, and who is available to receive official notices and papers served upon the corporation. A corporation that is closely held (not traded on a public exchange) may have a document called a "close corporation agreement," which can regulate the business affairs of the corporation and designate individuals as officers or directors of the corporation, among other issues.

A third alternative is to form what is known as a limited liability partnership.

Limited liability companies, corporations and limited liability partnerships are controlled by different provisions in the *Ohio Revised Code*, have different structures in terms of ownership interests, and also result in different tax consequences to the owners. For example, a C-corporation bears a double tax burden in that the corporation pays taxes for earnings during the fiscal year and the shareholders also pay taxes on dividends received from the corporation. Limited liability companies, on the other hand, have *flow-through* tax advantages in that the LLC does not pay taxes independently on earnings. Earnings (or losses) flow through the entity to the individual members, who then pay taxes on the income they receive.

Q: Are there any circumstances where a creditor could access my personal assets even though I have established a corporation or LLC for my business?

A: Yes. In rare circumstances, a creditor may be able to *pierce the corporate veil* and collect on a business owner's personal assets even though a corporation or LLC has been formed. Business owners should be very careful to separate their business assets from their personal assets at all times, including accounting records and books, bank accounts, lines of credit and tangible assets. An owner must also be careful to abide by corporate formality in order to avoid the appearance that the business entity and the business owner are, in reality, one and the same.

Q: Are there ever circumstances where I can be held liable for the criminal or reckless misconduct of my employee?

A: Rarely. A criminal act is generally considered to be outside of the scope of employment; however, if an owner knowingly participates in, or has knowledge of, but ignores the criminal or reckless behavior of an employee, the employer may still be liable for that employee's misconduct. For example, if an employer knows that his employee is trespassing upon the land of a third party to obtain a natural resource for the benefit of the business, the business owner will be vicariously liable for the intentional misconduct of the employee. An employer may also be held vicariously liable for the reckless conduct of an employee who is engaged in an ultra-hazardous activity, such as shooting a firearm, demolition, cleaning toxic substances and similar activities.

Q: Under what conditions can I make an employee an owner in my business?

A: An employee may become a co-owner of a business entity with the consent of the other prior owners. In the case of a corporation, the employee might receive shares of stock in the corporation as a merit bonus or through the purchase of shares as part of a capital contribution. In the case of an LLC, the employee would obtain a membership interest either through assignment or purchase. The process for bringing in new owners is defined in the articles of incorporation, in a close corporation agreement or in an operating agreement.

Q: What is the best entity to form for my business?

A: You should consult with an attorney and/or an accountant to weigh the benefits and detriments of each type of business entity and to determine what would be the most appropriate entity to use for your business.

–by Jack Neuenschwander, retired partner of the Piqua firm of McCulloch, Felger, Fite & Gutmann Co., LPA. Updated by Christopher R. Pettit, an attorney in the Columbus firm of Lane Alton & Horst LLC.

Shareholders Can Be Personally Liable for Corporate Obligations

Q: Businesses incorporate to protect their owners from liability for corporate obligations. Are there any statutory provisions imposing personal liability on shareholders?

A: Yes. Ohio statutes impose personal liability on shareholders in the following situations:

1) When a person subscribes for shares in a corporation, there is a personal obligation to pay the corporation for those shares.
2) Any shareholder who knowingly receives any dividend, distribution, or payment made contrary to the law or the corporate articles is personally liable to the corporation for the amount received in excess of the amount that would have been paid or distributed without violation of the law or the articles.
3) A shareholder may be personally liable for the purchase price of corporate shares and punitive damages if the shareholder sells such corporate shares in violation of the Ohio Securities Act.
4) Any shareholder selling shares in an insolvent corporation without disclosing the financial situation of the corporation is personally responsible for the purchase price to the purchaser.
5) Any shareholder exercising corporate rights, privileges and authority after the corporate Articles of Incorporation have been canceled or after the corporation has been dissolved are subject to the obligations resulting from the shareholder's actions.
6) A shareholder having control of more than one-third of the shares of a corporation may be held personally responsible if the corporation fails to report and remit Ohio sales and use taxes.

Q: Are there federal statutes that impose personal liability on a shareholder for the shareholder's conduct?

A: Yes. In addition to the federal liabilities on shareholders who are also officers and directors of corporations, there are several statutes that impose liability on shareholders simply for being shareholders.

1) To prevent 10-percent shareholders of a publicly held corporation from using inside information, these shareholders must return to the corporation any profits resulting from the shareholders' purchase and subsequent sale of the corporation's equity securities within a six-month period.
2) The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) imposes a liability on *owners and operators* for the costs associated with the clean-up of any spills, discharges or releases of hazardous substances. The Environmental Protection Agency considers shareholders to be owners, but normally has confined its imposition of liability to those shareholders who are active in the business. The courts have generally limited shareholder liability to those situations in which the corporation entity can be disregarded under state law.
3) A shareholder in "control" of a publicly held corporation is liable personally for the acts and omissions of that corporation in violation of the federal securities laws.

Q: What is meant by the phrase, "piercing of the corporate veil?"

A: In addition to the statutory liabilities, courts have imposed liability for corporate obligations on a shareholder when the corporate form is used to perpetrate a fraud or an illegal act. Normally, this *piercing of the corporate veil* is applied against a shareholder who dominates the corporation so that the corporation is considered to be an extension or "alter ego" of the shareholder and that the corporation has no separate mind or will of its own. Courts have not established a precise test for determining when corporate domination by a shareholder occurs to the extent that the existence of the corporation is disregarded. Each case is decided on its own facts. The shareholder's domination and control of the corporation must be used to commit fraud or an illegal act. The injury or loss must directly and foreseeably result from both the shareholder's control and the fraud, illegal act or unjust conduct.

Q: What can be done by shareholders to <u>prevent</u> a court from piercing the corporate veil?

A: Observe the formalities of the corporate organization. Hold meetings of the directors and the shareholders. Authorize actions such as loans, purchases of property and leases of real estate by written action or at a meeting following these steps:

1) Keep separate financial records for the corporation.
2) Keep the corporate record book up to date and record all corporate actions by the shareholders and directors.
3) Do not commingle the assets of the corporation with the assets of the shareholder or any affiliated entity.
4) Provide the corporation with adequate capital to start its operation.
5) Never mislead a creditor as to the financial condition of the corporation.
6) Use the formal corporate name on all purchase orders, invoices and communications with customers and third parties.
7) The corporate bank account should be set up in the name of the corporation and with the name of the corporation on all checks.

It is possible that a shareholder, by his or her conduct, may assume a personal liability. To avoid this, all corporate contracts, agreements, notes, documents and checks should be signed in the individual's corporate capacity, as in the following example: "Smith Corporation by John Smith, its president."

Q: Is there any duty of a shareholder to the other shareholders?

A: Yes. The courts have imposed upon a dominant or majority shareholder a fiduciary obligation when dealing with the other shareholders. The dominant or majority shareholder must take actions for the benefit of the corporation and all of the shareholders. The dominant or majority shareholder must act in good faith when dealing with other shareholders. For example, in a corporation where there are two shareholders—both of whom work for the corporation—one owning 60 percent of the shares and the other owning 40 percent of the shares, a fiduciary duty could be breached if the majority shareholder fires the minority shareholder without good reason and for the purpose of increasing the majority shareholder's salary.

–by Cleveland attorney Jason C. Blackford. Updated by Cleveland attorney Jack Kurant of Wachter Kurant, LLC and Cleveland attorney Michele R. Yeh.

Understanding Personal Liability for Corporate Obligations

A major benefit of incorporation is to protect shareholders' personal assets from corporate liabilities. The general rule is that shareholders are *not* liable for the debts or obligations of a corporation; however, if a corporation cannot pay its debts, there are circumstances where courts sometimes disregard the general rule and attempt to impose personal liability for the corporate debt on the shareholders by *piercing the corporate veil*. When this so-called piercing the corporate veil is successful, a claimant against the corporation may be able to collect from a shareholder's personal assets.

In Ohio, a claimant against a corporation must satisfy three elements to successfully pierce the corporate veil and collect from shareholders' personal assets. The claimant must be able to demonstrate that:

1) the corporation is completely controlled and dominated by its shareholders;
2) the corporation was used to commit fraud or an illegal act; and
3) the fraud or illegal act resulted in an injury or unjust loss.

Adherence to the following principles and compliance with state laws reduces the risk that a court will pierce the corporate veil.

1) Keep the corporation completely separate from its shareholders.

- **Observe corporate formalities and respect the legal separateness of the corporation.** Issue stock in compliance with the law. Hold regular shareholder and director meetings when required and ask shareholders or directors, as appropriate, to approve actions outside the ordinary course of business. Officers and directors should exercise independent judgment that is in the best interest of the corporation. Shareholder votes must be based on the number of shares held. In some instances, a close corporation agreement may serve to reduce the need for certain of the required formalities mentioned above.
- **Maintain adequate corporate and financial records.** Adequate records are especially important when shareholders and directors approve significant corporate activities (*e.g.*, borrowing, compensation and purchase decisions).
- **Use corporate funds and property only for corporate purposes.** Never use corporate funds for personal use. Pay dividends only when appropriate.
- **Conduct business in the corporate name.** Use corporate letterhead and the full corporate name in estimates, quotes, bids, invoices, purchase orders, contracts, etc. Have corporate officers sign their names and official capacity on all contracts and other corporate documents.
- **Keep corporate assets separate from shareholders' assets.**
- **When starting a corporation, conduct due diligence to ensure there is enough capital to fund the type and size of the business and to cover accompanying risks.** Avoid regular shareholder loans or contributions.

2) Make sure shareholders do not commit fraud or illegal conduct.

- **Shareholders should not siphon funds** to try to protect the corporation from judgments or other debts.
- **Shareholders must not mislead third parties** by suggesting they will fulfill corporate obligations or that the corporation has assets that are really owned by shareholders.
- **Do not permit the corporation to incur additional debts or liabilities if it is insolvent or in financial distress.**

In summary, in order to pierce the corporate veil and collect from shareholders' personal assets, a claimant must demonstrate that the corporation's shareholders reaped corporate benefits and profits at the claimant's expense. The mere fact that the corporation ceases operation without being able to pay all of its debts is not enough to cause shareholders to be personally liable for the corporation's obligations. But in today's economic climate, even the most basic corporate transactions are scrutinized to the highest degree when a corporation becomes insolvent. Compliance with the above principles will undoubtedly help shield shareholders from being liable for corporate obligations. Nevertheless, corporate officers and shareholders must remain vigilant and alert in their objective to operate their corporation within the boundaries of law—separately, independently, and free from fraud or illegality.

–Originally provided by attorney D. David Carroll of Bailey Cavalieri LLC in Columbus and Hollie K. Foust, formerly of the same firm. Updated by attorneys Adam Biehl and Jameel S. Turner, both of Bailey Cavalieri LLC.

Investments in India: A Structural Strategy

A U.S. company interested in expanding its business operations to India can form an agency, an association of persons, a liaison office, a project office, a joint venture and/or a subsidiary in India.

- **Agency**
  An agency gives a U.S. company an indirect presence in India. Under it, the U.S. enterprise appoints an Indian entity as its agent and, depending upon the agency agreement, the agent can buy or sell or provide any other service to the U.S. enterprise.

- **Association of Persons**
  As association of persons is a collection of different entities (*e.g.*, individuals or companies) that join together for a common purpose. An association of persons is formed by executing an agreement among the participants. The association need not register with authorities in India, but is a recognized entity for tax purposes.

- **Liaison Office**
  The liaison office collects information about possible market opportunities and provides information about the U.S. company to prospective Indian customers. It can promote export/import transactions and facilitate technical collaborations between U.S. companies and Indian companies. The liaison office cannot undertake any commercial activity, and cannot, therefore, earn any income in India. Approval through an application process from the Reserve Bank of India (RBI) is required to open such an office.

- **Project Office**
  U.S. enterprises planning to execute specific projects can set up temporary offices in India. The RBI grants general permission to foreign entities to establish project offices, subject to specified conditions. Such an office can only execute the project for which it was established.

- **Joint Venture**
  In a joint venture (the most sought-after option for U.S. companies seeking to establish a presence in India), a U.S. company forms a limited liability company (LLC) in India. This LLC partners with another Indian company for its operations. To establish a joint venture in India, U.S. companies should consider:

  1) **Choosing a local partner:** An appropriate local partner can play a significant role in overcoming various legal complexities and ensuring business synergy.

  2) **Identifying a location:** Important factors to consider when searching for a location are availability of infrastructural services as well as financial and tax incentives.

  3) **Negotiating:** Before negotiating, the parties should enter into confidentiality/ non-disclosure agreements to protect strategic business information to be exchanged for the joint venture operations.

- **Subsidiary**
  U.S. equity in Indian companies can be 100 percent, subject to any equity caps prescribed by RBI for specific sectors (*e.g.*, agricultural). A subsidiary can be incorporated under the Indian Companies Act as a private limited company or a public limited company. Both options offer liability protection and have minimal capitalization requirements.

- **Structuring Issues**
  U.S. companies might also consider investing in an Indian company through an intermediate holding company in a tax-favorable jurisdiction. Also, India has favorable tax treaties with these countries: Mauritius, Singapore, Cyprus, Luxembourg and the Netherlands.

  Every U.S. company planning to do business in India must develop a legal and tax strategy to support its business plans and objectives. This strategy should include due diligence concerning prospective partners and specific conditions that may affect the company's market prospects. It is wise to seek experienced counsel before entering the Indian market.

–by attorney Vinita Bahri-Mehra, a director at Kegler Brown Hill & Ritter LPA, and chair of the firm's Asia-Pacific practice.

Money Matters

Chapter 2

Financing Your Business

Maybe you have been able to finance the start-up and early growth of your business through the use of your own capital. But now, in order to sustain or grow your business, you need additional financing. What financing vehicles are out there for the average "lifestyle" business that does not expect to be the next Google?

The most commonly used financing options available to your business can be grouped into six categories:

1) credit cards;
2) angel investors;
3) venture or private equity financing;
4) factoring;
5) asset-backed lending; and
6) working capital lines of credit.

Many entrepreneurs finance initial business growth through the use of personal, uncollateralized credit cards. While images of plunging personal credit ratings, high interest rates and unmanageable debt may make credit card financing unattractive, it should not be ruled out. A number of national organizations offer small business owners credit cards with low, fixed interest rates and attractive payment terms.

Angel investors are high net worth individuals seeking better returns than offered through more conventional investment vehicles. They enjoy investing money, and sometimes time, in attractive businesses. There are many angel investors throughout Ohio and the Midwest. Moreover, individuals in group angel funds sometimes invest their own money through *sidecar* investments. Business should be aware, however, that strings may be attached to angel funds.

Venture and private equity funds abound, but the trick is to find one that would be attracted to your type of business. Think carefully about who to approach and what type of debt and/or equity arrangement each might seek. Some funds require you to relinquish ownership control. Most want some vote in all important business decisions and all want to thoroughly understand your *exit strategy*. Moreover, most venture and private equity funds must exit your business within a short time period and return their capital to their respective investors. There are three exit options: 1) sell the company; 2) have a public offering; or 3) undertake a recapitalization. Without an exit strategy, you may have trouble attracting fund investors.

Factoring is a viable option for some, particularly those businesses with account receivables that are slow to be paid and, therefore, hurt cash flow. A factoring company buys your receivables at a particular percentage of their stated value (say 80 percent). Some factoring arrangements allow the factoring company to "put" the receivables back to you should they fail to collect. While the cost is certainly higher than traditional bank financing, it is often a good short-term arrangement for the business experiencing less than stellar credit, poor cash flow or rapid growth.

Bank financing, be it asset-based or working capital, is the most traditional financing vehicle and the most difficult to attract. Asset-backed financing may be available to the business owner who might not be able to attract a cash flow lender but who has sufficient hard assets to cover the bank's credit exposure. Cash-flow lending requires a lender to study the company's financials and determine whether the business will remain cash-flow positive so it can repay the bank. As added security, lenders traditionally will secure all business assets and may seek to secure personal assets.

An experienced advisor can assist you in negotiating the maze of financing options and help prepare and review the necessary documentation any financing entity will require from you before investing in your company.

–by Thomas C. Washbush, a Columbus attorney.

Preparation Can Improve Bank Loan Experience for Business Borrowers

Whether you are starting or expanding your business, chances are you will need to ask a bank for financing. You may assume a bank will evaluate your business based purely on dollars and cents and your likelihood of repaying the loan, but a lending officer may also consider intangibles such as your community standing, reputation and overall benefit to the community

You can correctly assume that the lending officer and the bank want your business to succeed so you can repay the loan, but you should know that the bank (especially if it is a community bank) also has an interest in your business's success because of its positive impact on the community.

Before making an appointment with a loan officer, you should know what the bank is looking for and be prepared to provide the necessary information.

Information
You will need to provide the bank with the following:

- two to three years of business tax returns;
- two to three years of personal tax returns;
- a current financial statement;
- a year-to-date income statement and balance sheet on your business entity;
- a history of your business and/or a business plan. If the business is a start-up, then you will need to provide projections for the next three to five years and the basis for those projections.

Collateral
Banks typically will seek to obtain sufficient collateral to secure commercial loan requests. To determine whether your business has the necessary collateral, the bank will likely use the following criteria:

- If you are using commercial real estate for collateral, the bank will typically want to know that, based on the property's appraised value minus any current mortgages, your business owns at least 20 to 25 percent of the interest in the property.
- If you are using accounts receivable as collateral, then the bank will typically use the following formula: 100 percent of the receivable accounts, multiplied by the receivable collection rate, multiplied by 70 percent, minus any current liens against accounts receivable assets.
- If you are using equipment and furniture as collateral, the bank will typically credit between 80 and 100 percent of a new purchase or 70 percent of the asset value after depreciation is figured and minus any current liens against the equipment or furniture.
- If you are using cash assets, then the bank will typically consider 100 percent of the assets minus any cash asset liens.
- If you are using marketable securities (such as stocks or bonds) as collateral, then the bank will typically consider 70 to 75 percent of the portfolio's value and 65 to 70 percent of the mutual fund value, minus any current liens against your marketable securities.

Analysis
The bank will likely consider the following questions when deciding whether to grant your business a loan:

- Is there sufficient collateral?
- What is the personal credit history, the debt-to-income ratio and the liquidity of the business owners and/or any other guarantors of the loan? (Typically, banks look for a business to have no more than a 40 percent debt-to-income ratio.)
- Does the business have sufficient cash flow to service the debt? To find out if your business has sufficient cash flow to cover a loan, you may wish to contact a lender, an accountant, or an attorney.

–by Paul E. Peltier, an attorney and director of wealth management for Champaign Bank based in Dublin, and Timothy M. Oyster, a business banking officer for Champaign Bank. Updated by Jeffrey S. Rosenstiel, attorney and director of credit administration for Central Bank & Trust Co., and formerly a partner with the law firm of Frost Brown Todd LLC.

Should You Buy or Lease Your Business Assets?

Business owners often struggle with the issue of whether it is better to buy or to lease business assets such as vehicles, equipment, space, etc. Unfortunately, there is no one right answer. Rather, a business owner must look at a number of factors.

In many instances, an outright purchase of an asset makes more economic sense than a lease. A *lessor* who leases an asset to a business takes a risk, but also wants to make a profit, so risk and profit considerations are built into the lease price and paid by the *lessee* (the business). Obviously, a business owner can eliminate the lessor's profit by purchasing the asset directly.

When leasing makes sense
There are many situations in which the business owner is better off to lease an asset. Cash flow concerns may make leasing attractive. A lease generally requires less up-front cash and lower monthly payments, which can free up cash flow for other business needs.

Leasing also makes sense when an asset is only needed for a short period of time. Short-term leases work well for short-term asset needs and may be a smart decision when it is not known how long the business will need the asset. Another reason to lease is to avoid the risk associated with owning an asset.

Many business assets, especially high-tech equipment, are likely to decrease in value quickly. Many business owners are unwilling to assume this risk. A lease allows the business to pass this risk on to the lessor.

When buying makes sense
In general, it is more advantageous to purchase rather than to lease business assets. Purchasing assets will eliminate the lessor's profit, resulting in a lower overall cost for the business. Also, the law requires fewer disclosures for leases than for purchase loans, and lease agreements may be more complicated than purchase agreements or may contain undesirable limitations. Certain purchased assets (such as buildings) may provide equity for the business, and, over the long run, purchased assets should allow the business to retain more profits.

Weigh tax considerations
When determining whether it makes more sense to buy or to lease, a business must consider the tax ramifications. This is especially true if the business is looking at purchasing a luxury automobile that is subject to special depreciation and lease expense limits. Congress passed tax provisions a few years ago that limit the amount of depreciation that can be taken on many vehicles.

Similarly, there are some *income inclusions* that apply to more expensive vehicle leases. The amount reduces the lease expense deduction. Generally, the income inclusion rules are not as bad as the depreciation limitations. In other words, leasing can have a tax advantage over purchasing a luxury vehicle.

–by Bruce D. Bernard, Esq., tax strategist with Bernard Law, LLC in Worthington.

Retirement Plan Option for Small Employers May Make 401(k) Plan Affordable

Q: What, exactly, is a 401(k) plan?

A: A 401(k) plan is a type of profit-sharing plan under which employees can elect to defer a portion of their compensation. The employer may, but is under no obligation to, match all or a portion of the employees' deferrals.

Q: My employees would like my company to consider offering a 401(k) plan, but my business is small. Is such a plan affordable for small business owners?

A: Due to low employee contributions and relatively high administrative costs, 401(k) plans are not typically the most advantageous retirement plan option for many small business owners. However, plans can provide a significant design option that can benefit business owners at a relatively low employee cost. Although 401(k) plans previously allowed employees to defer a portion of their compensation to the plan, the owner's contribution was limited by the level of employee deferrals. Under Section 401(k)(12) of the *Internal Revenue Code*, the complex and costly non-discrimination rules have been simplified by optional *safe harbor* rules.

Specifically, a business owner can defer up to $17,500 in 2013 to a plan on his or her own behalf regardless of the level of participation by other employees, provided the employer makes a contribution on behalf of each eligible employee to the 401(k) plan equal to three percent of that employee's compensation. Alternatively, the employer can contribute a safe harbor basic matching contribution equal to 100 percent of the first three percent of compensation deferred by employees and 50 percent of the next two percent of compensation deferred (*e.g.*, if the employee defers five percent of compensation, the matching contribution will be four percent of compensation). An *enhanced match* of a 100 percent match on deferrals up to four percent of compensation may also be substituted for the basic matching contribution. Stated another way, for a three- or four-percent employee cost, the business owner can obtain a significant contribution with administrative costs that should be significantly reduced from those that traditional 401(k) plans.

Further, an employee aged 50 or older can defer additional *catch-up* contributions into the 401(k) plan up to $5,500 in 2013. The catch-up contribution is in addition to the normal $17,500 limit. Thus, the maximum elective deferral for an employee aged 50 or older is $23,000 (*i.e.*, $17,500 + $5,500) for 2013. The dollar limits for both the elective deferral and the catch-up contributions will be adjusted for cost of living in future years.

Q: What, exactly, are the benefits to a small business owner?

A: The following example illustrates the significant benefits available to the small business owner. Assume the following: annual revenues are $400,000; staff compensation is $108,000; and owner compensation is $170,000.

EXAMPLE:

1) The owner has $170,000 compensation.
2) $170,000 x 3 percent (safe harbor contribution) = $5,100.
3) The owner can defer $17,500 ($23,000 if aged 50 or older) to the plan because the safe harbor three percent contribution is satisfied.

4) Total for owner: $5,100 + $17,500 = $22,600 (or $28,100 if age 50).
5) The employer cost for non-highly-compensated employees is three percent of compensation or $3,240; *i.e.*, $108,000 x three percent = $3,240.

Under a safe harbor 401(k) plan, the benefit to the business owner is as follows: for a staff cost of three percent, or $3,240, the business owner can receive a total retirement plan contribution of $22,600 ($28,100 if age 50) from a total contribution pool of $25,840, or 87.5 percent ($31,340 or 89.6 percent if owner is age 50 or older) of all monies put into the retirement plan by the business and the owner.

Additionally, employees have been provided with the opportunity to save for their own retirement through the 401(k) plan.

Due to the safe harbor rules for 401(k) plans, the administrative burdens for such plans have been reduced. With the availability of significant contributions to the business owner, which, in practice, may not have been previously available, small business owners should consider changing both traditional profit-sharing plans and/or costly cross-tested plans into safe harbor 401(k) plans.

–by Richard A. Naegele and William P. Prescott, attorneys in the Avon firm of Wickens, Herzer, Panza, Cook & Batista.

Is a Safe Harbor 401(k) Right for Your Small Business?

A 401(k) retirement plan can be a valuable tool with which you, as a small business owner, can provide a plethora of essential benefits to your employees, as well as to yourself. A well-designed plan will assist you in attracting and retaining skilled employees while entitling you to a tax deduction for contributions made to your employees' accounts. Further, monies you and your employees contribute to the plan will grow on a tax-deferred basis until they are distributed. You can design a 401(k) plan to allow your employees to decide how much money they would like to contribute each year, and to manage their own account investments within the guidelines set for them. Such benefits have been shown to greatly motivate employees to save for retirement. They also contribute to the formation of a stronger bond between you and your employees, which has been shown to increase employee retention rates.

An increasingly popular type of 401(k) retirement plan is the Safe Harbor 401(k). Generally, if you contribute three percent of your employees' compensation to a "safe harbor" plan, *or* you make a four percent dollar-for-dollar match on the contributions of each plan participant, then all plan participants (including you, as the business owner) can make the maximum tax-deferred contribution to the plan ($17,500 for 2013, or $23,000 for participants over age 50).

Business owners who opt for non-safe harbor 401(k) plans must comply with certain non-discrimination rules that restrict how much they may contribute to the plan. Ordinarily, such "regular" 401(k) plans must satisfy non-discrimination testing each year to show that highly compensated employees (business owners who own five percent or more of the company qualify as "highly compensated" employees) do not benefit more than non-highly compensated employees. If, instead, you make a "safe harbor" contribution or match as discussed above, you can circumvent this non-discrimination testing process while achieving the maximum tax savings allowable under your plan.

Ultimately, a Safe Harbor 401(k) plan will allow you to provide the important benefit of contributing towards your employees' retirement while saving for your own retirement, without assuming the higher costs associated with the other available employee benefit options. The deadline for establishing a new Safe Harbor 401(k) plan is October 1 of each year. Consult with an attorney experienced in tax-qualified retirements well in advance of the October 1 deadline.

–by Kelly A. VanDenHaute, an attorney with the Avon firm of Wickens Herzer Panza Cook & Batista Co.

Key Considerations When Adding Private Equity to Your Portfolio

A private equity investment is an investment in a privately held company either made directly or, more typically, through a private investment fund. The investment fund professionals actively guide the companies the fund acquires. This active involvement optimizes the companies' potential value to the fund.

Private equity seeks to earn a higher return than publicly-traded stock to compensate for the lack of a public market on which the investment can be sold. Here are some things to consider when adding private equity to your portfolio:

1) **Diversification.** Until you have achieved diversification, avoid "one-shot" deals where all can be lost.
2) **Quality sponsors.** It all gets down to an investment in people. Be proud of the character, integrity and judgment of the people in whom you are investing.
3) **Quality co-investors.** Similarly, ask yourself if you are proud to be among the investment group. Can you speak to the character, integrity, judgment *and investment acumen* of your co-investors?
4) **Simple, understandable products or services.** Do you understand what you are investing in? Compare an electric toothbrush with disposable brushes to a free space, optical transceiver (whatever that is). If you do not understand it, you probably should not invest in it.
5) **Use of proceeds.** Understand how your money will be spent. For pure research and development? To test a product? To commercialize a proven product? To acquire a number of different companies? To enrich the promoter?
6) **Projected return.** As Yogi Berra said, "If you don't know where you're going, you'll probably end up there." You should know the projected return and the risks assumed in trying to achieve it. Higher risk investments should yield higher returns—annualized Internal Rate of Return of 15-30 percent. If less is projected, you should probably not bother. If more is projected, you should probably run for cover.
7) **Legal rights.** Before committing to invest, understand your rights (and obligations) as a minority shareholder or limited partner with respect to, among other things,
    - management fees and carried interests;
    - dilution;
    - distributions;
    - capital calls;
    - transfers of interests;
    - tag-along/drag-along rights;
    - registration rights.

–by Joseph K. Juster, chair of the General Corporate Group at the Cleveland office of Calfee.

Bill Collection: How To Get the Money You're Owed

Q: I own a small business and my accounts receivable increase every month. I have sent my customers statements and many sternly worded letters to little effect. What can I do?

A: You can begin collection proceedings against your customers by first getting a judgment in court and then *executing* on that judgment by garnishing bank accounts or wages, filing liens against their homes or ordering certain assets to be seized.

Q: If I have decided I have no choice but to sue my customers, what should I do next?

A: It may be easier to retain an attorney to file these lawsuits, but if you have only a few customers to sue and the amount you are owed is small enough, you might be able to file a lawsuit yourself in small claims court.

Q: If I sue my customers and receive judgments against them, they will be forced to pay me, won't they?

A: Many people do not realize that a judgment is only an official acknowledgment that money is owed to you and not a directive for money to transfer hands. It is your job to try to collect that money. The easiest way to do this is to garnish the debtor's bank accounts or wages. To garnish someone's wages, you must file paperwork asking the court to seize the money from the judgment debtor's bank account or wages. The debtor, in turn, will have a chance to be heard by the court before any garnishment is granted.

Q: How does the wage garnishment work?

A: A person's wages can be garnished only up to 25 percent per pay. If, however, the person is paying other court-ordered deductions such as child support, the amount that can be garnished will be reduced. Garnishments are continuous orders, meaning that once you file the paperwork, employers must withhold funds from an employee's paycheck until your judgment is satisfied. Unfortunately, if another creditor is already garnishing the debtor's wages, you may have to wait as long as six months until the other garnishment is complete.

Q: What other property can be garnished?

A: In addition to wage garnishment, a debtor's real and personal property is also subject to collection, including interests in residential property, motor vehicles and household items. However, recent changes to Ohio's exemption laws have increased protection for debtors. Specifically, the new law significantly increases the dollar amount of already existing exemptions for certain categories of property that an Ohio debtor may hold exempt from execution and garnishment. For example, the new law exempts from collection a debtor's interest in one motor vehicle in the amount of $3,225. Previously, the exemption was $1,000.

Q: Are there any other options for collections?

A: Yes. For instance, you may take your judgment and file it as a lien against a person's house and foreclose upon it. Also, you may ask the court to seize tangible items (*e.g.*, jewelry, computers, equipment) and sell them at auction and then give you the proceeds. These are fairly complex procedures that are difficult to do without a lawyer's advice.

–by Christopher Ernst and Daniel Gerken, attorneys with Bricker & Eckler LLP. Mr. Ernst is in the Cleveland office and Mr. Gerken is in the Columbus office.

A State Tax Time Bomb

You just finished reading a memo from your company's treasurer advising you that a southern state had billed the company for six figures worth of back taxes, interest and penalties dating back to 1989. To make matters worse, he told you that the company had also received questionnaires from two more state revenue departments indicating that they thought your company may be "doing business" in their states.

How can we owe money to these states? We don't have offices or employees in those states. Did any of our advisors tell us that we were engaged in interstate commerce and, therefore, not subject to such taxes?

The situation becomes more complex over the next few weeks as the company receives questionnaires from several more states. Another state has sent you a bill, which is larger than the first. How far back can they go and how do they know about us?

Unfortunately, many small companies are beginning to experience events similar to what has just been described. What formerly was a non-issue for small- and medium-sized businesses has become an expensive and frightening nightmare. What is going on and why does it seem to be getting worse?

As in every other area of life, state and local governments require money to operate. In order to effectively increase revenues, a government must either increase tax rates or do a better job of collecting taxes that it believes are owed. Accordingly, over the last few years, two trends have occurred with regard to business taxes. State and local governments have pressed for court interpretations that would allow them to tax companies doing business in interstate commerce. At the same time, those governments are devoting more resources toward collecting their taxes.

Courts appear to be moving in the direction of allowing states to tax companies based on "economic presence" in the state even when the company in question has no physical presence in the state. In October 2008, the Indiana Tax Court, relying on the rationale of a similar decision issued by the West Virginia Supreme Court of Appeals, held that an out-of-state credit card issuer is subject to the state's financial institutions tax, despite the fact that the company does not maintain any tangible property or employees in Indiana. Most recently, in 2012, the West Virginia Supreme Court of Appeals reaffirmed its prior ruling that physical presence within a state, through the establishment of offices and employees, is not required in order for a company to be subject to taxation. Additionally, courts in Iowa, Massachusetts and Louisiana have moved toward imposing taxes based on a business's "economic presence." This may signify a trend that could embolden other states to follow suit and press for taxation of the activities of out-of-state entities irrespective of a business's actual presence within the state.

Thus far, the U.S. Supreme Court has declined the opportunity to settle the debate over whether mere economic presence in a state is sufficient to permit state taxation of business activities. Congress could clarify matters, and, in fact, multiple bills have been introduced in the U.S. House of Representatives that would prohibit state taxation of an out-of-state company unless the company has a physical presence in the taxing state. However, as of this writing, no such bill has emerged from the House Subcommittee on Commercial and Administrative Law, and the fate of the proposed legislation is unclear. Given the uncertainty in this area, and the potential for tax liability in dozens of states across the country, companies doing business of any kind across state lines should obtain the services of a multistate tax professional to assist them in making an analysis of the company's methods of business and its tax exposure.

–by David L. Chilcoat, a partner (retired) in the Columbus law firm of Campbell Hornbeck Chilcoat & Veatch. Updated by Justin L. Knappick, an attorney with Dressman Benzinger LaVelle psc.

Business Taxes: Part of the Expense of Making Money

Q: I just started a new business in Ohio. What do I have to do about taxes?

A: First, your business should file for its federal Employer Identification Number (EIN), commonly known as the tax identification number. Your business should have an EIN even if it has no employees. To obtain the number, complete Internal Revenue Service Form SS-4. Through the form, the IRS asks basic questions such as the business name and address, the names of the owners or officers, the form of business (for example, corporation, limited liability company, partnership or sole proprietorship), the starting date of the business, a brief description of the business, its accounting year end and the number of employees expected over the next year. Form SS-4 and other IRS forms and instructions may be obtained from the IRS Internet site, www.irs.gov.

Q: What happens after I complete Form SS-4?

A: You may complete and file Form SS-4 online through the IRS Internet site or you may telephone the information on the form to the IRS. By applying online or by telephone, you will receive the EIN immediately. Alternatively, you may apply for an EIN by facsimile or mail. The instructions for Form SS-4 contain the addresses and telephone numbers for filing the form. Whatever method is used, after the IRS processes the registration, the IRS will send your business the applicable federal income tax and payroll and withholding tax forms. Your business may still need to register with state and local authorities.

Q: What about state and local registrations?

A: If your business will have employees, it must file for employer identification numbers in the state and locality where the employees will work. These filings will establish the business's accounts for state and local payroll and withholding taxes. In Ohio, unemployment compensation and workers' compensation also require registrations. In addition, certain types of businesses may need local licenses or permits before opening. Finally, if your business will collect and remit sales tax as a retailer, your business will need an Ohio vendor's license. You may obtain information and forms about Ohio taxes from the Ohio Department of Taxation at its Internet site, http://tax.ohio.gov, or call the Ohio Department of Taxation's Taxpayer Service Center at 1-800-282-1780. In addition, Ohio's state government Internet site has a comprehensive section about registration and taxes for new businesses at http://business.ohio.gov/starting.

Q: What taxes will my business pay?

A: Essentially, your business could be taxed by three levels of government: 1) federal; 2) state; and 3) local. In addition, for income taxes, your business could be taxed at its location and anywhere it conducts business if its business activities establish some connection or nexus to other locations beyond sales solicitation. Business taxes and the concepts of nexus and solicitation are complex; therefore, no short, definitive answer is possible here. However, Ohio businesses typically will owe federal, state and local income taxes; federal, state and local payroll and withholding taxes; state and local sales or use taxes; and local real property taxes.

In addition, because some taxes depend on the type of entity or the type of business conducted, other types of income, excise, property or transaction taxes could apply.

Q: When will my business pay these taxes?

A: Timely payment of taxes is required to avoid penalties and interest. Deadlines for filing some tax returns may be extended, but generally the time for payment of the tax owed may not be extended without incurring interest charges.

For calendar-year corporations, federal income taxes are payable in estimated quarterly installments on March 15, June 15, September 15 and December 15. Local income taxes usually follow the federal quarterly schedule.

Ohio has a commercial activity tax (CAT), a business gross receipts tax that replaces the Ohio corporation franchise tax and the Ohio personal property tax. Depending on the amount of gross receipts, CAT filers file and pay the tax annually or quarterly.

For pass-through entities, such as partnerships, sole proprietorships and some limited liability companies, the owners pay the income taxes. For the owners of such pass-through entities who are persons, the personal income tax rules apply and both federal and Ohio income taxes are paid quarterly on April 15, June 15, September 15 and January 15. Local income taxes may be due on a quarterly basis, too.

Federal, state and local payroll and withholding taxes are generally due monthly or semi-weekly. After registration, tax authorities will give your business payroll and withholding tax payment schedules that will vary according to the estimated amount due.

Real property taxes in Ohio are due twice a year. The due dates are December 31 and June 20, but most counties extend these dates.

Q: When are the tax returns due?

A: For calendar-year-end corporations, the federal corporate income tax return is due March 15, following the year end. Local income tax returns may be due then, too. For Ohio's commercial activity tax, annual filers file a return on May 10, and quarterly CAT filers file returns on May 10, August 9, August 10, November 10 and February 1.

For calendar-year-end partnerships, the federal partnership return is due March 15. For other pass-through entities, the personal income tax rules apply to owners who are persons, making April 15 the due date for reporting business income (or loss) on a personal income tax return. Local governments may require income tax returns on these dates, too.

Ohio sales tax returns are due semi-annually, quarterly or monthly depending on the sales tax due and whether the business holds a vendor's license or a direct pay permit.

Federal, state and local payroll and withholding tax return due dates also vary depending upon the amount due.

Finally, the IRS, Ohio and most local governments require annual reconciliations of the prior year's payroll and withholding taxes by January 31. Also, the IRS requires businesses to provide employees and others with certain information returns, such as Form W-2 or the Form 1099 series, by January 31.

All the dates listed in this article are subject to change, so follow the instructions listed on the applicable tax forms.

Finally, business and personal taxes are detailed and have many variables. Therefore, the information presented here considers only some basics. No general answer can cover all situations. Consult a tax practitioner for advice and answers about your tax questions.

–by Columbus attorney Scott F. Sturges.

Tax Planning for Mature Companies

Tax planning opportunities abound for companies that are fortunate enough to reach a mature state. A company is considered to have reached a mature stage when it no longer needs to retain significant earnings to sustain growth and expansion. Such a company has gone through the painstaking years of accumulating equity and struggling with financing growth, and its planning needs are far different from those of companies in the start-up or growth and expansion phases.

A company may continue in the growth and expansion mode for many years, but may manage its growth and become profitable. However, when the owners of such a sustained-growth company near retirement age, they must address many of the tax-planning issues they would normally consider if their company had already reached maturity.

Whether a company is in the start-up or growth and expansion phase or is a mature company, business owners are wise to “keep the company in a saleable position.” The succession plan for many business owners is to eventually sell the company to insiders or strategic buyers. Tax planning is one of many ways business owners can increase the value of the business to a prospective buyer.

One important factor that may affect an eventual sale is the type of business entity owners choose. When a company reaches maturity, it is usually beneficial for it to be a flow-through tax entity such as an S-corporation, a limited liability company or a partnership. These business types generally will result in only one layer of tax when the business is sold. An S-corporation may be especially attractive to buyers since certain opportunities are available only when there is corporate stock.

A mature company that no longer needs to retain earnings for growth and expansion should normally be a flow-through entity, regardless of the potential for sale. The flow-through entity generally will result in the lowest level of overall taxes. Further, the flow-through entity is better for estate planning.

There are, however, situations where a company should remain a C-corporation, even if a sale is anticipated. For example, a company should consider remaining a C-corporation if it has lower levels of retained earnings (say less than $100,000) from year to year and there are other tax planning opportunities available to avoid tax problems upon a sale. It is sometimes possible to take advantage of the lower current rates without compromising on the tax planning available upon a sale.

It is often advantageous to vertically or horizontally segregate a business into separate business entities. Sometimes this is desirable for liability issues. There can also be lower current income taxes and eventual lower taxes upon the sale of the company. Estate planning is often facilitated with separate entities.

Several other tax planning ideas that may be of value include the following:

- A deferred compensation or non-qualified stock option plan can create deductions at the company level to offset gains.
- Document times when owners are under-compensated, even though they are providing employee services, so you can justify providing a bonus in the future if it is advantageous to do so for tax reasons.

- Review any non-compete and employment agreement to make sure the company can maximize *shareholder intangibles* upon a sale.

Many tax-planning opportunities arise at the time of a sale. However, other ideas need to be implemented well in advance of the sale. Maximizing after-tax proceeds is the key.

Tax planning for mature companies is not limited to a potential sale of the business. Business owners also should consider implementing or updating qualified retirement plans. The key is to establish a plan that benefits the people the owners want to benefit. A qualified plan can allow current reduction of taxes, tax-free accumulation of income and deferral of income to be taxed at lower rates upon retirement.

Other fringe benefits should be reviewed. A medical reimbursement plan, long-term care insurance and health insurance for key employee retirees (including the owners) should be considered.

Reimbursement plans should be reviewed. Is the maximum tax advantage being received for work-related expenses incurred by the owners?

Key men and *buyout* life insurance policies often have not been structured properly for the succession plan. The tax and non-tax considerations of such policies must be reviewed.

In general, the owners should be looking at their overall succession and estate plans. These issues come to the forefront with mature companies. It may be appropriate for owners of such a company to build a new line of key management, shift wealth, shift income and identify potential strategic buyers for the future.

–by Bruce D. Bernard, Esq., tax strategist with Bernard Law, LLC in Worthington.

Dealing with Your Bank When Your Company Is Underperforming

If you are not meeting your banker's expectations, your loan is considered a "troubled loan." Here are some tips to improve your chances of turning your business around. Current market conditions and financial institution consolidation and volatility make it even more important to maintain a strong relationship with your bank and banker.

- **Establish a strong relationship with your lender.**
  Relationships matter. Get to know your banker. Invite him or her to your business. Share pertinent company information.

- **Provide information.**
  Bankers never complain that one of their portfolio companies is providing too much information.

- **Be honest.**
  Lenders can work through a myriad of problems with you, but dishonesty will sour the relationship, probably beyond repair. Failing to inform your lender about something significant is akin to lying.

- **Have a plan.**
  Lenders invest in people more than companies. It is critical to keep your lender's confidence. Take the time to work with your key staff and advisors to create a business plan that can get you back on track.

- **Be flexible.**
  Maybe your strategy is flawed. Do not be afraid to adjust market, customers, pricing and personnel to allow you to be profitable.

- **Be humble.**
  You are no longer dealing from a position of strength. You may be asked to enter into a forbearance agreement. You may be presented with tighter financial covenants, closer monitoring and more frequent reporting. Embrace these constraints; you probably do not have many viable alternatives.

- **Keep your eye on the ball.**
  With everything else going on around you, do not forget to mind the store. It is easy to fall into a catatonic state and do nothing.

- **Hire a qualified attorney to help you through the process.**
  Yes, your interests must be protected, but by someone who understands the art of pre-workouts.

- **Safeguard your collateral.**
  Whatever security was originally taken by the bank, make sure you keep it in working order. That collateral provides comfort to the banker. If the value of the collateral falls, the pressure on the banker to call your loan will continue to increase.

- **Continue to explore options.**
  Look for other funding sources. There are many alternatives to traditional banks. But remember, they all are going to be more expensive, which can make your recovery more difficult.

Remember, your banker wants you to succeed. If you are successful, so is the banker. Follow these suggestions and the odds of turning your business around will increase markedly.

–by Thomas C. Washbush, a Columbus attorney.

Knowing about Foreclosure Can Help You Avoid It

Q: What is a foreclosure?

A: A foreclosure is a type of lawsuit. In a foreclosure case, a lender sues any borrower who has failed to make mortgage payments as required under the terms of the loan contract. Most foreclosure suits have two "counts," or parts: count one is for a money judgment on the promissory note, and count two is for a foreclosure of the mortgage. The lender first seeks a judgment entry (the court's official written decision on the case) and then a court order to sell the borrower's real estate. The borrower's real estate is sold to raise money so that the debt owed to the lender can be paid. There is usually a promissory note signed by the borrower(s) that defines the debt, and a mortgage signed by anyone with a title interest in the land (usually the *titleholder*, but sometimes a *lienholder* or a *spouse with dower interest*, etc.). The borrower generally is a titleholder, and any titleholder signing the mortgage is known as the *mortgagor*, while the lender is known as the *mortgagee*.

Q: I hold the title to my business property, but I'm concerned I may not be able to continue making mortgage payments to my lender. Who can initiate a foreclosure on the property?

A: A foreclosure in Ohio is initiated when a complaint is filed in the common pleas court in the county where the real estate is located. Your lender can initiate a foreclosure, either in its name or in the name of a company, called a servicer, which your lender has hired to collect payments from you and to administer your loan account. Because modern mortgage lending practices are complex, your lender might not be a company or bank that services its own loan. Often, your lender or servicer is located out of town or even out of state. This makes dealing with your lender more difficult than in the "old days" when you could walk down the street and talk to the people in the bank who had lent you the money to buy your property. Servicers usually have "800" numbers for you to call toll-free to discuss your loan or websites so you can communicate with them. This information will appear on most letters sent to you from either the lender or servicer.

Q: Can I prevent a foreclosure action from being filed?

A: Yes. If you fall behind in your mortgage payments, or even if you know that you are going to fall behind in the near future, contact your lender or its servicing agent immediately. Lenders do not want their customers in foreclosure, which is costly and time-consuming to lenders. Often, the proceeds of the foreclosure sale are insufficient to pay off the loan. Most lenders have a workout or loss mitigation department (often referred to as "loss mit"). These people will talk to you to see if there is a solution other than foreclosure.

Before the 2008 mortgage crisis, many borrowers who fell behind in their mortgage payments could market and sell the property, including the business assets, to pay off the mortgage loan with minimum damage to their credit. However, plummeting market values made this option more difficult, resulting in more foreclosure suits.

Q: What alternatives might be tried before foreclosure becomes necessary?

A: The most frequent alternative to foreclosure traditionally has been a repayment agreement, sometimes called a *forbearance* agreement. The terms are flexible, but generally you will need to resume payments and make arrangements to pay the past due amounts over a short period of time. Another type of workout is called a *loan modification*, which is usually made to lower monthly payments permanently or for a fixed time period of anywhere from three or six months to five or ten years. To accomplish this, the lender can lower your principal balance or interest rate or even extend the final due date of your loan. A loan modification amends the previous contract so that it is, in effect, a new contract. Both the borrower and the lender must sign the loan modification, and the lender later will record the agreement.

Before entering into either a forbearance or a loan modification agreement, your lender will require you to complete a loss mit package. This package includes many forms and requires you to produce tax returns, bank statements and other financial documents. After the servicer reviews your completed loss mit package, the investor must also approve it. (An "investor" can be the lender, or it might be another party that has funded the loan.) It is important to note that investors can have widely varying guidelines for loan modifications, and these usually are not subject to government regulation.

Please also note that the government programs you might have read about in the news, such as the federal Making Home Affordable Program (also known as HAMP, HARP, or the "Obama Plan"), are limited to residential (and certain rental property) mortgage loans and do not apply to business loans.

Q: I have other loans with my lender besides my business's real estate mortgage. Might these be affected if my business mortgage is foreclosed?

A: Possibly. If you have obtained equipment financing, lines of credit or other loans from the lender that holds your mortgage, your loan documents might contain a provision called a *cross-collateral agreement.* This provision states that a default on one agreement will constitute a default on any other agreement also containing that provision. Thus, the mortgage default can lead to a *domino effect* where your lender calls all your other loans due with drastic results for your business.

Q: If I do NOT have other loans with my mortgage lender, but DO have different loans with other lenders, might these loans be affected by a foreclosure?

A: Possibly. Some business loans have provisions stating that if the lender "deems itself insecure," it can call your loan due. Defaulting on your mortgage loan might give your other lenders grounds to call their loans due even though you have continued to pay the other lenders according to the terms of those loans. In addition, credit cards often have *universal default* provisions under which credit card companies can declare default because of a foreclosure even though payments on the credit card are current.

Q: Is a lender required to work with me before filing a foreclosure complaint?

A: Generally, no. Most loan agreements (the promissory note as well as the mortgage) provide that, if you fall behind on one payment, the lender has the right to call the entire balance of the loan due and start a foreclosure case. Few lenders proceed in that way after only a one-payment default. However, by the time a loan is three months delinquent, lenders are looking very closely at whether to foreclose. The key to preventing the filing of a foreclosure is communication.

However, if you signed a *cognovit note*, the lender can have an attorney of its choosing confess a judgment against you with no notice before the *cognovit* judgment is entered. You will only receive notice after the judgment has already been entered. Finally, please also note that a lender is not required to accept partial payments, which means that it can even reject a tender of three-and-one-half payments when you are four months past due.

Q: What alternatives to foreclosure do I have after the lawsuit is filed if I want to keep the property?

A: Generally, the same types of alternatives exist as were available before the lawsuit was filed: forbearance agreements or loan modifications. In addition, there are three other main alternatives: *reinstatement, refinancing (*known as a *"refi"),* or *short sale*. *Reinstatement* is a process through which the borrower brings the account current, and any foreclosure suit is immediately dismissed. Almost every mortgage will have a paragraph describing the reinstatement process, which usually requires you, the borrower, to pay the lender's attorney fees and costs. Or you can *refi* the loan with a new lender and pay off the old mortgage. In that case, Ohio law does not require you to pay the lender's attorney fees. Last, in a *short sale*, the lender might agree to accept less than a full payoff through a private sale.

All of the options described above require you to complete a loss mit package. This package contains many forms and requires you to produce tax returns, bank statements and other financial documents.

Q: What alternatives do I have after the lawsuit is filed if I do NOT want to keep the property?

A: You can pay off the loan by a private sale (as opposed to a court-ordered sale) of the property. This might not be a preferred resolution if, as a business owner, you would like to continue doing business in the location your customers have come to know. A private sale must be for an amount sufficient to pay off your loan and all other lienholders, although some lenders might voluntarily agree to take less or even nothing.

Also, you can ask the lender to take the property back in full satisfaction of the debt. This is called a *deed-in-lieu of foreclosure* (DIL). Because many times the value of the property is less than what you owe on the mortgage, a DIL protects you from a likely deficiency judgment. A lender can obtain a judgment against you for the amount you still owe after the court-ordered sheriff's sale if the proceeds of the sale are not enough to pay off the debt. This is called a *deficiency judgment*. The lender could then garnish your bank accounts or take other steps to collect the deficiency. By accepting a DIL, your lender is forgiving you from the obligation to repay the remainder of the debt. Lenders will accept a DIL only if there are no other liens against the property and if the property is vacant.

Please also note that Ohio has a statute limiting a lender's right to collect a deficiency balance on a primary residence foreclosure to only two years after the sheriff's sale is confirmed. This might arise when you pledge your home as extra collateral in a business loan. In addition, in 2008, Congress enacted a law preventing lenders from filing a Form 1099 after a deficiency balance is charged off on a primary residence.

Q: Can bankruptcy help me avoid foreclosure?

A: Yes, depending on the type of bankruptcy case you file. Small business owners can file for protection under Chapter 11 or Chapter 13 of the Bankruptcy Code. A Chapter 13 bankruptcy permits you to repay the delinquent amount you owe your lender over time, up to five years. You have to pay the regular monthly payments and an additional amount each month until the loan is current according to the contract. A Chapter 11 filing can provide much greater flexibility in how to deal with a delinquent mortgage loan. You should consult with a bankruptcy lawyer for assistance in determining what type of bankruptcy case might help you avoid foreclosure.

Q: What are the steps in a foreclosure?

A: A foreclosure is a judicial process with a number of steps, which we will call the early, middle and late stages of a case.

Q: What happens in the early stage?

A: Before the case is ever filed, the lender sends a foreclosure referral package to an attorney. The attorney will review records at the courthouse in a process called a *title examination* to identify all persons who have an interest in your property, which will include individuals, their spouses for *dower* rights, partnerships, and corporate or governmental entities. Any person who has some type of ownership interest or lien against the property will be named a defendant in the suit. In addition to parties with an interest in the property, the complaint usually names any borrower or co-signer on the loan. By having all interested parties involved in the case, the court can make decisions that are binding on everyone concerned.

After the complaint is filed, the attorney will instruct the court to send you a copy of the lawsuit, usually by certified mail and/or through delivery by a sheriff's deputy. You are entitled to know about the lawsuit, and you must be served with a copy of it before your lender can proceed to sell your property. Once you receive a copy, you have only 28 calendar days (including weekends) within which to respond formally to the court. If you do not do so, the court can enter a default judgment against you. Anytime you receive a lawsuit filed against you, including a foreclosure case, you should consider discussing your rights, options and responses with an attorney.

Q: What happens in the middle stage?

A: After all the parties to the case have been served with a copy of the lawsuit, your lender will ask the court to order the sale of the property to pay the debt. This is usually done through a motion for a judgment entry. In cases where you also signed a promissory note evidencing your promise to repay the money that was lent to you, the lender will ask for a money judgment to be awarded against you. Usually, the court orders that a money judgment be awarded and that the property be sold to raise money to pay the debt.

Q: What happens in the late stages of a foreclosure?

A: After the court orders the property to be sold, the sheriff will appraise your property, schedule a sale and advertise the sale to the public. The sheriff's sale is a public auction, and any adult can bid and purchase real estate at a foreclosure sale. The property must sell for at least two-thirds of the appraised value of your property. The sheriff reports the results of the sale to the court. Then the lender requests the court to validate the sale, to order a new deed to be drawn to the purchaser and to distribute the sale proceeds. This process is known as the *confirmation* of the sale. The purchaser is also entitled to possession of the property after the sale is confirmed. The purchaser will then be entitled to seek the sheriff's assistance in evicting you if you remain on the property after the sale is confirmed. In the vast majority of cases, the lender buys the property back for an amount less than what was owed, which, as discussed above, results in a *deficiency balance*.

Q: Can I save my property even after the foreclosure sale?

A: Yes. You have a right under an Ohio statute to purchase your property back after the sale and before the sale is confirmed, if you can pay in full the amount that you owe in the judgment entry. This right is known as your *right of redemption*. See an attorney for details about how to accomplish this.

–Originally prepared by Alan J. Ullman, a Cincinnati attorney. Updated by John R. Cummins, an attorney associated with the Cincinnati office of Manley, Deas & Kochalski LLC.

My Customer Has Filed for Bankruptcy – Now What?

Q: My customer claims that he has filed for bankruptcy. How can I verify this?

A: A bankruptcy proceeding is filed in bankruptcy court and is a matter of public record. Your customer should be able to provide you with a notice from the bankruptcy court where the case was filed that sets forth, among other things, the date of filing and the case number. Also, your attorney should be able to obtain filing information.

Q: My customer hasn't paid our last two invoices for materials shipped three months ago. I just got a notice indicating that the company has filed for bankruptcy. Can I still send collection notices?

A: No. Bankruptcy law includes an "automatic stay" that prohibits you from taking any further collection actions once your customer has filed for bankruptcy. This means you cannot send any further billing statements or continue any lawsuits that you may have filed.

Q: I shipped goods to my customer before I knew he had filed for bankruptcy. Can I get my goods back?

A: Maybe. If you have delivered goods to the debtor within 45 days before the bankruptcy filing or the goods are in transit to the debtor at the time of the bankruptcy filing, contact your attorney immediately. Special "reclamation rights" may allow you to get your goods back, but there are tight time frames for the exercise of these rights.

Q: What's the difference between a secured creditor and an unsecured creditor?

A: A secured creditor has specific collateral for its claim, such as a house, car, equipment, inventory or receivables. The secured creditor does not lose the lien on its collateral just because a bankruptcy has been filed and normally retains the right to be paid from the proceeds of its collateral. An unsecured creditor has no such collateral.

Q: If I am an unsecured creditor, is there any way I can be paid once my customer has filed bankruptcy?

A: It depends on the type of bankruptcy that is filed. In the majority of Chapter 7 bankruptcy liquidations, there are no funds to distribute to unsecured creditors. If there *are* assets, you will need to file a proof of claim by the deadline on the form sent to you by the court in order to share in any distribution. In a Chapter 11 reorganization, a plan may be proposed to allow unsecured creditors to receive a portion of their claims.

Q: What is a "preference"?

A: One of the principles of bankruptcy law is equality of distribution of funds to creditors. The trustee often has the right to recover payments made by the debtor to creditors within 90 days before the bankruptcy filing, if the payments were made to cover back debts and were not made according to ordinary business terms. Such a payment is called a preference.

–by Julie E. Rabin, a principal in the Cleveland firm of Rabin & Rabin Co LPA.

Tax Abatements Exempt Real Estate Taxes for Improvement Projects

Q: What is tax abatement?

A: Tax abatement is the exemption, in whole or in part, of real estate taxes incurred from a specific project. Exemptions can apply to the improved value (new construction or renovation) of a specific property. Incentives are available to homeowners, business owners and developers.

Q: ***What levels of government can grant tax abatement?***

A: In most Ohio locations, municipalities (cities and villages) typically grant tax abatements. In some instances, however, counties and townships may have authority to grant tax abatements, so you should contact your local government to determine which level of government has authority to offer tax incentives.

Under Ohio's Community Reinvestment Area program, a city, village or county can petition the Ohio Department of Development to confirm that investment in housing in a particular geographical area has been discouraged. Once the Department has confirmed that housing investment in the area is weak, the community may offer real estate tax exemptions to taxpayers who are willing to invest in the area. Such exemptions can apply to homeowners as well as businesses. Businesses interested in pursuing this program can contact the local Community Reinvestment Area Officer.

The Ohio Enterprise Zone is another economic development tool that is administered by municipal and county governments. It provides real and personal property tax exemptions to businesses making investments in Ohio. In order to use the Enterprise Zone program, communities must petition the Ohio Department of Development for certification of a geographical zone with a contiguous boundary. Once a zone is certified, communities may enter into negotiated agreements with businesses to invest in the zone. Businesses interested in pursuing this program can contact the local Ohio Enterprise Zone Officer.

The Department of Development also provides other programs, including job creation tax credits and public improvement grants.

–by Kira S. Kittoe-Krivosh, Assistant Cuyahoga County Prosecutor and former attorney for the City of Garfield Heights.

Utilities

Chapter 3

Public Utility Rates: Who's in Charge?

Q: Who controls the rates I pay for public utility services such as telephone, gas, electricity, water and sewer?

A: The Public Utilities Commission of Ohio (PUCO) sets the rates for investor-owned utilities (IOUs), which provide most of the utility services in Ohio. These include companies like AT&T Ohio, Cincinnati Bell, Verizon North, Embarq, FirstEnergy, AEP, Duke Energy Ohio, Dayton Power & Light, Columbia Gas, Dominion East Ohio, Vectren Energy Delivery of Ohio and many other private companies. Some cities and villages provide utility services—usually water and sewer; their rates are set by the city or village council. The remaining utility services are provided by non-profit associations—chiefly rural electric cooperatives (co-ops). Their rates are set by their members rather than by the PUCO.

While most basic telephone services from traditional telephone companies are set on the basis of cost of service, many non-basic telephone services are based upon market conditions. Cable television providers are not regulated by the PUCO, but are or will be issued video service authorizations by the director of the Department of Commerce.

Q: Can a customer "shop around" and buy a portion of his or her energy service from a non-utility?

A: Yes. Currently, a gas customer who receives service from one of the four largest gas utilities (Columbia Gas, East Ohio Gas, Duke Energy Ohio, or Vectren Energy Delivery of Ohio) may qualify to choose his or her own third-party gas supplier. The gas supplier, or marketer, would charge the customer only for the gas itself. That supplier's rates are *not* regulated by the PUCO. However, comparison of such gas rates contained in an "Apples to Apples" chart is available by logging onto the PUCO's website (www.puco.ohio.gov) and clicking on the link for the topic, "Apples to Apples."

These programs that allow a customer to choose his/her own gas supplier are known as "customer choice" programs. Customers who participate in customer choice programs must continue to receive the actual physical delivery of natural gas from the public utility (such as Columbia Gas, Dominion East Ohio, Duke Energy Ohio or Vectren). Customers pay the utility *base rates* to cover the cost to transport the gas to the customer's premises. Not all gas companies offer customer choice programs and not all customer choice programs are available to every customer.

Electric customers served by the investor-owned electric utilities are able to choose their own generation supplier of power whose rates will not be regulated by the PUCO. The utilities, though, will continue to supply the "wire" service to ensure the power gets delivered. However, if a customer does not buy its own power, then the utility will supply power as well as the wire service.

Q: If a customer does not shop for power and the utility supplies the power, how is that power procured?

A: Ohio Edison/CEI/Toledo Edison and Duke have used auctions to procure power for customers who do not shop. Ohio Power and Dayton Power & Light supplies power at a price set by the PUCO. Ohio Power will switch to the auction method of procurement in 2015. These auctions are conducted by independent third-party bid managers and the results must be approved by the PUCO.

Q: What is the PUCO?

A: The PUCO is a state agency located in Columbus that has responsibility for regulating the rates and services of Ohio's regulated utilities. It consists of five commissioners, each of whom is appointed by the governor for a five-year term from a list of candidates provided by a special nominating council. Each commissioner is required to have experience in the fields of economics, law, finance, accounting, engineering or sciences. PUCO commissioners are assisted by a staff consisting of accountants, economists, engineers, rate analysts, attorneys and other support staff members. The staff not only advises the commissioners but also has a very important role in the rate-setting process.

Q: Why do we need a PUCO?

A: Most utility services are monopolies with no competitive market for setting prices or quality of service standards. In order to prevent a monopoly from over-charging customers, the Ohio legislature created the PUCO in 1913. The PUCO was empowered to regulate the rates and services of utilities by balancing the interests of utility customers with those of utility investors. Now, as some utility services are becoming competitive, the legislature is beginning to de-regulate them. For a utility company that is competing with others in the marketplace (much like any other company), the market would replace the need for regulation by the PUCO.

Q: How does the PUCO set my utility rates?

A: Rate cases at the PUCO usually are initiated by the public utility, although they may be initiated by customers or the PUCO itself. Generally, the utility begins the process by notifying the PUCO and the mayors of the affected areas of an intended rate increase. After the utility files a standardized application with numerous exhibits explaining why the increase should be approved, PUCO staff members analyze the information contained in the application and make field visits to review the utility's property, invoices and accounting books.

Approximately five to seven months later, the PUCO staff files a document detailing its findings, conclusions and recommendations. This is called a *staff report*. Other parties such as the Office of the Ohio Consumers' Counsel (a state agency representing residential consumers), commercial customers, industrial customers and cities, as well as the applicant utility itself, may file objections to the staff report. Hearings are then scheduled so that witnesses supporting the positions of the parties for and against the rate increase may be cross-examined.

At the end of the hearings, written arguments (briefs) are submitted. After reviewing the application, staff report and the record of the hearing and briefs, the PUCO renders its decision to grant, modify, or deny the rate increase. The entire rate case process usually takes between 10 and 12 months. Any party dissatisfied with the PUCO's decision may appeal to the Supreme Court of Ohio. The appeal process may take more than a year.

–by Stephen M. Howard, an attorney with the Columbus firm of Vorys, Sater, Seymour and Pease, LLP.

PUCO and Public Utility Rates: How Are They Set?

Q: Is there a formula that is used in setting public utility rates?

A: Yes. In the context of monopoly regulation, the Ohio legislature has prescribed by law the general formula that the Public Utilities Commission of Ohio (PUCO) must follow when deciding how much a utility may charge for its services. This formula is intended to produce rates based upon the public utility's cost of service. That formula is: Rate Base x Rate of Return + Allowable Test Year Expenses = Revenue Requirements.

The first component of the formula, known as the *rate base*, is the amount of dollars that the utility's owners have invested in property that is used and useful in providing utility service. Generating stations, substations, pipelines and buildings would be examples of rate base property. Rate base is reduced each year as it is used up or depreciated to provide the utility's services.

The second part of the formula is a reasonable and fair rate of return to investors of the utility. In recent years, it has been set at a rate between 8 percent and 13 percent. The rate base is multiplied by the rate of return to produce the level of *authorized income* that the PUCO deems appropriate.

The third part of the formula is the "allowable expenses" of the utility. A recent 12-month period called a "test year" is used to gauge the annual level of expenses that a utility may incur in providing utility service. These expenses include labor, operations and maintenance, insurance, depreciation, taxes, etc. Certain expenses are not allowed to be included, and others may be subject to adjustments.

The sum of the "authorized income" plus the "allowable expenses" equals the utility's *revenue requirement*. If the utility's current revenue levels are less than this revenue requirement, a revenue increase is necessary.

Public utility services that are provided by cities, counties or cooperatives are not subject to this general formula or to the authority of the PUCO.

Q: How does this revenue requirement translate into increases in rates on a consumer's bill?

A: If the utility needs a revenue increase, the PUCO must determine how that revenue increase should be recovered from the various customer classes. Most utilities have more than one customer class (such as residential, commercial, industrial, etc.), and the costs of serving these various classes of customers may differ. The PUCO must determine the appropriate revenue responsibility of each class of customer and then must design specific rates for each class. The utility is then ordered to file new rates (called *tariffs*) that carry out the PUCO's directive.

Rates for electric and gas utilities may be designed to recover costs that are a function of serving a customer (sometimes called "customer charges"), costs that are a function of the amount of energy or commodity consumed ("energy charges" or "commodity charges"), or a function of the amount of energy or commodity that is demanded by a customer at any single point in time ("demand charges").

Q: Are all public utility rates based upon the public utility's cost of service?

A: No. Non-basic telephone services, such as message toll long distance, are often based upon market prices. Natural gas and electricity customers in Ohio in many instances can purchase the natural gas itself or electric generation service from non-utility suppliers called *competitive retail natural gas providers* or *competitive retail electric service providers*, where the price is in part based upon market conditions. However, customers must still pay to the public utility the distribution rates (*i.e*., the cost to bring the natural gas or the electricity to one's home or business), which is still based upon cost of service principles.

Q: What is meant by an Electric Security Plan (ESP)?

A: Under recent legislation, electric distribution utilities (such as FirstEnergy, AEP, Duke Energy Ohio and DP&L) may apply for approval of an Electric Security Plan that includes provisions relating to the supply and pricing of electric generation service. Such an ESP may include provisions:

- for electric distribution companies to track and recover variations in fuel costs and environmental costs;
- to allow for the recovery of construction work-in-progress projects;
- to allow for generation charges that must be paid for by all distribution customers;
- that limit customer shopping for retail electric generation;
- for automatic increase and decrease clauses;
- to recover costs related to economic development, job retention and efficiency programs from all classes of customers.

These Electric Security Plans must be approved by the PUCO.

This legislation also permits an electric distribution utility to establish a standard service offer price for retail electric generation service that is delivered to the utility under a market-rate offer that is determined through a competitive bidding process.

Q: Does the law allow natural gas companies to be exempt from the general rate-making formula?

A: Yes. Where there is effective competition for commodity sales service or ancillary service and natural gas customers have reasonably available alternatives, a natural gas company may apply to the PUCO for commodity sales service or ancillary service to be exempted from the general rate-making formula. If the PUCO accepts the gas company's application, it will order those services to be exempted from the formula.

–by Stephen M. Howard, an attorney with the Columbus firm of Vorys, Sater, Seymour and Pease, LLP.

Know about "Customer Choice" Programs

When Selecting Your Gas Company

Under customer choice programs for Duke Energy Ohio, Columbia Gas of Ohio, Dominion East Ohio and Vectren Energy Delivery of Ohio, you may choose your natural gas supplier. Your local natural gas utility will continue to deliver the gas to your home or business. The following provides more information about the customer choice programs and choosing a new supplier.

Q: Who is responsible for overseeing the customer choice programs in the retail gas market?

A: The Public Utilities Commission of Ohio (PUCO) is monitoring competition in the retail gas market's customer choice programs, certifying competitive providers, providing dispute resolution services and providing educational services for small businesses as they seek information and guidance with the now competitive and highly technical but essential utility services.

Q: What is natural gas choice?

A: Natural gas choice is the result of voluntary programs developed by four Ohio gas companies: Duke Energy Ohio, Columbia Gas of Ohio, Dominion East Ohio and Vectren Energy Delivery of Ohio. Gas choice allows customers to select a supplier or continue to purchase natural gas from the local gas company. As a result of these choice programs, consumers can shop and compare prices for natural gas, just as they would for any other goods or services.

Q: How can a customer begin to explore options? Is there a deadline for making a decision?

A: Customers can choose a supplier at any time, but should first learn about the natural gas choice program and consider available options. In order to make an informed decision, consumers should do some comparison shopping. Questions to ask each supplier can include:

- Are you a PUCO-certified supplier?
- What is the price per hundred cubic feet (ccf) or thousand cubic feet (mcf)?
- Is the price fixed or does it change?
- If it changes, how does it change?
- Does the price depend on how much I use or when I use natural gas?
- Will there be a switching fee?
- Is there a fee if I cancel the contract early?
- Are there any built-in price increases or decreases?
- Is there a customer incentive for signing up?
- Are there any special add-on services?
- How long will the rate remain in effect?
- What happens when my contract expires?
- Will I receive one or two bills a month?
- Who provides the billing?
- Is there a budget plan?
- Are current budget plan customers eligible to participate with the supplier?

Q: What if a customer decides not to choose a particular gas supplier?

A: Customers of most natural gas utilities who do not select a supplier will have one assigned to them by their utility company. Customers of Duke Energy Ohio who do not select an alternate supplier will continue to receive their supply from Duke.

Q: Will a customer save money by choosing a new natural gas supplier?

A: There is no guarantee that every supplier offer will save a customer money each month. Gas choice programs allow for customers to seek opportunities to save money and for suppliers to promote competitive offers in hopes of attracting new customers. Many factors, including weather, gas usage and the natural gas company's regulated rate can impact potential savings. It is important to research the available offers and decide if choosing a supplier will save money.

Q: Can local governments create buying pools and negotiate an offer to supply natural gas to customers in their community?

A: Yes. This is called aggregation. Specifically, aggregation is the process by which consumers join together in a large group to buy a commodity such as natural gas. Ohio law allows communities—such as townships, cities and counties—to form the aggregated buying groups on behalf of their citizens. The governmental aggregator chooses an outside supplier for all of the customer-members in its group.

All governmental aggregators buying electricity must be certified by the PUCO. Communities that aggregate to buy natural gas are required to be certified by the PUCO unless they aggregate under an Ohio Constitution provision which allows *home rule,* or the right of communities to take action under their own charters.

If an aggregator is going to provide natural gas buying services, it must be certified. Certification by the PUCO means strict requirements for doing business in Ohio have been met.

Q: How does a consumer know if the supplier is a reputable company?

A: The PUCO certifies the natural gas suppliers to ensure they are sound companies, and PUCO rules govern suppliers' marketing, solicitation and enrollment practices and ensure that contracts with consumers contain sufficient information to enable consumers to make informed choices.

Q: Who can provide small businesses with more information on natural gas choice?

A: The PUCO can provide consumers with information about the natural gas choice programs. The PUCO's "Natural Gas Choice" brochure is a guide to choosing a natural gas provider.

The PUCO also offers Apples to Apples comparison charts of rates between these suppliers on their website, www.puco.ohio.gov. For information applicable to your area, look for the name of your serving incumbent gas company. Under the name of each company, you can click to obtain general information about natural gas service choices, a list of companies that have registered to participate in the current customer choice programs, and an Apples to Apples comparison chart of competitive providers' offers to allow you to compare rates of various companies providing gas service in your service territory.

PUCO Apples to Apples charts provide straightforward, unbiased information to assist consumers, and are the only charts in the state that require suppliers, under penalty, to provide accurate, up-to-date information about their latest offers. The PUCO can verify every offer listed.

To obtain a free copy of the Apples to Apples charts, or for additional information about choosing a natural gas supplier, contact the PUCO Call Center at (800)686-7826 [TDD: (800)686-1570] or visit www.puco.ohio.gov.

–originally prepared by Columbus attorney Mary W. Christensen. Updated by the Public Utilities Commission of Ohio.

Choosing a Local Telephone Company

Q: How can I choose a local telephone company now that there's competition?

A: As new telephone technologies continue to emerge, there are more and more choices for consumers, including small businesses, to pick from when it comes to telephone service. Gone are the days of just one telephone company providing service in an area. Now, competitive wireline telephone companies, as well as wireless, Internet and cable providers, offer telephone service packages to consumers (including businesses) all across Ohio. Because everyone has different calling needs, it is important to make sure that you pick the package of services that will best fit your telephone usage.

Q: How will my business decide which telephone company is best for us?

A: Start by analyzing your calling needs. Before looking at the telephone options in your area, make a list of the services you need. Ask yourself:

- How many telephone calls do I typically make each day? Each month?
- What telephone numbers do I call most?
- What time of day do I typically make telephone calls?
- Do I need call waiting, caller ID or voicemail?
- Are there packages available that can provide services like Internet or cable in addition to telephone?

Next, research and compare plans. Once your calling needs have been identified, research all the telephone companies offering service in your area. There are several factors you should consider when researching and comparing telephone plans:

- **What is the monthly telephone service charge?**
  Many companies offer deals where several services, such as local and long distance calling, call waiting, caller ID, Internet and cable service and more are packaged together at discounted rates. Depending on your needs, a service package may or may not be the most cost-effective option. If you are only interested in basic telephone service, please keep in mind that the traditional local telephone company is required to make this service available by itself, not packaged with any other services. Competitors may not offer this option. In addition to charges for telephone service, you will also want to make sure that you understand any additional charges or fees, including any surcharges, taxes and early termination fees for ending service before the end of a term agreement.

- **What calls are included in the monthly telephone service charges?**
  Most telephone service is based on some type of calling area, and you will want to make sure that the places you call the most are included in the calling plan that you select. Consumers may have to pay an additional charge for calls to phone numbers that fall outside of the calling area. Other plans offer unlimited local and long distance regardless of location.

- **How is the company's customer service and reliability?**
  Telephone reliability is important for everyone. If you are looking into a new company, be sure to ask about the company's maintenance, repair and outage policies. It is also important to know the company's customer service line hours. Wireless companies and Internet phone providers are not regulated by the PUCO.

- **Is 9-1-1 service included?**
  Not all wireless, cable and Internet phone companies are equipped to offer 9-1-1 service where the callback number and location are automatically provided to emergency responders. Ask about 9-1-1 service capabilities before signing up with a telephone provider.

The PUCO understands that choosing from the many telephone service options available can be a confusing task. To learn more about your telephone options and how to choose a telephone supplier, contact the PUCO Call Center at (800)686-PUCO (7826) [TDD: (800)686-1570] or visit the PUCO's website at www.puco.ohio.gov.

–originally prepared by Columbus attorney Mary W. Christensen. Updated by the Public Utilities Commission of Ohio.

Understanding a Local Telephone Bill

Consumer confusion over telephone bills has contributed to the growth of *slamming* (changing a customer's telephone provider without his/her permission), *cramming* (adding charges to a customer's bill for services he/she did not authorize), and other types of telecommunications fraud. The following information will help you understand the charges you may find on your telephone bill.

Q: Why are there so many charges on a local telephone bill?

A: In addition to charges for basic local service and calling features, there are several charges that the federal and state governments permit telephone companies to collect. Each charge is related to a specific program authorized by the Federal Communications Commission (FCC) or the Public Utilities Commission of Ohio (PUCO). To follow are the charges that appear on telephone bills:

- **Basic Local Service -** This charge is for your basic dial tone service, including any local usage package (*e.g*., message, measured or flat rates) and any regulated features you have chosen, such as call waiting or caller ID.
- **9-1-1 -** This charge maintains the lines and database for 9-1-1 emergency services (such as fire and rescue).
- **Federal Excise Tax -** This three-percent tax is mandated by the federal government and imposed on all local calls. The federal excise tax is no longer imposed on long distance calls and wireless service.
- **(Federal) Subscriber Line Charge -** This charge is mandated by the FCC and helps cover the fixed cost of the local phone network, including the lines and equipment from the central office to the customer. Depending on your local telephone company, this charge may appear as: "FCC Charge for Network Access," "Federal Line Cost Charge," "Interstate Access Charge," "Federal Access Charge," "Interstate Single Line Charge," "Customer Line Charge" or "FCC-Approved Customer Line Charge." This is a per-line charge, and the FCC caps the maximum price a company may charge. Customers with multiple lines may pay a higher subscriber line charge.
- **(State) Subscriber Line Charge -** This charge helps maintain the local phone network. It may appear as "Intrastate Access Fee" or "Access Recovery Charge." Not all local companies have this charge on the bill.
- **Local Number Portability Charge (LPN) -** This charge allows telephone companies to recover certain costs for providing residential and business telephone customers the ability to keep, at the same location, their existing local telephone numbers when they switch from one local telephone service provider to another. This is a fixed monthly charge, not a tax.
- **State and Local Municipal Tax -** This charge is placed by state, local and municipal governments on goods and services. For information about the state and local taxes listed on your telephone bill, you should contact your local and state taxation offices. These offices may be listed in the government section of your telephone directory.
- **Universal Service Fund (USF)/Universal Connectivity Fee -** This federal fee helps to make phone service affordable and available to all Americans, including consumers with low incomes, schools, libraries, rural health care providers and those living in areas where the costs of providing telephone service is high.

Q: What information must telephone companies include on bills?

A: Customers should be able to easily understand their phone bill. A telephone company’s bill must:

- identify the service provider associated with each charge;
- highlight any new service providers appearing on the bill along with a toll-free telephone number and a brief description of the service provided;
- identify current, past due, usage-sensitive, and one-time charges;
- identify and briefly describe taxes and any surcharges;
- explain any codes and abbreviations used on the bill;
- identify charges which must be paid to keep basic local service;
- provide a toll-free number for customers to call in order to make a complaint or obtain information.

Q: What can I do to ensure I’m only paying for the services I’ve ordered and the fees approved by the FCC and PUCO?

A: Treat your telephone service like any other major purchase. Review monthly telephone bills just as closely as you review your monthly credit card and bank statements. As you review your bill, ask yourself the following questions:

- Do I recognize the names of all the companies listed on my bill?
- What services did the listed companies provide?
- Does the bill include charges for calls I did not place and services I did not authorize?
- Are the rates charged by each company consistent with the rates that the company quoted to me?

If you do not understand a service charge listed on your telephone bill, ask the company that billed the charge to explain the charge to you *before* you pay the bill.

Carefully read all forms and promotional materials—including all fine print—before signing up for telephone services. If you change service providers, companies must send you a welcome packet within 10 days, confirming service. Carefully check this over to make sure it is correct.

Companies can compete for your telephone business. Use your buying power wisely and shop around. If you think a company’s charges are too high or its services do not meet your needs, contact other companies and try to get a better deal more suited to your needs.

Q: Where can residential and small business customers get more information to better understand their telephone bills?

A: The PUCO is the state agency charged with resolving utility complaints and disputes for residential and small business customers. To obtain a copy of PUCO fact sheets or any PUCO publication, or for assistance with utility questions, contact the PUCO Call Center at (800)686-PUCO (7826) [TDD: (800)686-1570] or visit www.puco.ohio.gov.

–Information provided by the Public Utilities Commission of Ohio.

Understanding Telephone Scams: Slamming and Cramming

Q: What is slamming?

A: Slamming is the illegal practice of changing your local or long distance telephone service without your permission. Before a telephone company can switch a customer, it must obtain the customer's permission through a written or electronic letter of agency, an electronic verification from the customer's telephone number or an independent third-party verification.

Q: What is cramming?

A: Cramming is the illegal practice of adding charges to your telephone bill for services that you did not order.

Q: What can I do if I discover that I have been slammed?

A: Contact the company you believe slammed you, and tell them that you want the problem resolved. If you have not paid the bill, tell the company you will not pay the first 30 days' charges after the date on which you were slammed, and request reimbursement for any charges you may have incurred from your local phone company for the unwanted switch.

Ask your local phone company to make sure you are switched back to their service. If your long distance was slammed, ask your local phone company to switch you back to the long distance company of your choice. They can also remove any disputed charges from the slamming carrier. Once you have been switched back, check into whether or not your local phone company can put a freeze on your local or long distance account to help prevent future slamming.

Contact your authorized phone company. Tell them you were slammed and want to be restored to your original calling plan and you want switching fees removed from your bill.

If you have already paid the bill for the calls that were slammed, ask your phone company how much credit you will be receiving.

Q: Will I have to pay for disputed charges that result from slamming?

A: You do not have to pay for service up to 30 days after being slammed if you **have not paid** your bill. This means you do not have to pay either your authorized telephone company or the slamming company.

If you **have paid** the unauthorized phone company, your authorized company will either credit you 50 percent of the charges you paid the slammer or, if you prefer, re-rate the charges based on its rates.

Q: Can I register a complaint against the company that slammed me?

A: Yes, you can register a complaint against the company you believe has slammed you. The Public Utilities Commission of Ohio (PUCO) is the state agency charged with resolving utility complaints and disputes for residential and small business customers. You can contact the PUCO Call Center for help at (800)686-PUCO (7836) [TDD: (800)686-1570], or visit the PUCO's website at www.puco.ohio.gov.

Q: What types of charges can be crammed onto my telephone bill?

A: Cramming charges can be almost anything, but usually involve some type of telecommunications-related service. These services may include, but are not limited to, non-regulated services such as voice mail, personal 800 numbers, paging services and pay-per-use ("900") calls. Services such as these are separate and distinct from your regulated local and long distance telephone service. Cramming may also include regulated local telephone service features such as call waiting or caller ID, which are offered by your local phone company.

Q: Will I have to pay for disputed charges that result from cramming?

A: If you find charges on your bill for services you believe you did not order, contact your local phone company and ask that the charges be removed. Your local phone service cannot be disconnected for non-payment of crammed charges for *unregulated* services. Your local service may only be interrupted if charges for *regulated* local phone service are past due. If the cramming charges are for regulated service features offered by your local phone company, your phone service may be disconnected if the charges are not paid or placed in dispute.

Q: What can I do to avoid being slammed or crammed?

A: While there is no foolproof way to guarantee you will not be a slamming or cramming victim, there are steps you can take to protect yourself:

- Examine your monthly bill and make sure you understand every charge. Look for unfamiliar company names, calls you did not make, or services you did not order. If anything is unclear or there is a company name you have not seen before, call your local phone company for an explanation. Telephone companies must clearly highlight a change in telephone service providers.
- Keep a note pad by the telephone and write down each phone service (*e.g.*, voice mail) that you authorize, as well as any long distance calls and calls to informational or "900" services.
- Be careful of "activation codes" or answering "yes" to questions that may be intended to get you to authorize a service that you do not intend to authorize.
- Read fine print carefully.
- Be sure you know who has been using your telephone.
- Request appropriate blocking features such as a "900" call block, collect call block or international call block.
- Ask telemarketers for written information about any service they offer you over the phone.

–Information provided by the Public Utilities Commission of Ohio.

What To Know about Aggregation

Q: What is aggregation?

A: Aggregation is when a group of customers join together to form a single, larger customer that buys energy for its members. A large buying group may be able to get a better price for the group members than an individual can alone.

Q: Does aggregation save consumers money?

A: While there is no guarantee that consumers will save money through aggregation, this opportunity can reduce suppliers' marketing and administrative costs because they can market to an entire group rather than to individuals. These reduced costs can be passed on as savings to individual consumers in the buying group.

Q: What is governmental aggregation?

A: Ohio law allows communities—such as townships, cities and counties—to form the aggregated buying groups on behalf of their citizens. The governmental aggregator chooses an outside supplier for all of the customer-members in its group. Aggregations can be formed to buy natural gas, electricity or both.

All governmental aggregators buying electricity must be certified by the Public Utilities Commission of Ohio (PUCO). Communities that aggregate to buy natural gas are required to be certified by the PUCO unless they aggregate under an Ohio Constitution provision that allows *home rule,* or the right for communities to take action under their own charters.

If an aggregator is going to provide natural gas and/or electric buying services, it must be certified separately for each industry. Certification by the PUCO means strict requirements for doing business in Ohio have been met.

Q: What is opt-in aggregation?

A: Opt-in aggregation is a program that permits each customer to sign up individually to participate in the program. If the local government chooses opt-in aggregation, it can proceed to develop a plan and start signing up customers. The plan must include all rates and terms for customers to consider when deciding to join.

Q: What is opt-out aggregation?

A: Opt-out aggregation is a program that automatically enrolls all local residents, unless they individually opt out of the program (choose not to be included). If a community chooses this form of aggregation, a number of steps are required:

- A majority of voters must authorize opt-out aggregation in an election. The issue appears on a primary or general election ballot for consideration.
- If authorized by a majority of the vote, the local government must form a plan of operation and management and hold at least two public hearings to allow customers to voice any concerns over the proposed plan.
- Once the local government has adopted the plan, all customers to be aggregated must be notified that they will be automatically enrolled in the program unless they specifically elect not to participate. This notification must also state the rates, charges and other terms and conditions of enrollment in the program. The opt-out notice is usually a letter accompanied by a post card to be mailed back if

the customer does not want to participate, or sometimes, a phone number to call or website to visit to opt out.
- The local government must allow anyone enrolled in the program an opportunity to opt out every two years without paying a switching fee.

Q: Should I decide to opt in or opt out?

A: When deciding to join an *opt-in* government aggregation or deciding whether to stay in an *opt-out* government aggregation, here are some things to consider:

- The goal of the buying group: Will the aggregator be looking for the lowest price, sources used to generate the electricity or additional services when finding a supplier?
- Number of group members: Larger groups will usually have better "buying power."
- Length of the contract: How long is the contract and how will it be renewed?
- Terms and conditions: Be sure you read and understand them, including membership requirements, billing methods and any fees.

Q: Who is eligible for aggregation?

A: For both natural gas and electric aggregation, customers who are already enrolled in the Percentage of Income Payment Plan (PIPP - a payment plan for past-due bills) are not eligible. These customers will be aggregated as a separate group.

For natural gas aggregation, the only other customers who are not eligible to participate are those that are already under individual contracts with suppliers as part of a natural gas choice program. These customers will not appear on eligible customer lists provided to the governmental aggregator or the governmental aggregator's chosen supplier.

For electric aggregation, all customers (other than PIPP customers) are eligible and their names will appear on customer lists provided to the governmental aggregator or its chosen supplier. It is important to note that, if you are already under a contract with a supplier and your community aggregates, you still may be switched to the aggregation's supplier unless you actively opt out. That is a decision for you to make. If you are considering a switch to the aggregation's supplier, you will want to talk to your chosen supplier to find out if there are any penalties for the early cancellation of your contract.

Q: Where can consumers learn more about aggregation?

A: If you have questions about your community's aggregation plans, call your local city, county or township official's office.

The PUCO, the sole agency charged with regulating public utility service, can answer questions regarding aggregation. For more information or to obtain copies of the regularly updated "Apples to Apples" electric or gas supplier comparison charts, contact the PUCO Call Center at (800)686-PUCO (7826) [TDD: (800)686-1570], or visit the PUCO's website at www.puco.ohio.gov.

–Information provided by the Public Utilities Commission of Ohio.

Choosing an Electric Supplier

Under customer choice programs you may choose your electric supplier. Your local electric utility will continue to deliver the electricity to your home or business. If you are considering switching suppliers, take a moment to read the following information. The Public Utilities Commission of Ohio (PUCO) is committed to ensuring that you have the information needed to make an informed decision about choosing a new supplier.

***Q:* How can I compare suppliers?**

A: The PUCO provides a regularly updated Apples to Apples comparison chart of the certified suppliers' offers. The chart includes: a list of PUCO-certified suppliers that are actively enrolling customers, suppliers' phone numbers and websites, price options, total rates and basic terms of the contracts offered. For your free copy of the most recent comparison chart, call the PUCO Call Center at (800) 686-PUCO (7826).

***Q:* What is the Price to Compare?**

A: The Price to Compare is calculated by taking the amount of your bypassable generation component and dividing it by the total number of kilowatt-hours used for the month. An alternative supplier's price for generation must be lower than your price to compare for you to save money with that supplier.

***Q:* Where can I find my Price to Compare?**

A: When shopping for a supplier, please keep handy your most recent electric utility bill that includes your Price to Compare. This will make comparing offers easier. The bill also shows your customer number, which a supplier will need to enroll you as its customer.

***Q:* Who is responsible for safety and reliability?**

A: Whether you stay with your local electric utility or switch to another company for your electric supply, your local utility will continue to respond to your electric safety concerns and provide the same reliable electric service as always. The PUCO is committed to ensuring that customers will continue to receive safe, reliable and adequate electric service.

Four simple steps to choosing a supplier:

1) **Compare offers.**
   Find your Price to Compare on your utility bill and use that number to compare to other offers listed on the PUCO's Apples to Apples comparison chart. Since your Price to Compare is made up of several different factors, it can vary from month to month. To get a better understanding of your average Price to Compare, take a look at a few of your recent bills. After determining your Price to Compare, use the Apples to Apples chart to identify offers based on cost, contract length or other incentives.
2) **Contact suppliers.**
   Contact the suppliers that you are most interested in and ask the questions provided below. To sign up, simply call that supplier. The supplier will contact your local electric utility for you.
3) **Read and understand the supply contract.**
   Make sure you carefully read and understand all of the terms and conditions of your supply contract. The supplier should be able to answer any questions you have.

4) **Receive confirmation.**
Your local electric utility will send you a letter confirming the supplier you have chosen. If the information is correct, you do not have to do anything. If the information is not correct, contact the utility and request that the switch be stopped. You have seven days from the postmark date of the letter to make any changes.

Questions to ask a supplier:

- Are you a PUCO-certified supplier?
- What is the price per kilowatt hour (kWh)?
- Is the price fixed or does it change?
- If it changes, how does it change?
- Does the price depend on how much I use or when I use electricity?
- Will there be a switching fee?
- Is there a fee if I cancel the contract early?
- Is there a customer incentive for signing up?
- Are there any special add-on services?
- How long will the rate remain in effect?
- What happens when my contract expires?
- Will I receive one or two bills a month?
- Who provides the billing?
- Is there a budget plan?
- Are current budget plan customers eligible?
- Are there any built-in price increases or decreases?

Inquiries, disputes and complaints
If you have an outage report or inquiry regarding your bill, meter or safety concerns, call your local electric utility.

If you have a complaint or inquiry regarding your electric supply contract, call your supplier. If your complaint or inquiry is not resolved, call the PUCO Call Center at (800)686-PUCO (7826) or TTY/TDD (800)686-1570.

–Information provided by the Public Utilities Commission of Ohio.

Intellectual Property

Chapter 4

Copyright Basics

Q: What is a copyright?

A: A copyright is a grant of rights from the government for original works of authorship that are fixed in a *tangible medium of expression*.

Q: What are "works of authorship"?

A: *Works of authorship* include, but are not limited to, books, songs, plays, dances, computer programs, pictures, sculptures, motion pictures, CD-ROMs and buildings.

Q: What is a "tangible medium of expression"?

A: It is any method of storing the original works of authorship, such as the canvas of the "Mona Lisa" or the CD on which the Beatles' song, "Yesterday," is recorded. The media can be paper (such as advertising, instructions, training manuals or drawings) or something that requires a machine to be seen (such as DVDs or CDs).

Q: I have a great idea. Can I copyright it?

A: No. Copyright protection is limited to protecting *expression* and does not protect the *ideas* expressed in the work. For example, J. K. Rowling cannot copyright the idea for the Harry Potter books in the United States; however, she copyrighted the individual books in the United States.

Q: How do I get copyright protection?

A: Copyright protection exists automatically from the moment the work is fixed on some type of tangible media. However, in the United States, generally the work must be registered with the Copyright Office of the Library of Congress before a lawsuit may be brought against an infringer. Copyright infringement most commonly occurs whenever a copyrighted work is copied, in whole or in part. Copyright infringement may occur even when the infringing copy is not identical, but is only substantially similar to the original. Registration is also a prerequisite to the awarding of some types of damages for infringement.

Q: Do I need a copyright notice?

A: Until a few years ago, if a work was published without a copyright notice, all copyright protection was waived. That is no longer true for newly published works. It is helpful to display a copyright notice because it makes it easier to pursue infringers. The copyright notice includes the word "copyright" and/or the copyright symbol, ©, the name of the copyright owner and the year the work was first published.

Q: How long does copyright protection last?

A: Effective in 1998, the Sonny Bono Copyright Term Extension Act increased the term of copyright protection. For instance, now protection lasts for the life of the author plus seventy years after he or she dies, if the author is an individual and the work was created after January 1, 1978. The Act extended the protection 20 years.

Q: How long does the protection last for works created by an employee?

A: Copyright works created by an employee during the scope of his or her employment are owned by the employer. The Sonny Bono Copyright Extension Act also extended the copyright term for such works. If the work was created after January 1, 1978, the copyright protection in that work lasts for a term of 95 years from the year of the work's first publication or a term of 120 years from the year of creation of the work, whichever expires first.

Q: Is the act named after the famous partner of Cher?

A: Yes. Sonny Bono, the famous partner of Cher, was also a member of Congress before his death. The act was named in his honor.

–by Patricia A. Walker, an attorney and principal with the Medina firm, Walker & Jocke.

“Fair Use” Doctrine Permits Limited Copying of Copyrighted Material

Q: What is a copyright?

A: A copyright is a grant of rights from the government for original works of authorship (such as books, songs, plays, computer programs and CD-ROMs) that are fixed in a tangible medium of expression. Any method of storing the original works of authorship, such as the canvas of the “Mona Lisa” or the CD on which the Beatles’ song, “Yesterday,” is recorded is a *tangible medium of expression*. The media can be paper (advertising, instructions, training manuals or drawings) or something that requires a machine to be seen (video tapes, computer disks or CD-ROMs).

Q: What is copyright infringement?

A: A copyright owner has certain exclusive rights. These include the rights to reproduce, distribute, display and perform the work. The copyright owner also has the exclusive right to prepare *derivative works*, which are works based on the original, but which include some different or additional material. A violation of any of the copyright owner’s rights constitutes copyright infringement. Copyright infringement most commonly occurs whenever a copyrighted item is copied in whole or in part. Copyright infringement may occur even when the infringing copy is not identical, but only *substantially similar* to the original. When a substantial portion of a copyrighted work is used in another work, it also usually infringes as an unauthorized *derivative work*. For instance, if you owned an original painting and you made prints of that painting, you infringed on the copyright of the artist who painted the picture. Only the artist or someone who contractually received that right from the artist can reproduce the painting.

Q: Are there some instances where a work of an author can be copied without infringing the copyright?

A: Yes. A work of authorship can be reproduced, distributed, displayed and performed by someone other than the work’s creator without constituting copyright infringement in limited situations. The United States statutes concerning copyrights contain exceptions to a copyright owner’s exclusive rights. However, the broadest exception is the “doctrine of fair use.”

Q: What is a “fair use”?

A: Reproducing, distributing, displaying or performing a copyrighted work may, in limited circumstances, be found to be a *fair use*. A fair use is something that is permitted by law that would otherwise constitute copyright infringement. For example, if a page from an encyclopedia is copied at the public library for personal use, it is probably a fair use.

Unfortunately, deciding whether a use is a fair use is often difficult. Therefore, it is always wise to consult an attorney experienced in intellectual property law in order to determine whether or not you might be infringing a copyright.

Q: How is it determined if a use is a fair use?

A: A determination of fair use requires the weighing of a number of factors. Some of the factors in determining whether a use is a fair use are:

1) the purpose and character of the use;
2) the nature of the work;
3) the amount of the work involved;
4) the effect of the activity on the market for the original work; and
5) whether the original work is published or unpublished.

Q: What is the most important factor in the fair use analysis?

A: Often the character of the use is the most important factor. If the use is related to a profit-making activity, this suggests that the use is not a fair use. For instance, photocopying a Dilbert® cartoon, framing it, and selling it would not be a fair use. However, hanging that framed photocopy in your own home study would probably be a fair use. If, however, it is determined that the framed cartoon reduces the market for framed Dilbert® cartoons sold by Scott Adams, it may not be fair use. The fair use analysis is not always easy.

Q: Is copying a copyrighted work for a non-profit organization always a fair use?

A: No. A number of churches have gotten into trouble for copying music or lyrics. The copying reduces the market for the sheet music and therefore is not considered a fair use.

Q: What if the work copied is a collection of facts?

A: The doctrine of fair use grants broader use without infringement if the work is a collection of facts such as a database of baseball statistics or an encyclopedia, as opposed to a fictional work such as *Twilight* by Stephenie Meyer.

Q: How does the amount of the work copied affect the determination of fair use?

A: If the amount of the copyrighted material copied is small and it does not impact the copyright owner's ability to make money on his or her work, it will weigh in favor of fair use. For instance, a literacy critic who quotes a line or two from a book in his or her review will probably be protected by the doctrine of fair use.

Q: Is it a fair use to copy an unpublished work?

A: Uses of unpublished works are less likely to be fair uses than published works. The law gives a copyright owner the right to control when his or her work is first published. All of the fair use factors must be considered and weighed in deciding if an activity is exempt from infringement liability. As this involves making a legal judgment, questions about fair use should be referred to an attorney experienced in copyright law.

Q: What are the penalties for copyright infringement?

A: The penalties for copyright infringement can be severe. The law provides the copyright owner with the right to obtain actual damages or *statutory damages*. Statutory damages are those set by law and can range from $200 to $150,000 per infringement plus attorney fees. As a result, damage awards can be much higher than the actual loss to the copyright owner. Also, in some circumstances copyright infringement may be a criminal offense punishable by fine or imprisonment. For these reasons it is important to work with experienced legal counsel when dealing with copyright issues.

–by Patricia A. Walker, an attorney and principal with the Medina firm, Walker & Jocke.

Frequently Asked Questions about Copyrights

Q: What is a copyright and what does it protect?

A: Copyright is actually a bundle of rights. The federal copyright statute gives the copyright owner the exclusive right to do the following and to authorize others to do the following with original works of authorship:

- reproduce the work;
- prepare derivative works based upon the prior work;
- distribute copies;
- display the work publicly; and
- perform the work publicly.

Q: Who can claim copyright?

A: In general, the author who created the work. The exception is work for hire, which means either that: 1) an employee who prepared the work within the scope of employment (the copyright to the work is owned by the employer), or 2) the work is one of nine specified categories of works, and the work's creator and the commissioning party agree in writing that the copyright is owned by the commissioning party. Joint authors are co-owners of the copyright absent a written agreement to the contrary.

Q: What is the first sale doctrine?

A: It is the right of the owner of a copyrighted work (*e.g.*, manuscript, painting, photograph, architectural work or computer program) to sell, lend or lease the object that embodies the copyrighted work. It does not transfer the copyright or convey any rights in the copyright.

Q: What is required to register a copyright?

A: In general, you need only submit to the Copyright Office of the Library of Congress a two-page form, a $65 filing fee and a copy of the work. You may also file your application electronically for a lower filing fee of $35.

Q: Why register a copyright?

A: If the copyright to a work is registered within three months of publication and before infringement, the chief benefit is to permit the copyright owner to request statutory damages (between $750 and $30,000 and up to $150,000 for willful infringement) for each infringement and attorneys' fees and costs that are discretionary with the court. Statutory damages often exceed actual damages, and the possibility of statutory damages gives the copyright owner substantial leverage.

Q: Must I register the copyright to use the copyright symbol ©?

A: No. It is generally advisable to use © to put others on notice of rights regardless of whether registered. It also precludes an innocent infringer defense to infringement. The proper copyright notice is: © [year of publication or creation] [copyright owner's full or abbreviated name or trade name].

Q: If fair use exists, why do I need permission of the copyright owner?

A: The fair use defense is highly fact-specific. It is only available for use for purposes such as criticism, comment, news reporting, teaching, scholarship or research. If even a small part of a copyrighted work is being used in advertising or for commercial gain, it is always safer to obtain permission.

Additional information is available from the U.S. Copyright Office as follows:

Via the Internet, circulars, announcements, regulations and all application forms are available at www.copyright.gov.

Via email, ask a copyright question by submitting an inquiry to www.copyright.gov/help/general-form.html.

Via telephone, information specialists are available to answer general questions at (202)707-5959, but they cannot give specific legal advice and opinions.

–by Susan D. Rector, an attorney with the Columbus office of Ice Miller LLP.

Copyright Notice and Registration Benefits Copyright Owner

By the time they begin to read, most people have seen a copyright notice. Most, however, misunderstand the meaning of the notice and its role and purpose in protecting copyrights. If the work is infringed, proper copyright notice and proper registration of the copyright can enhance the copyright owner's award of damages.

It is a myth that copyright notice is required for a copyright in a work to exist. However, the myth does have some basis in history. In the past, according to United States law, the copyright notice was required for creating and maintaining copyrights—with some exceptions.

Since March 1, 1989, however, even if a work does not have a copyright notice on it, copyrights can exist and be enforced, with a few exceptions. Under copyright law in the United States today, including a copyright notice on a work is entirely optional. The copyright owner does not even have to include a copyright notice on publicly distributed copies of a work. For example, a newspaper publisher does not have to include a copyright notice in the newspaper to assert a valid copyright.

Although the copyright notice is no longer necessary, it is very advantageous to use it. For example, if a copyright infringement suit is brought on a work distributed with a copyright notice, it is easier to assert damages against the purported infringer because the infringer cannot claim to be an *innocent infringer* who did not know the work was copyrighted. Thus, the copyright owner likely will be entitled to a greater amount if the court determines there has been an infringement and orders the defendant to pay damages. And, if the U.S. copyright owner has properly registered the work in a timely manner with the U.S. Copyright Office, there is a potential for even greater damages (referred to as *statutory damages*) against the infringer. If the copyright owner is eligible for statutory damages, then, in the case of a willful infringement, the court in its discretion may increase the award of statutory damages to a sum of not more than $150,000. Also, in certain circumstances, the court may award court costs and a reasonable attorney's fee to the prevailing party.

Registration of the copyright in the U.S. Copyright Office is a relatively inexpensive process, particularly if one considers the valuable legal rights available to properly registered copyright works. Copyright registration can, for most works, now be done online using the Electronic Copyright Office (eCO) at www.copyright.gov/eco/. Basic copyright registration claims that can now be done online include literary works (*e.g.*, books, computer programs), visual arts works, performing arts works, sound recordings, motion pictures, and single serial issues.

While a copyright notice is no longer required for a copyright to exist (but highly recommended because of the benefits afforded the copyright owner under the Copyright Law in the United States), if you are going to use it, you might as well do it right. Federal law sets forth the proper elements of a copyright notice.

The general form of the copyright notice is set forth in the federal copyright statute (17 U.S.C. 401). There are three parts to the copyright notice under this law:

- The first part has three options: the © symbol (the letter "C" in a circle), the abbreviation "Copr.," or the word "Copyright." (In the case of a sound recording, the letter "P" in a circle is used instead.)
- The second part of the notice is the year of first publication of the work.

- The third part of the notice is the name of the copyright owner or some abbreviation by which the name can be recognized, or some generally known alternative designation of the owner (*e.g.*, "IBM").

The year of first publication may be omitted when a pictorial, graphic or sculptural work, with accompanying text matter, if any, is reproduced in or on greeting cards, postcards, stationary, jewelry, dolls, toys, or any useful articles.

The positioning of the copyright notice on the work is important. A notice should be affixed to the copies of the work in such a manner and location as to give reasonable notice to the claim of copyright.

Examples of possible copyright notice positions include:

- For a book: Copyright notice should be placed on the title page or the page immediately following, either side of the front or back cover, or the first or last page of the main body of the work.
- For computer programs: Copyright notice should be placed with or near the title or at the end of the work on paper printouts of the work, at the user's terminal at sign-on (and removed only after the user takes some action such as pressing a key or clicking on a mouse), on continuous display on the terminal, in the "About" box, or reproduced durably on a label securely fastened to the copies or to a container used as a permanent receptacle for the copies. Proper placement of the copyright notice depends on the specific work.

The bottom line is that a proper copyright notice, along with the proper and timely registration of the copyrights in the work, can greatly enhance the copyright owner's remedies in the event the work is infringed.

–by Alan S. Wernick, an attorney in private practice focused on information technology and intellectual property law, and a member of the bar in IL, NY, OH, & DC.

Spreadsheets and Intellectual Property

Susan, an employee, develops a spreadsheet. She says that she created it at home, on her own time and using her own computer. While it is beyond the scope of what her employer expects of her, it will be useful to the company that hired her.

Susan brings the spreadsheet to work, and it becomes the rave. It is novel and useful, displaying and analyzing crucial data in a new way. It saves the company money, and actually starts making money for the company. Competitors do not have this. Also, someone at the company has turned the spreadsheet, and the ideas and methods it uses, into an “app” for smart phones and tablet computers.

Weeks later, Susan applies for another position at the company, but it goes to someone else. Susan quits, taking the spreadsheet file with her, and warns her managers and co-workers to stop using it and the app, or else. Company managers say it all belongs to the company, and that they will use it as long as they want.

Somewhere, an intellectual property trial attorney smiles, and an insurance defense attorney feels a chill. We have copyright, trade secret and possibly patent law issues here. Problems of proof and discovery abound. Was the work done within the scope of her employment? Whose resources were used? How much money did the company make or save? Was Susan really an employee, or just an independent contractor? Did she register the copyright? How much of Susan’s original material and ideas are in the app?

First of all, let us consider what *intellectual property* entails. Intellectual property is something derived from the work of the mind, from human creativity. It includes ideas, inventions (patentable or not), trade secrets, processes, data, formulae, literature, music, art, expression of all kinds and other activities of human beings.

Secondly, creation of intellectual property is not the exclusive domain of artists, engineers, musicians, or programmers. We are all capable of producing it, and tools available today present a wealth of opportunities. Susan produced something from her mind that proved to be quite valuable. Certainly, that spreadsheet is intellectual property, as is the app that was derived from it.

So how might this problem have been prevented? One preventive measure is something that technology companies have used for years: agreements that define and assign rights in intellectual property, commonly called *IP agreements*. Susan did not sign such an agreement. If she had, the agreement probably would have defined the intellectual property at hand, assigned rights to the employer, and asked the worker to pledge to cooperate if and when it should be time to register copyrights, seek patents, or take similar steps. Clauses in IP agreements define and use terms such as *software*, *algorithms*, and *improvements.* These days, the clauses should also include *spreadsheet* and *database*, as well as other works created from ordinary desktop computer tools and adapted for specific tasks. And, everyone who creates intellectual property must sign these agreements.

Not every spreadsheet is as valuable as Susan’s, but some are. All companies, not just technology companies, must recognize and protect their assets by having employees sign IP agreements—not just programmers and engineers.

–by Steven A. Hill, a Reynoldsburg business and intellectual property attorney.

What You Don't Know about Patents Could Hurt Your Business

Most business people rarely confront a legal matter that involves a patent. However, anyone who runs a business should know the basics about patents, because they can provide a dramatic advantage (or cause a disaster) for your company.

Q: Why should I care about patents?

A: Any business that manufactures a product or provides a service should consider intellectual property protection. If you are not protected, your competitors are free to copy your products or business activities. In addition, if your competitors obtain patents, you may lose your ability to compete with them or be forced to pay for infringing on their patent rights. Ultimately, your failure to care about patents could put you out of business.

Q: What is a patent?

A: A patent is a grant of special rights from the government. A patent owner is given the right to prevent others from making, using, selling, or offering to sell his or her invention. In the United States, patent rights may last for 20 years from the date the patent application is made.

Q: What can be protected by a patent?

A: There are three types of patents: utility, design, and plant patents. Utility patents are the type with which most people are familiar. These patents protect a wide variety of things, such as devices, machines, processes, methods, chemical compounds, and even genetically engineered bacteria. Design patents protect ornamental designs for manufactured articles. Plant patents protect new types of asexually reproduced plants.

Q: How does the government decide if an invention is entitled to be patented?

A: A patent application describing the invention is submitted to the U.S. Patent and Trademark Office. The application includes *claims*, which precisely describe the invention the applicant believes he or she is entitled to own. The U.S. Patent and Trademark Office examines the application and decides if a patent should be granted. Although the legal tests used to determine whether or not an invention can be patented are complicated, according to a *rule of thumb* a patent will be granted if the invention is substantially different and better than the state of the art.

Q: Is it possible to lose the opportunity to obtain a patent?

A: Yes. Unfortunately, it happens often. Most commonly, someone waits too long before filing a patent application. In the United States, generally it is too late to apply for a patent if an invention has been on the market for a year. Although this may seem harsh, the rules in foreign countries are even worse. In most countries, a patent cannot be obtained if an item was disclosed to the public before a patent application was filed. This is why business people who plan to sell overseas should consider filing for a patent early in the development of any new product. On March 16, 2013, the United States changed from a "first to invent" system to a "first to file" system. This means that a patent application should be filed as early as possible. In most cases an inventor should file an application before publicly disclosing, selling or offering for sale his or her invention.

–by Ralph E. Jocke, an attorney and principal with the Medina firm, Walker & Jocke.

What You Don't Know about Trademarks Could Hurt Your Business

Almost every business uses trademarks. However, most business people rarely think about trademarks, even though a trademark represents one of a business's most valuable assets: its reputation. Trademark rights may be lost if they are not properly obtained and protected. The trademark rights of the competition also must be understood, or a business may have to pay a great deal of money for infringing on those rights.

Q: What is a trademark?

A: Anything customers associate with a business's products or services can be a *trademark*. Trademarks are usually words, slogans or designs, but in some situations, sounds, colors, or even distinct scents can be trademarks. Words that merely describe goods and services cannot, however, be protected as trademarks.

Q: What is a service mark?

A: A *service mark* is a mark that is used in conjunction with services.

Q: How do you protect a trademark?

A: A business has some legal rights simply because it has used a mark. Better protection is available through registration of the mark with the U.S. Patent and Trademark Office. A person can apply for registration before his or her business begins using the mark.

Q: What is the effect of federal registration of a trademark?

A: Except in certain situations, once a trademark is registered, the owner of the registration is the only one in the United States who may use the trademark in conjunction with goods and services for which the mark has been registered. A trademark also serves as protection against a competitor's use of confusingly similar marks.

Q: Does it matter when a person applies for registration?

A: It can make a big difference. If a company does not register a trademark, another firm in the same business may be able to use it. The other firm also may obtain a federal registration, which may limit the first company's ability to use the mark. The legal rules in such situations are tricky. One thing is certain: the earlier an entity registers its mark with the U.S. Patent and Trademark Office, the stronger the entity's legal position will be in the event a trademark problem arises.

Q: Can a trademark be registered with the state of Ohio instead of the U.S. Patent and Trademark Office?

A: Most states, including Ohio, will register a trademark. A state registration, however, usually only documents that someone is using a mark. It does not provide the legal rights available through federal registration.

Q: What is the best way to select a new trademark?

A: Picking a new trademark involves finding a mark that customers will like and remember. Generally, the best trademarks are arbitrary or fanciful marks. Made up words such as Kodak® or Teflon® are very distinctive. Trademarks that are somewhat suggestive of the business's products or services are often used, but may not be as distinctive. Of course, marks that are generic names or merely descriptive of the goods or services cannot be protected as trademarks and should not be considered. Once a possible new trademark is selected, it is best to have a trademark attorney make sure that it can be used without infringing on someone else's trademark. Someone who infringes may not only be prevented from using the mark, but may also have to pay damages and attorney fees.

Q: Is it possible to protect a trademark in foreign countries?

A: Yes. Almost every country recognizes some type of trademark rights. It is generally necessary to register the mark with the authorities in each country or regional trademark jurisdiction to have protection. The federal registration of a mark in the United States provides no rights in other countries. Businesses should consider protecting their trademarks in all countries where they have distributors or a significant number of customers.

–by Ralph E. Jocke, an attorney and principal with the Medina firm, Walker & Jocke.

Frequently Asked Questions about Trademarks

Q: Can a word, logo or tagline be protected as a trademark?

A: Yes; any distinctive word, name, symbol, device, slogan, package design or any combination of these that identifies and distinguishes a specific product or service from another can be protected.

Q: What is the difference between a trademark and a service mark?

A: A trademark is used to identify the source of origin of a product and a service mark is used to identify the source or origin of a service provided to nonaffiliated third parties. The term *trademark* is often used to refer to either type of mark.

Q: What is the difference between a trademark and a brand?

A: While a trademark is used to help consumers identify a product and its source, a brand generally goes beyond identifying the source or origin of goods and services. A successful brand is well known to consumers and builds authority by promising particular qualities, including intangible qualities (such as taste, durability, reliability, prestige, etc.).

Q: When is it proper to use the symbols ™ and ®?

A: The symbol ™ or ℠ is used to identify the brand of a particular product while it awaits registration with the U.S. Patent and Trademark Office (a process that can take 12 to 18 months or more). It can also be used to indicate a word or logo is being used as a mark when trademark registration is *not* being sought (the owner need not have a pending state or federal registration to use ™ or ℠). It is proper to use ® when a mark is federally registered.

Q: What is the benefit of registering a trademark?

A: Registration puts others on notice that the owner claims rights to the mark and deters unauthorized use. Federal registration has the significant benefit of freezing prior users who have not federally registered in their geographical boundaries and gives the registrant the exclusive right to use the mark throughout the rest of the United States in connection with the stated products or services.

Q: How do I determine if a mark is already registered or being used?

A: Federally registered marks are listed on the U.S. Patent and Trademark Office website at www.uspto.gov. Online databases can be searched for a fee to detect state registered marks and those that are being used but are not registered. National trademark search firms will also conduct more exhaustive searches to determine what trademarks are being used and provide full reports of their search results.

–by Susan D. Rector, an attorney with the Columbus office of Ice Miller LLP.

Use Your Trademarks Wisely and They’ll Serve You Well

Your company’s trademarks are valuable assets which, with proper treatment and due care, can serve you well for many years. The U.S. Patent and Trademark Office defines a trademark as a word, phrase, symbol, design, or combination of these, which identifies and distinguishes the source of the goods or services of one party from those of others. However, many trademarks, which were once proud possessions of large corporations, have been lost through misuse or because they became generic. “Aspirin” and “cellophane” are examples of marks that are now generic terms and no longer identify any particular company’s product. If your company’s trademarks were lost, they could be used by anyone and would no longer signal the public that the products and services they stand for are from your company. It is relatively easy to protect and care for trademarks. Follow these simple rules in all uses of your trademark, wherever it appears:

1) **Use trademarks in a distinctive manner.** Always distinguish your mark from the surrounding text. The general rule is to capitalize trademarks completely, put them in italics, use initial caps with quotes, or, at a minimum, use initial caps. If you have a stylized word for a mark, consider using the stylized depiction even in text. Whatever depiction you choose for the mark should be applied consistently.

2) **Identify trademarks with their status.** If a mark has been registered in the United States Patent and Trademark Office, “®” should be used with it. If the mark has not been registered, “TM” should be used. If it is an unregistered mark for services rather than goods, it should be marked with “SM.” At the least, the proper status identifier should be used on all prominent appearances of the mark and on the first appearance of the mark in any text.

3) **Trademarks are proper adjectives. Use them with the generic name of their product or service.** At a minimum, use the generic term after the trademark at least once in each document, preferably the first time the mark appears. For example, “Windows XP® operating system is the preferred operating system for corporate IT departments,” or, “The RegulatorPro™ UPS takes power management even further.”

4) **Never use trademarks in the possessive form.** Trademarks should never be used in the “…’s” form, unless the mark itself is possessive such as “McDonald’s® restaurants.”

5) **Do not pluralize your trademark.** Since trademarks are not nouns, they should never be used in the plural form. Instead, pluralize the nouns they describe. For example, use “ThinkPad notebook computers are superior” rather than “ThinkPads are superior.”

6) **Trademarks are never verbs.** For example, write “Xerox® photocopiers allow you to photocopy documents the way you want,” NOT, “You can Xerox® any document the way you want.”

7) **Trademarks are privately owned; always indicate the owner.** You can indicate the owner’s name with a simple footnote or notice paragraph that could appear on the cover page, the copyright notice page, the bottom of the page on which the trademark is used, or on the last page. For software, the owner’s name can appear on the log-on screen, the splash screen, the “About” screen, or another similar place. The notice may read, for example, as follows: “The following are trademarks or registered trademarks of Microsoft Corporation: ActiveX, PowerPoint, XL and design (the Microsoft Excel

logo).” You may list marks in their stylized or design form, or in descriptive form as the Microsoft Excel logo was listed in the sample notice above.

–by Alan J. Hartman, a partner in the Cincinnati firm of Dressman Benzinger LaVelle psc.

What You Don't Know about Trade Secrets Could Hurt Your Business

Although you may not think that your business owns any *trade secrets*, they are probably used every day. Businesses of every kind, large and small, have information that can be protected as a trade secret. Unfortunately, the failure to protect trade secret information properly may place your valuable business information in the hands of the competitors.

Q: What is a trade secret?

A: A trade secret is something not generally known or readily discoverable by people outside your business that gives you an advantage over your competition. Although most people think of trade secrets as exotic formulas and processes, more common things may also be trade secrets, such as customer lists, marketing plans, sources of supply, assembly processes, dimensional tolerances for parts and future product concepts.

Q: Are there any advantages in protecting something as a trade secret instead of with a patent?

A: Yes. In some circumstances, you can protect non-patentable concepts and information as trade secrets. In addition, while patent protection may last for a maximum of about 20 years, trade secret protection will last for as long as the information remains secret. It is also sometimes less costly to protect a trade secret than to acquire a patent.

Q: Are there any drawbacks in using trade secret protection?

A: The major drawback is that you must always be careful that the information remains secret. An accidental "public" disclosure may result in the loss of protection. Having adequate protection may require having your employees and contractors sign *confidentiality agreements*. It may also require keeping doors and files locked to prevent customers and delivery people from having access to the information. Unfortunately, anything that can be readily *reverse-engineered* (re-created by looking at a final product and determining how it was created originally) cannot be protected as a trade secret, and patent protection must be sought to protect your rights.

Q: Can I legally enforce the rights in my trade secrets?

A: The owner of a trade secret may obtain an injunction in court to prevent the wrongful use of his or her trade secret. Damages may also be awarded. It may also be a crime to steal someone else's trade secret, and criminal charges may be brought against the wrongdoer.

Q: How can I be sure that my trade secrets are protected?

A: The best way to make sure your trade secrets are protected is to have an intellectual property audit. This usually involves working with an attorney who can identify your trade secrets and determine the steps that can be taken to better protect them. The audit also may uncover ways to better protect your business's other intellectual property. It is a good practice to have an audit conducted every few years to ensure that your trade secret protection continues as personnel and business practices change.

–by Ralph E. Jocke, an attorney and principal with the Medina firm, Walker & Jocke.

Insurance and Risk Management

Chapter 5

Planning and Managing Your Insurance Coverage

If you are a business owner, there are some important things for you to consider when selecting insurance coverage and when dealing with claims. If disaster strikes, your insurance policy can be your first line of defense to save your business. Spending enough time *before* a crisis happens proactively planning the depth and breadth of the coverages you need and getting them in place can literally save your company later.

Reading through an insurance policy is kind of like translating a book written in a foreign language. If you are not fluent in the language in which the book is written, you probably will not accurately comprehend the book's meaning if you try to decipher it on your own using a dictionary to literally translate the words. You need a skilled translator. Your insurance broker-agent is your translator for your insurance policy. As the insured, you need to understand what you are buying—what the policy will cover and any exclusions or limitations to it—and your broker-agent is the key. Your broker-agent can also tilt the scales in your favor by acting as your advocate in obtaining coverage from your insurance carrier in situations where its existence may be questionable. The broker-agent you select should be one you can trust to spend the time to really get to know your business, properly evaluate its activities and operations, and determine what coverages you will need. Ideally, your broker-agent will be someone who either is familiar with your particular industry, or has someone at their firm who is familiar with it and can be used as a resource.

Evaluating your business, the different types of coverage needed and in what amounts is not always a simple and quick process. The type of business you operate and any hazards it presents to your employees or others; the insurable commercial risks raised by its operations; and where, how and by whom each part of its operations are carried out all determine what types and amounts of insurance coverages you will need. Do you utilize engineers and other professionals who design products or structures? You may need specialized coverage to cover their design activities. Are you a manufacturer who routinely ships products (either yourself or through a third party) to a customer prior to title passing? Are you sure you have insurance coverage if your completed product is damaged in an accident on the way to the customer? Do you routinely use subcontractors to construct a product either on your property or another site? Do you know if damage to your product from their activities is covered? Do you have one or more critical pieces of equipment, the failure of which could seriously interrupt the revenues of the company? Do you have coverage for that? These are just a few common examples of issues that are often not given enough consideration during the process of purchasing insurance coverage.

Insurance policies are not "one size fits all." There may be different coverage language and exclusions even in the policies of insurers purporting to cover the same matters. Your broker-agent should understand and be able to explain these differences in a detailed written package comparing alternatives. You should also consider having your attorney review the coverage you plan to buy.

Most businesses have insurance claims sooner or later. It is critical that you put your insurance carrier on notice of the existence of a claim and the facts giving rise to it as soon as possible. Failure to do so can be grounds to deny the claim. Don't simply accept a denial of coverage on its face, as the issue of whether coverage exists is not always clear. Have your broker-agent and your attorney present your claim in a coherent, well-organized and well-documented written package.

If a claim comes in the form of a lawsuit against your company, notify your attorney immediately. Let your attorney submit the lawsuit to your insurance carrier. Your attorney will know how to demand action from your insurer under the applicable policy language to require the insurer pay for a defense of the claim and for coverage for any potential judgment. Although insurance policies will often provide for the appointment of an attorney to defend the claim against you, they will often do so under what is known as a “reservation of rights.” Often, there may be alternative claims, some of which would be covered by the insurance if the plaintiff is successful in obtaining a judgment, and others that would not be covered. It is a good idea to have your own legal counsel involved in at least overseeing your defense—and perhaps actively participating in the defense—in a case involving a reservation of rights.

Your insurance coverage is important to the survival of your business. Give it the attention and consideration it deserves at the outset and evaluate it on an annual basis. When the time comes for you to use it, you will be glad you did.

–by W. Kelly Lundrigan, a Cincinnati attorney who focuses his practice on consulting with small businesses.

Know about Taxes When Using Business Life Insurance

Q: ***I own a business with two other equal owners. Last year, it grossed $1.5 million. We believe that the business is worth more than $750,000 if we were to sell it. The business owns a total of three policies of term life insurance, $250,000 on each of us, payable to the business. Can the business deduct the premium payments as a business expense?***

A: No, not if the business is either directly or indirectly a beneficiary under the policy.

Q: ***If the business designates one of us as an owner and beneficiary of the life insurance policy, can the business deduct the premium as an ordinary business expense?***

A: Yes, indirectly. The business may deduct the premium payment as compensation paid to the insured owner, and the owner must declare that as compensation on his income tax return. It will be subject to payroll taxes.

Q: ***If I die and the business owns the policy and receives the life insurance proceeds, does the business have to pay income tax on the proceeds?***

A: Probably not. Generally, life insurance proceeds are received free of income tax. However, if the business is incorporated (a C-corporation for income tax purposes) and does not meet *small corporation* status, the life insurance proceeds may be subject to *alternative minimum* income tax—a tax covering certain items (including life insurance proceeds) that would otherwise escape taxation. Although we do not know whether this business is a C-corporation, we do know that it has average annual gross receipts of $1.5 million last year. Unless the average annual gross receipts are more than $7.5 million, the corporation will be considered a small corporation and will be exempt from the alternative minimum tax.

Q: ***If I die and the business owns the policy and receives the life insurance proceeds, does the business owe estate tax?***

A: No.

Q: ***If I die and the business owns the policy and receives the life insurance proceeds, will my estate have to pay Ohio and federal estate tax on the proceeds?***

A: Not to the state, since Ohio repealed the state estate tax for deaths on or after Jan. 1, 2013. If the total value of your estate exceeds $5.25 million, federal estate tax may be due. So long as the business owns the policy and is the designated beneficiary, the life insurance proceeds will not be included in your estate. However, your one-third share of the business will increase by $83,333 (one-third of $250,000). Values of certain assets, such as business interests, may be established through the use of arms-length agreements between the owners and/or the business. These agreements are commonly called *buy-sell* agreements. Appropriate use of buy-sell agreements often saves estate taxes by fixing reasonable values.

Q: ***If I own the life insurance policy which is payable to the business upon my death, will I save Ohio and federal estate taxes?***

A: Yes and no. Ohio repealed its estate tax for deaths on or after Jan. 1, 2013. For federal estate tax purposes, $250,000 will be included in your estate even though the business receives the proceeds, because you owned the policy. However, the total value of your estate must exceed $5.25 million before there is a federal estate tax concern.

Q: ***What should I do in order to protect my family and minimize my income and estate taxes?***

A: First, you and your partners should agree on your mutual business and personal objectives should one of you die. Second, you should state these objectives in a written *buy-sell* agreement. Third, you and the other owners should review the costs and benefits of using life insurance to fund the buy-sell agreement. Fourth, you and the other owners should coordinate your wills and trusts, if any, accordingly.

Fortunately, Congress has increased the federal estate tax thresholds to $5.25 million per taxpayer effective Jan. 1, 2013. A small business owner has much less worry today that his family will be forced to sell the business in order to pay estate taxes.

Note: Because this area of the law is very complex, you should seek counsel from a qualified estate- or business-planning attorney.

–by Paul S. Klug, an attorney with the Cleveland firm, Ziegler Metzger LLP.

Business Insurance Protects Property and Covers Liability

Q: I have recently purchased a manufacturing business and its plant. What kinds of insurance should I purchase to make sure I am protected against the major risks of my business?

A: A business owner should always consider at least two general types of insurance. The first is *property insurance*, which covers damages to buildings, goods, equipment and other business assets caused by fire and lightning, or by third parties or employees. The second is *liability insurance*, which protects the business against claims by others for injuries or property damage caused by the business.

Some insurers will offer a package of insurance coverage called a business owners policy (BOP). These policies are often designed to provide a cost-effective option for small- and medium-sized businesses by packaging both property and liability coverage, as well as additional coverages commonly purchased by business owners.

Depending on the size and nature of the manufacturing business, a business owner may also consider *inland marine* coverage, which protects products in transit. A *crime policy* may be necessary to protect against loss from burglary, theft or robbery. If the business is a corporation or limited liability company, a business owner may also want to consider *directors' and officers' liability coverage*.

Q: When I look for property insurance, what types of assets should I expect the policy to cover when a fire occurs?

A: Any property insurance policy should cover the building where the fire occurred and any damaged contents. However, a business owner should also look for coverage for contingent losses, such as the fixed expenses that had to be paid even though the plant did not operate, lost profits, the cost of paying some other company to manufacture the goods while the plant was down, and the cost of putting the plant back in operation as quickly as possible. These costs often fall under coverage for *business interruption* or *contingent extra expense*.

If the business is part of a supply chain, a business owner may want to consider *contingent business interruption* coverage. This insurance will cover losses sustained by the business when a supplier or key customer suffers a physical loss that interrupts the owner's business.

Q: If I do not own the building but only lease it from its owner, will that affect whether I should have a property insurance policy?

A: Yes, because the lease will most likely spell out the duties of the tenant (you) and the landlord (the owner) as to obtaining insurance coverage and restoring destroyed or damaged property. You would probably prefer to pass to the landlord the obligation of insuring the building and the cost of insurance premiums for that coverage; if, however, the lease says the landlord will do that, then the landlord will probably have control over how the destroyed or damaged building will be rebuilt. Therefore, in balancing out your needs, you might have to agree in the lease to insure the building in order to be able to decide how any repairs would be done.

In any event, you should shoulder the responsibility of insuring your own equipment and goods within the plant, and your operating expenses, lost profits, etc., incurred during the down time after a fire.

Q: What are some examples of accidents from which liability claims are made against a business?

A: Most liability claims arise from the following three scenarios: 1) an employee injures the claimant while the employee is in the course and scope of his work for the business; 2) the claimant is injured by a dangerous condition on the business premises; or 3) the claimant is injured by a product made or sold by the business.

The first scenario often occurs when an employee causes an automobile accident while on the job. Another motorist injured in the accident will often make a claim against both the employee and the employer.

The second scenario may arise when a customer slips and falls on a wet floor. However, it may also arise if a customer is injured by a criminal attack by a third party. These claims sometimes occur when a customer is physically attacked in a parking garage or during a convenience store robbery. The business may be held liable if it had reason to know of a significant risk of criminal attack and failed to take steps to either protect its customers or warn them of the risk. Claims arising from dangerous conditions on business premises are called *premises liability* claims.

The third scenario arises most often in manufacturing or retail businesses when a consumer is injured by the product produced or sold. These claims are called *product liability* claims. A familiar example is the customer who is burned by a hot cup of coffee. It may also arise when a food product is found to be contaminated or a household product is found to be unreasonably dangerous.

Q: What kind of insurance is available to protect a business against liability claims?

A: The most common liability insurance coverage is found in a *comprehensive general liability policy* or *CGL policy*. These insurance policies typically provide for a legal defense for the business—known as a *duty to defend* —as well as coverage for any legal judgment or settlement the business is required to pay (*indemnification*). CGL policies generally cover claims for injuries caused by employees, premises liability claims and products liability claims. However, it is important to review your policy carefully and talk to your insurance agent or broker. Some CGL policies are more limited and may require the purchase of additional policies for product liability, environmental or pollution liability and employment practices liability.

Also, Ohio's statutory law requires most employers to participate in the workers' compensation program, which provides a type of insurance protection for employees who are injured while working for their employers.

Q: Can I take the risk of doing business without adequate insurance?

A: To take such a risk would not be wise. Despite any savings resulting from not paying insurance premiums, the risk of loss through fire or through liability claims is too great. The insurance market provides a number of alternatives at competitive prices to make business insurance affordable, beneficial and almost indispensable.

–originally prepared by Jack L. Neuenschwander, retired partner of the Piqua firm of McCulloch, Felger, Fite & Gutmann Co., LPA. Updated by Monica L. Waller of Lane, Alton & Horst, LLC in Columbus.

Protecting Income with Disability Insurance

Disability insurance can help prevent a financial disaster by protecting your income and/or that of your employees should you or an employee become unable to work due to sickness or injury. Because disability insurance policies are not standard and include a number of variables, it is important to understand the options available so you can tailor an insurance policy to your own business situation.

Basic Policy Provisions

Definition of disability

While many people focus on the cost of a disability insurance policy and the benefit they could receive in return, the first thing you should consider is the definition of disability. Make sure you understand in what circumstances you will be considered disabled within the terms of the policy, and therefore be eligible to receive benefits from that insurance coverage. The language can be confusing.

One thing to consider is whether a person will be deemed disabled if unable to perform the "substantial and material duties of (his or her) own occupation." Consider what defines your occupation and what your substantial and material duties include in that position. What if you perform some, but not all, of those duties? What if you are unable to work in your own occupation, but you can work in an occupation for which you are reasonably suited based on your education, training and/or experience? For example, a trial lawyer who suffers an injury that limits or eliminates his or her ability to travel physically to court may be unable to try cases, but still may be able to conduct relevant legal research. Under those circumstances in many cases, the lawyer may not be considered disabled, even though the lawyer's income would surely be substantially less as a legal researcher than as a trial lawyer. Nevertheless, the lawyer may be able to receive partial benefits depending on the wording of the policy. Make sure you are covered for the work you actually do.

Definition of total disability

When reviewing a policy, find out how total disability is determined. What if your business is receiving some income, but you are unable to work yourself? Is there a particular reduction in percentage of income before the insurance company will consider you totally disabled?

Partial disability option

Look for a provision that affords coverage if you are able to work, but only on a part-time or sporadic basis. Some insurance companies refer to this as a partial disability benefit or residual disability benefit. Just as with the example above, even if you are able to work a few hours a week after an injury or illness, disability protection is still crucial since your income would be substantially less than before the injury or sickness. Also examine the policy to see if it stipulates that your earnings must be reduced by a certain amount or percentage before you would be considered partially disabled.

Benefits

While the monthly benefit you will receive is undeniably important, it also is critical to determine the maximum amount of the total benefit provided for when considering a policy. Benefits typically are paid based on a percentage of lost income. Does the definition of earnings include any bonuses received? If you are self-employed, how does the policy define your income, since there may be some substantial peaks and valleys throughout the year?

Also find out how long the benefits will continue and if benefits will stop or be reduced when you reach a certain age, regardless of the length of disability.

Premiums
In most cases, a disability insurance policy will renew annually on its anniversary date. Check to see if the premiums will stay level throughout the life of the policy or if they will increase every year or at certain attained ages. Is the schedule just an estimate or are the premiums guaranteed?

Renewability
Since the policy must be renewed annually, ask if a change in any employee's health will affect the company's right to continue renewing the policy. If the policy is purchased through a group such as a trade association, must employees maintain membership in that group every year at renewal time? Is there an age limit after which you may no longer purchase or renew insurance coverage?

Waiting period
The waiting period is the amount of time you must be disabled before benefits are paid. Insurance companies will not insure to protect income from the first day the insured is disabled. Waiting periods vary from 30 days to one year with a consequent decrease in premium as the waiting period is increased.

Optional Provisions

There are a number of policy provisions that are not necessarily standard, but may be very important to you, based on current or expected future circumstances.

Underwriting
When an individual purchases a disability policy, it will be underwritten, meaning the insurance company will want to review the results of a physical examination and medical history before agreeing to issue a policy to the prospective insured. However, a company with a substantial number of employees may be able to negotiate with an insurance carrier to waive the underwriting requirement. Organizations such as trade associations also may have greater bargaining power, enabling members to obtain policies without the underwriting stipulation.

Pre-existing condition limitations
Many policies contain a provision that denies coverage for a disability that results from a condition for which an insured has received treatment from a medical professional within a specific time period (for example, the preceding 12 months). If you regularly see a health care provider for a condition such as a back problem, examine the policy to see if you will be eligible to receive benefits should the condition eventually cause you to become disabled.

Conversion to an individual policy
If the policy is purchased by the employer, can an insured convert the policy to an individual policy if he or she leaves that place of employment?

Rehabilitation benefit
Check to see if the policy will pay for physical therapy or other assistance that may be needed for you to return to work. Similarly, does the policy pay for retraining if necessary?

Additional Items to Consider

Stability of insurance company

Is the insurance company issuing the policy financially stable? Verify that it has a secure rating from A.M. Best or another recognized insurance rating agency.

Offsets

Determine if the benefit will be paid regardless of any other sources that might help replace at least part of your income, such as workers' compensation or Social Security benefits.

Exclusions

Look for any exclusions that might be particularly relevant to your situation. Examples include age limitations, minimum hours of work per week and limitations on payments for disability caused by certain conditions, such as mental disorders.

Cost of living riders

If you are disabled for an extended period of time, will the benefits increase as the cost of living rises? This option is usually available for an additional surcharge.

Seek Guidance and Advice from Your Advisers

Because of the many variables and individual circumstances, it is prudent to thoroughly research and analyze all the relevant issues before purchasing a disability insurance policy. In addition to consulting your insurance agent, it is wise to talk to your lawyer to ensure that your company's employment policies dovetail with the disability insurance program you are considering. Your tax adviser can help you understand the tax treatment of benefits an insured might receive in the event of disability.

–by Alan Berliner, a partner in Thompson Hine, LLP's Corporate Transactions & Securities Practice Group in Columbus.

Long-Term Care Insurance:
Overlooked Health Care and Tax Planning

Introduction
In the event of an illness or injury that requires a substantial recovery period or duration of care, private health insurance, Medicaid or Medicare will cover most major medical expenses, such as treatment by skilled professionals, hospitalizations or physical therapy, as well as some medications. However, in certain circumstances, an illness or injury will render a patient in need of extended or lifetime assistance with certain activities of daily living (ADL) such as dressing, eating, bathing or simply moving around the room or house. Home health agencies, nursing homes and hospice personnel are available to assist with ADLs. However, these ADL services are often minimally covered or excluded from coverage by private insurance, while Medicare and Medicaid offer ADL assistance for only a limited period of time. As a result, many families exhaust savings and benefits while paying out of pocket for such ADL services. Long-term care (LTC) insurance can be used to control these ADL costs.

Q: What is LTC insurance?

A: At its most basic, LTC insurance is an agreement between a person (policyholder) and an insurance company. According to that agreement, the insurance company agrees to pay for ADL services received by the policyholder when those ADL services are provided in a nursing home, hospice, assisted living facility, or in the residence by a home health agency. The specific ADL services that are covered vary with each LTC policy. In addition, each LTC policy has different triggers to coverage, such as the requirement that the policyholder must have a serious ongoing medical condition and must be unable to perform two or more ADLs. An LTC insurance policy can be a stand-alone policy or it can be a benefit under certain life insurance policies or annuities. Many LTC policies waive payment of future premiums after LTC services begin.

Q: What planning issues are associated with LTC insurance?

A: Several planning issues arise when purchasing LTC insurance. Two of the more prominent issues to consider are 1) income taxes and 2) Medicaid benefits.

With respect to income taxes, two main issues should be considered: 1) the income tax treatment of premium payments made to maintain an LTC insurance policy; and 2) the income tax treatment of benefit payments made according to the LTC policy's terms.

With respect to premium payments, starting in 1997, certain LTC premium payments became deductible from taxable income as medical expenses, so long as the LTC insurance policy was a *qualified* policy. In order for a policy to be "qualified," it must include specific benefit triggers, such as certification that the policyholder will be unable to perform at least two ADLs for at least 90 days or needs "substantial supervision" due to a severe cognitive impairment. Policies sold before 1997 are automatically qualified, so long as the product was approved by a state insurance commissioner. Policies sold after 1997 need to specifically meet necessary requirements.

When employers provide LTC coverage for employees, the premiums paid by employers are not treated as employee income for tax purposes. Also, the employer payments are 100 percent deductible as an employer business expense. Starting in 2003, self-employed and S-corporation shareholders are now able to deduct 100 percent of the individual deduction limit.

On the benefit payment side, a plan purchaser should also ensure that the LTC insurance policy is a “qualified” policy. Benefits paid according to a qualified LTC insurance plan, including annuity plans, are not taxable as income to the recipient as long as the policy is qualified and the benefits do not exceed $175 per day, adjusted for inflation.

From a Medicaid perspective, the timing and duration of benefit payments should be considered. The LTC policy benefits should cover home care, as well as the daily cost of nursing home care in the area where the insured is living or will be living. The policy should also allow for inflation either in the benefit limits or the policy’s terms. LTC coverage should also last long enough that it can bridge any gap in Medicaid coverage that may result if personal wealth planning would require a transfer of assets after the policyholder moves into a nursing home.

Ohio has added a new tool in long-term care planning. Effective September 10, 2007, insurers licensed in the state can issue *partnership-qualified* LTC insurance policies or riders that meet certain federal and state requirements. These policies or riders can be issued via groups or to individuals.

An LTC partnership policy helps policyholders preserve personal assets while planning for their medical needs later in life. An LTC partnership policy also helps policyholders leverage their private coverage with Medicaid services. Under a partnership-qualified LTC insurance policy, the policyholder is eligible for a “dollar-for-dollar” disregard in the asset portion of a Medicaid eligibility determination that is equal to the face value of the LTC policy. As a result, if the policyholder’s LTC insurance partnership policy either does not pay quite enough to cover all LTC expenses or has been exhausted, the policyholder’s Medicaid “spend-down” requirement would exempt personal assets equal to the amount of benefits actually spent under his or her LTC insurance partnership policy. These protected assets are also protected from Medicaid estate recovery after the policyholder has died, and, therefore, the assets can be passed on to the policyholder’s heirs. The partnership policy thus encourages more personal responsibility and creates an individual safety net, while also preserving the Medicaid eligibility of policyholders with longer claim needs.

Conclusion

LTC insurance policies can play a significant role in ensuring a person’s long-term quality of care and in protecting that person’s assets. Many state insurance departments, including Ohio’s, publish detailed information on LTC insurance offered in their states. All consumers, including employers, would be wise to review the department’s information, and to shop and compare coverage before purchasing LTC insurance. Employers should consider LTC benefits that will give employees peace of mind about their ability to manage an unexpected illness or injury.

–originally prepared by the Ohio Department of Insurance and updated by attorney Brandon A. Borgmann of the Columbus firm of Carlile Patchen & Murphy LLP.

Shoplifting and Loss-Prevention Programs

Shoplifting and theft can result in substantial business losses, including merchandise loss, apprehension costs and litigation. Several Ohio statutes apply to theft and shoplifting offenses. Knowing the general elements of the laws (and their practical application) is essential to an efficient loss-prevention program.

Ohio's Shoplifter Detention Law (ORC 2935.041) permits merchants and/or their employees to detain shoplifting suspects. If a merchant, employee or agent has probable cause to believe that store property has been stolen or shoplifted, he or she can detain the suspected thief in a reasonable manner for a reasonable length of time in the store or in its immediate vicinity:

1) to recover the stolen property;
2) to facilitate an arrest by a peace officer and/or;
3) to obtain an arrest warrant.

The statute does not permit the merchant or its employee to search the suspect or seize any property belonging to the suspect without the suspect's consent, or to use undue restraint.

The Ohio Shoplifter Detention Law is a reasonable response to a real need, but it does not provide absolute immunity to a merchant and/or its employees for a wrongful detention or alleged harm to a suspect. In 1991, a Franklin County jury awarded a shoplifting suspect more than $12 million in damages for permanently disabling injuries sustained during a shoplifting arrest. The suspect was accused of stealing four "AA" batteries. In a number of other reported civil cases, juries have awarded substantial damages to accused shoplifters.

Merchants clearly have a legitimate interest in maintaining a loss-prevention program and training employees to aggressively (but intelligently) reduce shoplifting losses. However, the use of physical force or unreasonable detention of shoplifting suspects can be expensive for the merchant—whether the suspect committed the offense or not. A merchant can be sued and, regardless of the court's ultimate decision, may incur considerable costs.

Several statutory procedures available to merchants should be considered as a part of the overall loss-prevention strategy:

1) Theft or shoplifting by minors is a continuing challenge for some merchants, but parents or guardians of a minor are liable for the willful damaging or theft of property up to $10,000 plus court costs (ORC 3109.09).
2) An adult and/or minor may be sued in civil court (according to ORC 2307.60 and 2307.61), and when the value of the willfully damaged or stolen property is less than $5,000, the injured party may demand, in writing, payment in full before filing a civil lawsuit. The restitution demand letter must comply with Ohio law (ORC 2307.61). It should warn the person accused of damaging or theft that, in a subsequent lawsuit, a court could award actual damages, a minimum of $200 in liquidated damages, up to three times the value of the damaged or stolen property, and administrative costs that would include court costs and reasonable attorney fees.

As part of a comprehensive loss-prevention program, a business owner/merchant should consult with an attorney and other merchants to determine the most efficient, cost-effective loss-prevention program to meet the business's needs. Civil and criminal litigation can require many employee hours, store resources and potential legal fees. Additionally, damages could be awarded to a shoplifting suspect should a court or jury find that an arrest was unwarranted and/or unreasonable. All such factors should be considered when developing an effective loss-prevention plan.

–by Hon. Richard M. Wallar of the Hocking County Probate and Juvenile Court.

Is Your Business at Risk for a Professional Negligence Claim?

If you're a licensed professional, you are potentially exposed to a claim of professional negligence—malpractice, by any other name. Physicians and nurses, real estate agents and brokers, engineers and architects, chiropractors, podiatrists, accountants, dentists, attorneys, pharmacists... virtually anyone who pursues a career in a licensed professional setting may have to defend against such a claim.

If someone brings a professional negligence claim against you, you will usually receive advance notice in the form of a letter. Sometimes, however, receiving a complaint and summons may be your first clue. If you receive a summons and complaint, you have 28 days to answer the allegations. Otherwise, you could be found in default. Seeking legal counsel immediately after receiving the complaint is essential.

No matter how or when you are notified, the complaining party (the *plaintiff*) always has the burden of establishing all four elements of a claim of professional negligence (duty, breach of duty, proximate cause, and damages). Unless all four elements are established by a *preponderance of evidence*, the claim will fail.

In order for a plaintiff to prove the claim against you, another professional who practices in the same field as you do and is recognized by the court as an "expert," must testify that you owed some duty and that you breached your duty. The expert also must testify how your alleged failure caused the injury or damage and offer an opinion about how the injury or damage might be compensated (called "damages").

Whether you are bringing or defending a professional negligence claim, you should be aware of the various statutes of limitation that apply. In other words, the claim must be brought within a particular period of time or a court will not hear it.

Except for claims of wrongful death, a one-year statute of limitations applies to "medical claims," such as claims against physicians, nurses, dentists, optometrists, chiropractors, podiatrists, physical therapists, physician's assistants, and emergency medical professionals; and claims against facilities, including hospitals, nursing homes and residential facilities (or an employee of any of these). Under specific and limited exceptions, this one-year statute of limitations may be extended. If the claim involves negligent credentialing against a medical professional, then a separate two-year statute of limitations applies.

Most other professional negligence claims are governed by a separate one-year statute of limitations period. With certain limitations and exceptions, this one-year limitation period applies to claims against attorneys, real estate professionals and other licensed professionals. However, claims of accounting negligence are governed by a four-year statute of limitations. Also, claims against architects, engineers and other "design professionals" for personal injury or death allegedly stemming from a faultily designed, constructed or re-constructed building are governed by a ten-year statute of limitations.

What can your business do to protect its professionals? Make sure your professionals are covered under a liability insurance policy, guarding against the potential risks and losses associated with malpractice claims. These policies are subject to specific underwriting terms and conditions, provide varying levels of coverage and, as is typical of any insurance policy, provide for certain coverage exclusions. If you are a licensed professional, you should carry an appropriate liability policy. You should know, however, that no insurer will insure you against losses suffered by your client if your *intentional* conduct caused the damage.

Because every set of circumstances is unique, the information in this article is intended as a guide only and should not be used as a substitute for advice from your counsel.

–by Doug Holthus, an attorney with the Columbus office of Poling Law.

Insurance for Cyber Risks

The online component of your business brings risks that are new and dramatically different from the traditional risks for which a business purchases insurance coverage. Evolving technology provides new possibilities for damage to your business that may not be covered unless your policies have been specifically updated to cover these risks. As technology changes the way business is transacted, few consider the effects on their insurance. Just having a website or the ability to send emails over the Internet means you need to review your coverage.

Assess Your Risks

The potential risks are many and varied. What if your computer system goes down or data is corrupted? Consider, for example, the effect on your order entry system, including damages ranging from the costs of repairing your equipment to damage to your reputation. What if someone hacks into your system and steals confidential information of your customers?

While business interruption insurance may cover some losses, the language in these policies was written before hackers and denial-of-service attacks were concerns. Reviewing policies with an independent insurance professional may help you discover coverage gaps or claims not previously considered. Take specific steps such as:

- **Talking with your insurance agent.** Ask about recent updates and specific cyber risk products. Be wary of exclusions. Make sure all coverages are coordinated, including intellectual property and media coverages, fidelity and surety bonds, and excess and umbrella policies. Make sure your agent tailors the coverages to the needs of your business.
- **Carefully reviewing** your general liability policies, property damage coverages (first party), business interruption insurance, and errors and omissions policies. A number of courts have found that property damage does not include misuse or loss of electronic data. Because of these cases, many insurance policies now specifically exclude coverage for misuse or loss of electronic data.
- **Considering coverage for possible damage to your property.** Business interruption policies should be updated to cover partial shutdowns of your business, such as when your online system is incapacitated, but your brick-and-mortar business remains open. Traditional insurance policy requirements of *physical harm to tangible property* are outdated given the intangible nature of your data stored electronically. In many cases, electronic data processing endorsements will not overcome this gap in coverage.
- **Considering coverage for liability to others.** Your business is only one concern. You may have potential liability to others by, for example, allowing disclosure of customers' confidential information. The courtesy and convenience of supplying links to other sites through your website increases exponentially the potential for third-party liability, including possible patent or trademark infringement. Make sure your errors and omissions coverage covers what you do now and may plan to do in the near future. Do you have insurance coverage for the cost of defending third-party claims against you?
- **Determining how to limit security exposure.** Insurance is available for many of the damages that can be caused by hackers and viruses, etc. You should consider extending directors' and officers' liability insurance coverage to include claims for failure to provide adequate security.

Next Steps

- **Revisit your computer security policy.** How vulnerable is your company? Determine where insurance is appropriate.
- **Check your privacy policies and procedures.** Consumers and other businesses expect confidentiality. Make sure you are taking proper steps to protect others' confidential information.
- **Think globally.** Determine not only your back-up plan, but also the back-up plans of those on whom you rely.
- **Stay current.** Changes will continue as risks develop and litigation ensues.

–by Alan Berliner, a partner in Thompson Hine, LLP's Corporate Transactions and Securities Practice Group in Columbus.

Ohio Provides Continuing "Mini-COBRA" Coverage for Former Small Business Employees

The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) generally provides that certain qualified beneficiaries who lose coverage under an employer-sponsored health plan may elect to continue coverage under the plan in certain situations. COBRA applies to employers with 20 or more employees. If an employer has fewer than 20 employees, those employees may have continuation coverage rights under state continuation coverage law (sometimes referred to as "mini-COBRA") rather than COBRA. This fact sheet provides an overview of Ohio law on health plan continuation coverage under Ohio's mini-COBRA provisions.

Q: Who is eligible for coverage under the Ohio continuation law?

A: In order to be eligible under the Ohio continuation law, an employee must have been:

1) continuously insured under a group policy during the three-month period preceding the termination of employment;
2) involuntarily terminated for reasons other than gross misconduct; and
3) not covered or eligible for coverage under Medicare or under other group coverage.

An employee should check the terms of the employer's group insurance coverage to determine what continuation benefits the employee is entitled to receive.

Q: How long may coverage last under the state continuation law?

A: Individuals may continue coverage for a period of up to 12 months.

Q: What benefits may be continued under the state continuation law?

A: This continuation coverage requirement covers hospital, surgical and major medical benefits. In addition, continuation coverage must include prescription drugs if this coverage is included in the group coverage. Continuation need not cover dental or vision care.

Q: How does an individual elect continuation coverage?

A: The employee must apply within the earlier of:

1) 31 days of losing coverage;
2) 10 days from the day the employee's coverage would otherwise terminate if the employee received notice of continuation rights before loss of coverage; or
3) 10 days from the date the employee received notice about continuation coverage, if the employee received such notice after losing coverage.

Q: Must employers in Ohio with fewer than 20 employees notify employees of the right to continue coverage at the time they are involuntarily terminated?

A: Ohio law requires small business employers to notify an employee of the right to state continuation coverage when the employee is notified of the employment termination. This notice must include details of the required monthly payment amount for continuation coverage (including the manner of payment).

Q: What if there is a disagreement about whether a former employee is eligible for group continuation coverage?

A: Former employees may contact the Ohio Department of Insurance (ODI) at (800) 686-1526 if they believe the insurance company is not complying with state group continuation coverage rules or for more information about state continuation law. Information is also available through www.insurance.ohio.gov (type "COBRA" in the search box).

–by Jason Rothman, an attorney in the Cleveland office of the international labor and employment law firm of Ogletree, Deakins, Nash, Smoak & Stewart, P.C.

Employer-Shared Responsibility Provisions of the Affordable Care Act[1]

Effective in 2014,[2] the tax code provides penalties applying to large employers (generally, those with at least 50 full-time employees) that fail to provide health care coverage, or provide coverage that does not meet certain standards.

- ***Possible penalties for not providing health care coverage to full-time employees.*** An employer failing to "offer…minimum essential coverage" to "substantially all" (generally meaning 95 percent) full-time employees and their dependents may be subject to a penalty *if at least one full-time employee* obtains health insurance coverage through an Affordable Insurance Exchange ("Exchange"). Very generally, the penalty is $2,000 per full-time employee per year, with the first 30 full-time employees excluded. Thus, for example, if an employer has 100 employees for whom it does *not* provide coverage, and one of those employees obtains coverage from an Exchange and also qualifies for a premium tax credit, that employer will be subject to a $140,000 penalty (a $2,000 base penalty for that employee *times* the 70 employees considered for this calculation = $140,000). As this example shows, all it takes is one employee obtaining coverage from an Exchange and qualifying for a premium tax credit to trigger a penalty that takes into account all employees.

- ***Possible penalties for providing coverage that is "unaffordable" or does not provide minimum value to full-time employees.*** An employer offering full-time employees coverage that does not provide "minimum value" or is not "affordable" may be subject to a penalty of up to $3,000 per affected employee for each full-time employee who obtains coverage through an Exchange and is eligible for a premium tax credit or cost-sharing reduction.

These potential penalties are determined according to the number of full-time employees employed for a given month, or the number of full-time employees who receive a premium tax credit or for whom a cost-sharing reduction was allowed or paid in a given month. The government has recognized that determining full-time status on a monthly basis may cause practical difficulties for employers, so safe harbor rules, discussed below, offer an option for employers who desire greater predictability in complying with the mandate.

Planning for Compliance

To plan for compliance with the Affordable Care Act, employers should take the following steps:

1) Determine which employees are full-time employees and which are "variable hour" or "seasonal" employees, and modify health coverage eligibility accordingly. Consider all common-law employees under the IRS test when determining full-time employee status for purposes of the "pay-or-play" penalty described above. Don't forget temporary employees, project-based employees, employees paid on commission, interns, co-ops, collectively bargained employees, etc.

[1] Current as of July 2013

[2] On July 2, 2013, the U.S. Treasury Department announced that the Obama administration would provide an additional year before certain provisions of the Affordable Care Act go into effect. This will effectively delay the employer mandate assessments against employers until 2015.

- ***Full-time positions.*** A current or new employee who is not a seasonal employee and is reasonably expected to work a full-time schedule of 30 hours of service (including certain paid leave) per week should be treated as a full-time employee. Health coverage should be offered to such an employee at or before the end of the employee's initial 90 days of employment. If coverage is not offered to such an employee, the employer faces a possible penalty of up to $2,000 per full-time employee per year.

- ***Variable hour or seasonal positions*.** A new employee is a variable hour employee if, based on the facts and circumstances at the employee's start date, it cannot reasonably be determined that the employee will, on average, work at least 30 hours per week.

  The IRS has not yet provided a definition of "seasonal employee" for this purpose. For 2014, however, employers can use a "good-faith interpretation" in determining which employees are seasonal employees.

  Employers can use "measurement periods" to determine, over a period of time, whether a variable hour or seasonal employee can be considered a "full-time" employee. If, for example, an employee who exceeds the 30 hours per week average during a given measurement period will be considered full-time for a "stability period" (generally, a period in which the employee will be covered under the health plan), regardless of the number of hours the employee actually worked during that stability period.

2) Confirm that the coverage offered to full-time employees is affordable and provides at least minimum value.
   - ***Affordability.***
     Coverage is "affordable" under the Affordable Care Act if the employee's cost of coverage for self-only coverage does not exceed 9.5 percent of household income. The proposed Affordable Care Act rules provide three affordability "safe harbors" allowing employers to satisfy the affordability requirement:
     - ***W-2 safe harbor.***
       Generally, an employer meets this safe harbor if the lowest cost of self-only coverage providing minimum value during an entire calendar year does not exceed 9.5 percent of the employee's Form W-2 wages from the employer for that calendar year.
     - ***Rate of pay safe harbor.***
       Health coverage will be considered affordable if the employee's monthly contribution (for the lowest "self-only" option) is equal to or lower than 9.5 percent of the employee's monthly wages or salary.
     - ***Federal Poverty Line safe harbor.***
       An employer will satisfy this safe harbor for a calendar month if the employee's required contribution for the lowest cost of self-only coverage providing minimum value does not exceed 9.5 percent of a monthly amount with such amount based on the federal poverty line for a single individual for the applicable calendar year (divided by 12 to get the monthly amount).

- ***Minimum value.***
  Employers should ensure that the plan they offer employees covers at least 60 percent of the total costs of benefits that are allowed to be incurred under the plan.

3) Consider the health plan's current definition of "eligible employee." If coverage is limited to full-time employees, is the plan definition consistent with the IRS's definition?

4) Consider the health plan's definition of "dependent," and whether it fully encompasses the IRS's definition of "dependent."
   - The penalty rules require that a "dependent," meaning a child up to age 26, be covered. "Child" includes a biological child, an adopted child, a stepchild, and an "eligible foster child" (an individual who is placed with the taxpayer by an authorized placement agency or by judgment, decree or other order of any court of competent jurisdiction).
   - The definition of "dependent" does not include the employee's spouse.

5) Consider adopting a document that formalizes measurement periods. Also, update all plan documents for consistency. Other administrative rules to consider include those dealing with:
   - Counting hours of service;
   - Special leaves of absence (under FMLA, USERRA or for jury duty) that require averaging to calculate hours during the measurement period;
   - Rehires, where the break in employment service is less than 26 weeks;
   - New employees who move from a variable hour or seasonal position to a full-time position; and
   - Special transition rules.

–by Jason A. Rothman, an attorney in the Cleveland office of Ogletree, Deakins, Nash, Smoak & Stewart, P.C.

Employee Hiring/Firing

Chapter 6

Don’t Take Potential Employees at Face Value

Suppose you own a motel and a nice young man, Norman Bates (remember the movie *Psycho*?), applies to you for a job. His résumé looks fine (lots of experience in motel management) and he interviews well. Would you hire him without checking him out further? Hopefully not.

If you do not at least make a stab at checking his background, you could be held liable for the next Janet Leigh he cuts down to size. Here are cutting-edge approaches you can use to guide your hiring procedures.

Check them all out.
Always check with an applicant’s previous employers. Courts sometimes hold employers liable for negligent hiring when an employee injures someone and the employer did not conduct a background check.

A law—not a shot—for immunity.
Ohio law gives former employers qualified immunity if they respond to your request and tell you about your applicant’s past job performance with them. They do lose their immunity if they disclose false, misleading or malicious information. When in doubt, check with your lawyer.

A credit report for credibility.
For applicants seeking jobs involving the handling of money or prescription drugs, entering customers’ homes, working with children or the elderly, or driving company vehicles, you should consider a credit report or, at least, a criminal background check.

But do it right. The Fair Credit Reporting Act requires you to get written permission from applicants if you want to get credit reports or background checks for employment purposes.

Give fair warning.
And before you turn down a job-seeker based on a credit or background check, you must give him or her a *pre-adverse action disclosure*. And you must include a copy of the Federal Trade Commission document, “Summary of Your Rights Under the Fair Credit Reporting Act.”

But if your applicant is Norman Bates, you might want to mail these documents to him.

–by Joseph B. Swartz, a partner with Weston Hurd LLP, in Cleveland. This article is taken from an article in the Ohio State Bar Association’s <u>Labor and Employment News</u>.

Managing the Hiring Process

One of the most significant steps you, as an employer, can take to ensure efficiency and effectiveness in product or services delivery is to hire and retain the right people to do the job. Despite this reality, many businesses, both large and small, do not take adequate steps during the hiring process to ensure they hire the right individuals. While the hiring process is not an exact science, there are measures you can take to remove some of the guesswork.

When beginning the hiring process, you should ask a few internal questions:

- What will the new employee do?
- What types of experience, skills and abilities should the person have?
- How will this person interact with other employees and customers?

Answering these basic questions will allow you to set a framework that will enhance the probability of hiring the right person.

On the job application form and during interviews, tailor your questions so they are job related. Ask all applicants the same basic questions. Be aware that federal and state laws place numerous restrictions on the types of questions that may be asked. For example, an employer cannot discriminate based on certain characteristics such as age, race, color, gender, religion, disability, marital status or national origin, so inquiries in the interview process must avoid these subjects. (Sexual orientation is another characteristic that is protected by city ordinance in some municipalities including Cleveland, Columbus and Toledo.)

Even casual questions about protected characteristics can potentially create liability. Further, if an applicant volunteers such information, the employer who uses the information to discriminate can be held liable. It is important that all those involved in the interview process understand these limitations, since the actions of employees can create liability for the business.

An increasing number of employers are recognizing the benefits of using the Internet for vetting applicants in the pre-employment process. While Google and social networking websites can help employers learn more about applicants, be careful about when and how you access applicants' social networking websites. Do not ask for an applicant's password or access an applicant's website through fraudulent or improper techniques. Also, do not view an applicant's social networking website before interviewing the applicant. Accessing information about a potential employee on the Internet may bring to light information that an employer cannot consider in the context of the individual's employment (such as sex, race and other protected characteristics). An employer can avoid this potential problem by having someone outside the hiring process perform Internet searches on applicants and only report relevant information that can legally be considered for employment purposes.

Do not make any promises during the interview process. Employers should not bind themselves to conditions regarding discharge, benefits, or policies and procedures. In Ohio, the general rule is that employees serve at the will of the employer, although numerous judicial decisions over the past 20 or so years have created many exceptions to this doctrine. Any promises could create an implied contract or a legal promise known as *promissory estoppel* that could bind the employer to the promise.

Make sure you request and follow up with references. This may seem obvious, but it is often overlooked. In addition to asking general questions, a reference check with previous employers should always include the question, "Would you re-hire this person?" Under Ohio law, employers are entitled to immunity concerning information they provide in response to a reference check in most situations, so long as the information given is true and accurate.

A successful interview process requires advance planning, so you should spend adequate time preparing for the entire process. Your business should have an outline of interview questions and should be prepared to ask the tough questions. With this advance preparation, a business can go a long way toward getting the right person while avoiding costly and time-consuming legal action.

–by Marc A. Fishel, a partner in the Columbus law firm of Downes Fishel Hass Kim LLP.

Know the Law When Using an Outside Agency To Do Background or Credit Checks

Q: Can I order a credit check on an applicant before I make an offer of employment?

A: Yes, if the employee consents in writing. Oftentimes an employer will review a consumer credit report of an applicant for employment as part of a background check. The Fair Credit Reporting Act (FCRA) permits an employer to request such a report for employment purposes, which may include evaluation of an individual for employment, promotion, reassignment, or retention.

You must make clear and conspicuous disclosure of your intent to get the report to the prospective employee, who must consent in writing. This writing must be separate from the employment application.

If the employer denies employment even in part based on the information in the credit report, the employer must inform the applicant of this fact before taking any such action based on the report. The employer must provide to the prospective employee: 1) a copy of the report; and 2) a written description of the prospective employee's rights (often referred to as the Consumer Bill of Rights).

The employer cannot request the report after the employee ends his or her employment. An employer is permitted to obtain consumer reports containing additional information, such as reputation and personal characteristics, but only upon notice to the employee. Employers who unlawfully obtain credit reports can be liable to the employee for actual damages, punitive damages and attorney fees, as well as subject to criminal liability. Be aware that even the lawful use of credit reports may nonetheless run afoul of the civil rights laws. If an employer's use of credit reports consistently impacts the hiring of minorities in a negative way, for example, the employer may be liable for discrimination.

Q: Can I order a criminal background check on an applicant for employment?

A: Yes, if the employee consents in writing and receives the same protections as he or she would with a credit background check. As confusing as it may seem, Congress regulates criminal reports as part of the FCRA.

Q: Do you mean that the FCRA regulates criminal background checks as well as reference checks?

A: Yes. Congress originally enacted the FCRA in 1971 to protect individuals from abuses by private companies that created huge databases on individual credit histories. In the years since, these and other businesses have compiled or gained access to criminal records and other information about individuals. Congress responded to this development with an amendment to the FCRA to cover criminal background checks by outside agencies.

Q: So what, exactly, are the restrictions on criminal background checks?

A: When you use an outside agency to gather information about an individual for employment purposes, you must: 1) make a clear and conspicuous disclosure to the individual of your intent to get the report; and 2) obtain his or her authorization in writing in order to get the report. This written authorization must be separate from the employment application.

***Q:* What if the background information is negative? Can I refuse to hire the person?**

A: In order to use information obtained from an outside agency for employment purposes, you must:

1) inform an applicant if employment is denied, at least in part, due to the information in the report; and
2) provide to the prospective employee a copy of the report and a description in writing of the rights of the prospective employee (Consumer Bill of Rights) before taking any such action based on the report.

You may obtain consumer reports containing additional information, such as reputation and personal characteristics, but only upon additional notice to the prospective employee.

***Q:* What happens if I do not follow the procedures properly?**

A: You could be liable to the employee for actual damages, punitive damages and attorney fees, and even criminal liability. In other words, you may obtain and use background checks, but you must do so properly.

***Q:* Do employers have other options for gathering background information on applicants or employees?**

A: Yes. Employers can conduct background and reference checks themselves. If you do not use an outside agency, you can gather information without the restrictions discussed above. In fact, an Ohio law will protect you from lawsuits by employees claiming that you gave or obtained a poor reference about them (see article on reference-checking law).

***Q:* What could happen if I decide not to conduct any reference checks at all?**

A: Two things, neither of which is good. First, you may hire an unfit employee. Second, you could face a suit for negligent hiring if the employee hurts someone.

You may be liable for negligent hiring if:

- you hire an unfit employee;
- you fail to make reasonable inquiry into the employee's background;
- a reasonable inquiry would have led to rejection;
- you knew or should have known that your employee's contact with others created a risk of harm; and
- you fail to conduct a background check that would have led you to reject the employee, and he or she harms another person while in your employ.

***Q:* It sounds like I can get into trouble no matter what I do. What is the best course of action?**

A: Be careful, but do not become paralyzed. First, always conduct reference checks. At a minimum, contact the former employer. If you hire an agency to give you a background check, whether credit or criminal, follow the FCRA procedures (outlined above). Finally, use the reference information wisely. If the candidate is unfit, do not hire him or her.

–by Neil E. Klingshirn, partner in the Akron-based firm of Fortney & Klingshirn, and Maribeth Deavers, partner in the Columbus firm of Isaac Brant Ledman & Teetor, LLP.

Reference-Checking Law Benefits Employers

Q: Why was Ohio's reference-checking law enacted?

A: In 1996, a reference-checking law was enacted to help protect employers from frivolous lawsuits sometimes brought by disgruntled former employees. Most Ohio employers engage in a form of *due diligence* as part of their hiring process by investigating the backgrounds of prospective employees. Due to the onslaught of workplace violence, employers may face *negligent hiring* suits if they fail to request or obtain accurate information about the job history of potential employees. At the same time, employers who are asked to provide information about former employees are concerned about being sued by the former employees over the release of information. This latter threat has kept many employers from providing detailed reference information about former employees. The intent of the reference-checking law was to ease this "catch-22" situation for employers.

Q: What does the reference-checking law say?

A: Under this law, anyone who employs one or more persons within the state of Ohio (including private as well as public employers), or acts directly or indirectly in the interest of such a person, is considered an employer. An employer who provides job performance information for either a current or a former employee is not liable to that employee, or to the prospective employer, or to anyone else for any harm that may result from disclosing this information *unless* the greater weight of the evidence shows that the employer:

1) knowingly disclosed false information with the intention of misleading a prospective employer (or anyone else) in *bad faith* or with *malicious purpose*; *or*
2) disclosed information that constitutes unlawful discrimination against the individual's protected class status (such as race, color, religion, sex, national origin, disability, age, or ancestry), or violated the employee's rights under Ohio's Credit Transaction Act (regarding credit checks).

Q: How does the reference-checking law differ from the law used to govern these situations in the past?

A: Before this law was enacted, the common law standard used in Ohio made it easier for employees to win suits against employers because they only needed to show the court that the employer acted with *actual malice*, meaning that the employer either "knew or should have known" that he or she was providing false information.

Under this law and subsequent case law, employees are required to prove that the employer *actually knew* the information he or she was providing was false or acted with reckless disregard for the truth of the information provided. This standard was set to make it more difficult for employees to win suits against employers. Also, the law allows employers to collect reasonable attorneys' fees and court costs if the lawsuits brought against them are found by the court to be *frivolous* or unwarranted.

Employers are expected to be careful and prudent in their selection of employees due to the threat of negligent hiring suits in the event a bad hiring decision is made. Quality hiring decisions are enhanced through detailed information of a prospective employee's prior job history. The reference-checking law makes it less dangerous for employers to provide detailed information in response to reference-check requests.

–by Donald R. Keller of *the Columbus firm, Bricker & Eckler LLP, and Timothy J. Owens of the Columbus firm, Lane Alton & Horst LLC.*

Employers Have "Qualified Privilege" When Conveying Information about Employees

Q: My employee has accused me of including false information in his performance review. Does he have any legal recourse?

A: As long as you did not know the information was false and did not act with reckless disregard as to its truth or falsity, you are generally free to express your opinion in a performance review, even if that information is false. In Ohio, employers are protected by what is called a *qualified privilege*. This privilege generally allows employers to freely communicate their thoughts about employees.

Q: What is a qualified privilege?

A: Qualified privilege means that the employer's communication is protected by law unless:

- it was not for a legitimate purpose; or
- it was communicated to a person without a need to know; or
- it was made with actual knowledge that it was false or with reckless disregard as to its truth; or
- it was made for a discriminatory reason related to an employee's race, religion, age, disability, national origin or gender.

Q: If an employer knowingly communicates false information about an employee, is it considered defamation?

A: Possibly. Defamation is a false publication (either orally or in writing) to a third party that:

- causes injury to a person's reputation; and
- exposes the person to public hatred, contempt, ridicule, shame or disgrace; or
- affects the person adversely in their trade or business.

However, defamation does not include opinions unless they involve or imply false statements of fact.

Q: I own a small business, and one of my employees is asking to see a copy of her personnel file. Am I obligated to provide it?

A: If you are an employer in private industry, Ohio law does not require you to provide copies of personnel files unless there is an employment contract, employee handbook or collective bargaining agreement that says otherwise.

–by Frederick M. Gittes, a partner in The Gittes Law Group in Columbus.

Employee or Independent Contractor?

Know the Difference

Perhaps no issue of law or business has been as controversial or as pervasive as determining whether workers should be treated as employees or independent contractors. Regardless of the efforts of Congress, the IRS, industry associations and the courts to streamline an approach, this complex issue will continue to require the careful factual and legal analysis of a professional. Safe harbors provided by Congress in the 1978 Revenue Act remain available but were hotly contested by the IRS on an industry-specific basis through the ‘90s. Well-intentioned efforts to provide preliminary guidance on this issue to businesses by the IRS through its SS-8 program have provided disappointing and often costly outcomes, because even when the facts strongly indicate independent contractor status under accepted public rulings and procedures, those who apply are almost always determined to be employees.

The issue of the independent contractor/employee dichotomy is contentious because much is at stake. Employees can be much more expensive than contractors, especially for small businesses. Compliance costs in establishing a payroll system, withholding income and employment taxes and filing employment tax returns, depositing payments, and issuing W-2s in a timely fashion almost always require the services of an accountant, even for domestic workers and in-home caregivers. In addition, a business must contribute to the employment taxes for its employee workers, but not for independent contractors. The employer’s portion of FICA, FUTA, Medicare tax, state unemployment tax and workers’ compensation insurance may put a business at a competitive disadvantage against businesses operating with independent contractors. Some businesses use independent contractors to reduce the cost of labor by contracting at rates other than those provided under collective bargaining agreements and reducing the cost of employee benefits such as vacation/sick pay, health insurance, and pension/profit-sharing contributions. With this many opportunities and separate laws in play, businesses have been known to make costly mistakes.

The business owner should be aware that there are positives and negatives when contracting with independent contractors or hiring employees. The purpose of this article is to sensitize the reader to some of the issues so that he or she will better recognize when and how to seek appropriate counsel.

Q: I am starting up a new business. How do I know whether my workers are employees or independent contractors?

A: The best time to deal with this issue is when you are forming your business. You will need an accountant to set up a bookkeeping system, project working capital needs, and establish tax return and other compliance systems. Ask your accountant first. Do not rely on what you hear that “everyone else is doing.” An experienced certified public accountant (CPA) will be familiar with the 20 common law factors, safe harbor under Section 530 of the 1978 Revenue Act and the different tests used by the state. Your CPA also should know how competitors treat their workers. Your control over the worker, as well as whether the worker has a significant economic capital investment, licenses, or takes a meaningful risk of loss in connection with his or her services, significantly impact the answer. There is usually a conservative approach. Your CPA should be able to help.

There are often alternative strategies. Some of these are legal, safe, and can save significant operating costs. Others are reckless or overly aggressive. A good tax, labor or employee benefits attorney is your best choice if you are in a gray area or have special business needs. Many local bar associations have lawyer referral services and can provide you with information about attorneys who have the appropriate expertise and practice in your geographical area.

Attorneys or CPAs can help you best if they are part of your professional team. Involve them in your decision-making and know when and how to use them.

Remember, attorney-client communications are confidential and *privileged*. The IRS cannot compel your attorney to disclose the facts you provide, the questions you have, or the advice given. While the advice of an accountant also must be kept confidential, and has limited privilege, communications with an accountant are *not privileged in the same way*. Any information used to prepare a tax return can be compelled to be provided to the IRS in an exam. This means that the IRS can, during an examination, compel an accountant to disclose information pertaining to the preparation of tax returns, including the reporting positions taken on employment tax returns. When in doubt, explore any questions involving material risks with an attorney advisor first.

Q: I was examined by the Ohio Bureau of Employment Services or Workers' Compensation. The agent concluded that my workers are independent contractors and not employees. The IRS can't require me to treat them as employees, can they?

A: Unfortunately, the IRS can, and in many circumstances, it has. The approaches of the state and federal governments are not identical. Even the approaches within the federal government between the IRS and the Department of Labor are not identical.

Q: I am incorporated and my workers all signed agreements stating that they are independent contractors. If the IRS examines my tax returns and reclassifies my workers, can I be held liable if they failed to pay their taxes?

A: It is very possible. The IRS generally can examine and adjust tax returns within three years after the due date or actual filing, whichever is later. If your business has no employees, it may never have filed an employment tax return. Theoretically, all years remain open to adjustment, regardless of the passage of time. Therefore, if you have treated all your employees as independent contractors, you may effectively have no statute of limitations and your risk-exposure may be great.

If your workers are treated as independent contractors but are truly employees, the law imposes an obligation on your corporation to withhold and pay federal employment taxes to the IRS/Treasury even if the workers may have paid these taxes directly (as if they were self-employed workers). Your corporation can be required to pay the taxes again and the employees may be able to apply for a refund of a portion. The IRS is not bound by the contract between your corporation and its workers, although the contract can provide important evidence of your workers' status. Unfortunately, if your contract is not carefully worded, your workers may not be classified as you intend.

Many IRS reclassifications have led to the bankruptcy of businesses. Some of the important cases interpreting employee status are decisions made by federal bankruptcy courts. Withholding taxes are *not* dischargeable in bankruptcy. The IRS can assess the withholding taxes of the corporation against any officer, director or other person who has authority to pay, knows that the tax is due and willfully fails to pay it. Such personal liability can be used as a collection approach for some of these employment taxes in connection with a reclassification of workers. This personal liability is *not* dischargeable in bankruptcy.

These are extreme examples of what can happen. If you have a reasonable, but mistaken, belief that your workers were independent contractors and issued 1099 forms as required, there are statutes covering such situations, and your corporate obligation can be reduced. There is a government settlement program that may substantially reduce your exposure. Separate opportunities are available for taxpayers who voluntarily convert contractors to employees, and other, less beneficial opportunities are available even upon audit. The tax and penalties, perhaps even interest, may be reduced or eliminated, but to do so usually requires prospectively treating these workers as employees. If your workers cooperate with you to provide affidavits that they have paid their taxes, you may be able to take credit for some, though not all, of the employment taxes.

In short, it is important to have good advice when establishing your business. If you are examined on an employment tax reclassification issue, involve an attorney early; it can make all the difference.

Q: I am a general contractor. One of my subcontractors on an important job is having cash flow problems with his payroll. To keep his workers on the job, he has asked me to either loan him the net payroll or pay his workers directly. If I decide to help him out, could I be held liable for his employees' employment taxes?

A: Yes. Either of these accommodations can leave you liable for the employment taxes of the subcontractor if the subcontractor does not deposit the employment taxes on time.

Q: I am buying an incorporated business and the seller has extensively used independent contractors. If I buy his stock and these workers were actually employees, can I be held liable? What if I just buy his assets?

A: If you buy his stock, the IRS and the state of Ohio can still examine, re-determine employment status and collect against the corporate assets. Sometimes, careful examinations of the facts and a properly collateralized indemnity agreement will suffice. For example, filed tax returns may be examined, and other federal and state records may be examined by the buyer with the seller's consent. Sometimes enough of the purchase price can be retained by the buyer to cover the potential tax exposure or other seller collateral can be retained by the buyer for a reasonable audit period, during which the seller agrees to hold the buyer harmless from loss. Other times, not. For example, it may be impossible to hold the buyer harmless if the seller must spend all of the proceeds to pay its known obligations.

Buying assets instead of stock can help. However, it is important to check for federal and tax liens and to inquire into pending examinations. Some of these federal and state employment taxes can follow the assets, in some instances even without the filing of a notice of lien.

In buying a business, there are no substitutes for careful examinations of liens, reviews of tax returns, careful evaluations, and well-drafted and collateralized purchase agreements.

–by Gary M. Harden, an attorney with the Toledo firm, Eastman & Smith, LTD.

Employment-at-Will Doctrine Has Limitations

Q: Due to a loss of business, I need to terminate a long service employee with health problems. Can I do it?

A: Except under certain circumstances, an Ohio employer generally has the right to fire an employee without cause according to the *employment-at-will* doctrine. Employment is generally *at will*, unless the employer has agreed to continue an employee's employment for a specific period of time or has agreed to terminate employees only for just cause, such as in the case of employees who are covered by a collective bargaining agreement. Employees who are employed at will may quit at any time, but may also be fired at any time. There are, however, some important limitations on an employer's ability to fire workers (see below).

Q: I always gave a particular employee good reviews and once told him he would always have a job here if he kept up the good work. Does he have a contract?

A: Yes, but the term of the contract is probably still *at will*.

Every employee has a contract, including the employee in your example. The employment contract covers what you will pay for work performed. Employment contracts are generally informal and do not have to be in writing.

The question remains, though, whether this employee has a contract for a specific term of employment. If not, the employment is *at will*, meaning either one of you can terminate the employment contract at any time.

In your case, you told your employee that he would always have a job if he kept up his good work, which he did. Although you meant it at the time, your circumstances have changed and you would like to terminate his employment. Can you do so?

The answer is probably "yes," because you did not commit to employing him for a specific period of time. While a promise of this nature may invite litigation, Ohio courts will *not* assume, in such a case, that the employer meant to continue the employment forever. Rather, courts will look at all of the circumstances, and not just the one statement you made. For example, a court may consider statements in an employee handbook or a promise such as, "You will have a job until the plant closes," especially if made with an employee whose job was necessary for closing the plant.

Standing by itself, though, a promise of employment for "so long as you do a good job" is probably not specific enough to alter the at-will status of employment.

Q: I hired a senior executive from California and paid to relocate her family to Ohio. She agreed to repay her moving expenses if she leaves before two years. She also agreed not to compete against me for two years after she leaves. Do these two agreements mean I cannot fire her for two years?

A: No. You made two agreements for specific periods of time, but neither one of them promised employment for a specific period of time. The non-compete agreement does not cover her employment; rather, it covers the period after her employment ends.

Your promise to repay relocation benefits might look like an agreement to continue employment, but Ohio courts have generally concluded that such a promise defines the time required for an employee benefit to vest and not the length of time of employment.

Q: What if my employee also belongs to a union? Is he or she an "at-will" employee?

A: Probably not. Employees covered by collective bargaining agreements generally can only be terminated for *just cause* under the terms of the agreement.

Lack of work, documented poor performance or employee dishonesty may be *good cause* to terminate an employee. If you cannot convince the judge or arbitrator of this, however, the judge or arbitrator can order you to put the employee back to work with lost wages and benefits. In other words, the union could file a grievance challenging this termination, and the union may choose to take that grievance to arbitration, where a neutral third party will take evidence and decide whether your reason for the termination is for just cause. You will have to convince an arbitrator that your business conditions gave you just cause to terminate an employee, and that this was the proper employee to terminate.

Q: My employee has no contract and is not in a union. Can I fire him for any reason?

A: No. You cannot fire an employee for an unlawful reason. Under various state and federal laws, unlawful reasons include terminations:

1) because he/she supports or opposes a union;
2) because he/she complained to you, in concert with at least one other employee, about his/her wage, hours or other terms and conditions of employment;
3) based on race, color, religion, sex, or national origin;
4) because you want a younger work force;
5) for having a handicap that does not interfere with your employee's job;
6) for refusing to break the law;
7) because a single creditor garnished the employee's wages;
8) because he/she complained about illegal or unsafe activities;
9) for complaining to appropriate government agencies about safety matters;
10) for serving on a jury or testifying at a civil rights hearing;
11) for filing a worker's compensation claim; or
12) to prevent her/him from receiving a pension.

This is not a complete list of unlawful reasons. Check with an experienced employment lawyer if you are not sure whether your reason for terminating an employee may be unlawful.

If a reason is not unlawful, you can legally terminate an employee even if the reason is unwise or unfair. For example, if you do not like an employee or the way he or she dresses or acts, you may lawfully terminate him or her.

Q: If my employee is in a protected group or has engaged in protected conduct, does that mean I cannot fire him?

A: Not necessarily. While you cannot fire the employee ***because*** he is in a protected group or engaged in protected conduct, you may nonetheless terminate that employee for a legitimate reason. The problem you may run into, however, is that the retaliation and discrimination laws allow employees to ask juries to second-guess employer motives. Thus, if you terminate an employee right after he or she complained about a co-worker's sexually harassing conduct, a jury may believe that the complaint caused the termination.

As another example, if an employer suspends an employee for a long-standing attendance problem several days after he said he could not come to work because of poor air quality in the shop, a jury might believe that the suspension had more to do with the complaint of poor air quality than with the employee's poor attendance.

At bottom, treat employees in a protected group or employees who engaged in protected conduct as you would treat any other employee. Apply discipline even-handedly. That way, if you need to take an adverse action against a protected employee, you can show that you dealt with that employee's performance problem the same way you handled similar problems with non-protected employees.

–by Neil E. Klingshirn, partner in the Akron-based firm of Fortney & Klingshirn. Updated by Gregory A. Gordillo, a principal in the Cleveland firm of Gordillo & Gordillo LLC.

Know the Law before Hiring or Relocating Employees for Work in Ontario, Canada

Whether you already have operations in Ontario, Canada, or you are thinking of embarking on operations there, you should be aware of important differences in the labor and employment laws that will apply.

Q: Our company will be sending a few of our employees to work at our branch in Ontario, Canada. Won't American labor and employment laws simply apply to them while they are relocated?

A: Generally, no. As the law stands right now, United States labor and employment laws will not typically apply to issues that may arise during the Canadian phase of their employment, but that may depend on the circumstances of their employment. For instance, if they are not simply "on loan" to the Canadian branch for a short period of time (*i.e.*, in the role of a consultant), if they are going to be on the payroll of the Canadian branch employer, and if they are paying Canadian income taxes, the terms of their employment will most likely be governed by Ontario and Canadian laws.

Q: Are there any laws in Ontario we should know about, like the Fair Labor Standards Act here, that deal with issues like minimum wage, overtime and hours of work?

A: Yes. Employment in Canada is regulated by the province in which the employee is working, unless the employer is a federal corporation (*e.g.*, banks, post offices). That means every province has legislation designed to protect all employees working in that province regarding issues like minimum wage, overtime, hours of work, statutory holidays, benefit plans, vacation, pregnancy and parental leave, and termination issues. In Ontario, this legislation is called the Employment Standards Act (ESA).

Q: Is there anything special that our company should know about in advance if we have to terminate an employee who is working in our Ontario branch?

A: Yes. In Ohio, employers can typically terminate employees for any non-discriminatory reason at any time, and employees likewise can typically leave their employment at any time. Canadian courts, however, insist that the relationship between and employer and an employee is a binding contract (even if there is nothing in writing). While either the employee or the employer can break that contract for any reason that is not discriminatory (and at any time during the employment relationship), prior notice must be given of either party's intention to break that contract. If no notice is given, money damages (or *notice pay*) must be paid, with some exceptions, for willful misconduct, disobedience and willful neglect of duty. There are also numerous specific rules for dozens of particular industries, from IT professionals to salespersons and trade show representatives.

Q: What is notice pay?

A: *Notice pay* is what an employer must pay an employee who has not been given the required amount of prior notice of the employer's intention to "break the contract" between them. Notice pay must equal the amount of money the employee would have received if proper notice had been given before the termination.

Q: How much notice is enough?

A: Ontario's ESA sets out the *minimum* periods of notice that must be given when an employee is terminated. The amount varies with length of service and the precise occupation involved, but can be as long as eight weeks. There are also special rules for mass layoffs of 50 or more people, which can require eight more weeks' prior notice.

Q: Isn't notice pay the same as severance pay?

A: No. In Ontario, notice pay is different from severance pay. In almost all cases, any employee who is not being terminated for cause will be entitled to notice pay. Under the ESA, whether or not a terminated employee is entitled to severance pay depends on length of service, how much money your company spends a year on its Canadian payroll, or how many employees are being simultaneously terminated. So, under certain circumstances, an employer may have to pay *both* notice pay and severance pay to terminated employees.

Q: What if one of our employees becomes disabled while working in Canada? Are we obliged to follow any laws like the Americans with Disabilities Act (ADA) here?

A: Yes. *The Ontario Human Rights Code* (OHRC) is the law that protects individuals in Ontario from different types of discrimination (race, age, gender, national origin, etc.) and includes disability discrimination. The OHRC imposes an onerous duty on employers to accommodate physically and mentally disabled employees "to the point of undue hardship."

Q: What is undue hardship?

A: If the Ontario-based employer finds itself in a situation where an employee is unable to work due to medical reasons, that employer will generally be expected to accommodate the employee's disability unless it can quantifiably demonstrate that the burden will be so heavy as to substantially alter the business or substantially threaten its viability. This is a much heavier burden on business than the duty of "reasonable accommodation" under the U.S. Americans with Disabilities Act.

Q: If an employee who is working in Canada accuses the company of discrimination, can that employee file a lawsuit?

A: No, but the employee can file a complaint with the Human Rights Tribunal of Ontario, an administrative agency with broad remedial powers. The *Ontario Human Rights Code* recognizes a very broad range of impermissibly discriminatory categories, including race, ancestry, place of origin, color, ethnicity, citizenship, religion, gender (including pregnancy), sexual orientation, disability, age, marital status, financial status, receipt of public benefits and even record of offenses.

Q: Where can I find more information?

A: The Ontario Ministry of Labour maintains a compliance guide at: www.labour.gov.on.ca/english/es/pubs/brochures/br_compliance.php

–originally prepared by Columbus attorney Cindy-Ann L. Thomas. Updated by Jeffrey S. Moeller, an attorney practicing immigration and employment law at Hermann, Cahn & Schneider in Cleveland.

Employers Must Take Steps To Avoid Hiring Illegal Aliens

Q: I own a restaurant, and often am approached about offering jobs to aliens. What does the law say about whom I can and cannot hire?

A: Ever since passage of the Immigration Reform and Control Act of 1986 (IRCA), it has been a violation of federal law for any employer (even of one employee) to knowingly employ an alien not authorized to work in the United States, or to hire anyone (citizen or alien) without keeping special records, using the federal Employment Eligibility Verification Form (I-9), available at www.uscis.gov/forms, to verify the identity and employment eligibility of all employees. Some states (but not Ohio) have passed laws that create other obligations and liability relating to the employment of illegal aliens.

Q: What steps do employers have to take to avoid employing illegal aliens?

A: Under the IRCA, employers generally must require every new hire, even U.S. citizens, to complete a Form I-9, titled the "Employment Eligibility Verification Form," published by the U.S. Citizenship and Immigration Services (USCIS). The Form I-9 was most recently updated March 8, 2013. Beginning May 7, 2013, employers were required to use only the new Form I-9 (Rev. 3/08/13). In addition, USCIS now requires employers to make the instructions available to their employees at the time they complete Form I-9.

If you hire someone who is not a United States citizen or lawful permanent resident, that employee likely has authority to work in the United States only until a defined end date. For these employees, the employer must pull their I-9 Form before the expiration date of their work eligibility, obtain from them a new work eligibility document showing that their entitlement to work in the United States has been extended and update the I-9 form appropriately. Employers need to establish a reliable tickler system to prompt this re-verification process.

The I-9 process requires employers to maintain a difficult balance made even more difficult in the aftermath of the events of September 11, 2001. On one hand, IRCA requires employers to insist that all new hires present documentation to verify their identity and work eligibility. On the other hand, the Form I-9 requirements are designed to prevent unnecessary or discriminatory inquiry into the employee's nationality, and IRCA generally prohibits employers of more than three employees from discriminating against non-citizens who are eligible to work.

As of February 2013, most states (but not Ohio) have passed laws that address the employment of unauthorized foreign nationals. Generally speaking, these laws fall into three categories: 1) those requiring all employers to take more steps than IRCA requires to verify the employment authorization of new hires; 2) those requiring state contractors to take special steps to confirm the employment authorization of their employees as a condition of their contracts; and 3) those that impose sanctions for employing unauthorized aliens beyond those imposed by IRCA. Beginning Nov. 30, 2012, a total of 20 states required (or will require in 2013) the use of the federal electronic system called *E-Verify* to confirm the employment eligibility of at least some public and/or private sector new hires. These states include: Alabama, Arizona, Colorado, Florida, Georgia, Idaho, Indiana, Louisiana, Michigan, Mississippi, Missouri, Nebraska, North Carolina, Oklahoma, Pennsylvania, South Carolina, Tennessee, Utah, Virginia and

West Virginia. Of these 20 states, four require the use of E-Verify for all but the smallest private employers. E-Verify is administered by USCIS and the Social Security Administration, and has been the subject of considerable controversy.

Q: What is E-Verify and how does it work?

A: An employer must enroll in order to use E-Verify, which is an Internet-based system that compares information from an employee's Form I-9 to data from the U.S. Department of Homeland Security and Social Security Administration records to confirm employment eligibility. E-Verify uses information from the Form I-9, which the employer still must complete and retain according to the rules and procedures applicable to Form I-9s generally. The employer uses the Form I-9 information to "create a case" in E-Verify for each employee.

If E-Verify cannot initially match the employee information to existing data, the employer will be prompted to review and correct the information, if necessary. Otherwise, E-Verify will display an initial response within three to five seconds. If E-Verify returns an "Employment Authorized" response, the employer can continue to the last step in the verification process and close the case. E-Verify may also return the results "DHS Verification in Process" or "Tentative Nonconfirmation." A "DHS Verification in Process" will eventually lead to either an "Employment Authorized" or a "Tentative Nonconfirmation," usually within 24 to 48 hours. A "Tentative Nonconfirmation" will require the employer and the employee to follow up and attempt to resolve the discrepancy.

The employer must close all E-Verify cases once a final verification result is received, regardless of the result. E-Verify will ask if the employee is still working for the employer and will then instruct the employer to choose the reason why the case is being closed. Once the case is closed, the employer must either record the case verification number on the employee's Form I-9 or print the case details and keep them on file along with the employee's Form I-9.

Q: What documents must employers review to complete the Form I-9?

A: To fulfill its I-9 obligations under IRCA, employers must require new hires to supply documents to establish their identity and their employment eligibility. Most new hires will need to supply one document to establish their identity (a driver's license or any other document found on "List B") and another to establish their employment eligibility (a birth certificate or any other document found on "List C"). A few documents establish both identity and employment eligibility (such as a passport or some other document found on "List A" on the back of the Form I-9).

Q: Are photocopied documents acceptable?

A: No, with one exception: certified copies of birth certificates are acceptable.

Q: What are the earliest and latest dates for completing an I-9 Form?

A: The form cannot be completed until the applicant is offered a job, and should not be completed until the new hire starts work. It MUST be completed no later than three days after the date the employee starts working for pay, unless the employee is an alien who submits a receipt showing an application to the USCIS for a valid employment authorization document and then supplies the document within 90 days.

In October 2004, legislation was enacted that allows for the I-9 to be completed, signed and stored on a computer. In June 2006, regulations were issued implementing the new statute that set forth the rules and standards for completing forms electronically and also for the scanning and storage of existing I-9 forms.

Q: Do I, as an employer, need to keep a copy of the documents presented to verify identity and employment eligibility?

A: No, but you can, and many (but not all) immigration lawyers think you should. Keep in mind, however, that if you choose to keep a copy for one new hire, you must keep copies for all new hires, and you MUST keep them all in a file or files separate from any employee's personnel file.

Q: Where and for how long must I keep I-9 forms?

A: Keep all I-9s and supporting documentation in a file that is separate and apart from any personnel file for a period of three years after the date of hire or one year after the termination of the employment relationship, whichever is later.

Q: Is it my responsibility to determine whether or not the documents presented to me are authentic?

A: If the new hire presents qualifying documentation that reasonably appears genuine and relates to the person presenting it, the employer MUST accept it; the employer cannot discriminate against non-citizens by insisting on any particular form of documentation or on additional documentation requirements for proof of identify or employment authorization beyond those established by IRCA. If the documentation turns out later to be fraudulent, and you have otherwise complied with the I-9 rules, you will not be subject to sanctions.

Q: If a graduating foreign student applies for an opening for which he or she is clearly qualified, but can obtain employment eligibility only if I apply to the USCIS on his or her behalf, am I legally required to submit the application?

A: No. An employer has no obligation to obtain permission to employ an otherwise ineligible foreign national.

Q: What should I do if I rehire a person who previously filled out a Form I-9 for me?

A: You can use the old Form I-9 if you rehire the person within three years of the date the original I-9 was completed. You may also choose to complete a new I-9 instead. Also, it is not necessary to complete a new I-9 after:

- an employee completes paid or unpaid leave (such as for illness or a vacation);
- a temporary lay-off;
- a strike or labor dispute; gaps between seasonal employment.

Q: What are the penalties for failing to prepare or maintain a Form I-9?

A: Under the IRCA, an employer can be fined anywhere from $275 to $16,000 per unauthorized alien, depending upon the severity of the offense. Fines for record-keeping violations can range from $100 to $1,100 per individual. There is even the possibility of criminal penalties (fines and imprisonment for up to six months) for *pattern and practice* violations or knowingly accepting fraudulent documents.

Q: What are the penalties for discrimination based on citizenship status?

A: IRCA prohibits employers with four or more employees from discriminating on the basis of citizenship status, which occurs when adverse employment decisions are made based upon an individual's real or perceived citizenship or immigration status. Examples of citizenship status discrimination include employers who hire only U.S. citizens or U.S. citizens and green card holders; employers who refuse to hire asylees or refugees because their employment authorization documents contain expiration dates; and employers who prefer to employ unauthorized workers or temporary visa holders rather than U.S. citizens and other workers with employment authorization. There is an exception for employers who require U.S. citizenship for a particular job because it is required by federal, state or local law, or by government contract. IRCA penalties for discrimination range between $375 and $3,200 for each victim for the first offense; $3,200 to $6,500 for the second offense; and $4,300 to $16,000 for the third offense.

–by Barton A. Bixenstine, shareholder at Ogletree, Deakins, Nash, Smoak & Stewart, PC, in Cleveland.

U.S. Immigration Laws Allow Treaty Trader Visas

E-2 treaty investors
The United States has reciprocal trade treaties with many countries, allowing persons to enter and establish a variety of businesses in each country. A person from another country may be able to obtain a visa to enter the United States as an *E-2* treaty investor if he or she is coming to develop and direct the operation of a business in which the person has invested (or is about to invest) a substantial amount of capital. There must also be a trade treaty with the person's home country in place. For a list of treaty countries, visit: http://travel.state.gov/visa/fees/fees_3726.html

Unlike most non-immigrant categories, the U.S. consulates abroad, rather than the U.S. Citizenship and Immigration and Services (USCIS), usually process applications for E status in the first instance. The method of processing E-2 visas can vary, depending on where the person is located when applying for the status. E-2 visas can be obtained by petitioning USCIS or by applying for the status at a U.S. consulate or embassy abroad. Note, however, that not all U.S. consulates and embassies process E-2 visas, and research on a particular consulate or embassy should be conducted before an appointment is scheduled. Some consulates and embassies also have very particular expectations about how applications should be organized, so research your post in advance.

You should know:

- Employees of an E-2 treaty investor who share the same nationality as the primary investor may also be admitted, if they will perform duties requiring special qualifications necessary for the efficient operation of the business.
- The primary investor is initially admitted for two years, but this period can be renewed repeatedly (as long as the business continues to succeed). A spouse and children may be admitted as well. Spouses may apply for work authorization.
- The funds to be invested must be committed at the time the visa is issued. The amount needed varies widely depending on the type of business and the consulate involved. It can be difficult for a person to obtain an E-treaty visa for investment funds of less than $100,000 in U.S. currency, however. Less may be acceptable if the business is still substantial (*i.e*., able to support employees and still be more than a self-employment mechanism).
- The business needs to be something more than a self-employment mechanism; showing how the business will create jobs for U.S. workers greatly improves the chance for success.
- As long as the amount of capital at risk is substantial, the type of business is not important. Many motels and small businesses are operated by E-2 treaty traders.
- If the treaty trader is a business rather than an individual, at least 50 percent of the underlying business must be owned by citizens of the treaty nation. The place of incorporation does not matter.

E-1 treaty traders
A person may qualify as an *E-1* treaty trader if he or she is coming to the United States to carry on substantial trade in goods or services between the United States and that person's own treaty nation. More than 50 percent of the international trade must be back and forth with the applicant's nation. For instance, if the treaty trader is from Canada, more than 50 percent of the international trade must be between the United States and Canada. For a list of E-1 treaty countries, again see: http://travel.state.gov/visa/fees/fees_3726.html.

You should know:

- These E-1 businesses may be smaller and have less money at stake than E-2 companies.
- The trade can be in goods (such as an import/export business) or services (such as a special company catering to tourists from one particular nation).

–by Jeffrey S. Moeller, an attorney with the Cleveland firm of Hermann Cahn & Schneider LLP.

Protect Your Interests with Non-Competition Agreements

Employees today are ready, able and willing to leave your job for one with your competitor, who may even have recruited them. Small business owners are particularly vulnerable to "employee raiding" by larger competitors.

To protect their investment in employees, small business owners increasingly turn to non-competition agreements. Through such agreements, employees must, in exchange for their employment, accept reasonable restrictions on their ability to compete for a period of time after the termination of their employment. For example, a Columbus-based employer may require its employee not to compete within a five-mile radius of downtown Columbus for one year following the termination of employment.

Q: Are non-competition agreements enforceable?

A: Courts generally will enforce non-competition agreements if:

1) the employer proves it has a legitimate business interest to protect;
2) the employee's right to compete is restricted only enough to protect the employer's business interest;
3) the employer gave the employee something in exchange for the non-competition agreement; and
4) the agreement does not injure the public.

Most courts will enforce a non-competition agreement for a year or two in the same geographical area that the employee worked.

CAVEAT: If you do business outside Ohio, some other states refuse to enforce such covenants.

Q: What are some examples of an employer's legitimate business interests?

A: An employer can legitimately prevent an employee from taking advantage of relationships or information acquired as a result of the employment. If an employer gives a new employee its confidential customer list, for example, the employer can enforce an agreement preventing the employee from contacting those customers on behalf of a competing business.

Q: Must I give my employees anything in return for signing non-competition agreements?

A: Yes. To enforce such a contract, you should give the employee something for signing it. The best thing to give in exchange for a non-competition agreement is a job. In other words, if you require a non-compete at the time of employment and as a condition of employment, you have

Do Non-Competition Agreements Transfer with the Sale or Merger of My Business?

Protecting the proprietary nature of work product through the use of non-competition agreements is vitally important to business owners and has an impact on the value of businesses. The Supreme Court of Ohio, in *Acordia of Ohio, LLC v. Fishel*, 133 Ohio St.3d 356 (2012), clarified the question of whether non-competition agreements can be enforced post-merger. In an earlier decision, when faced with this question, the Court held that non-competition agreements were not enforceable unless they contained language allowing their terms to be transferred to "successors or assigns."

In reversing that decision, the Supreme Court of Ohio held that, in accordance with R.C. 1701.82(A)(3), "…all assets and property, including employment contracts and agreements, and every interest in the assets and property of each constituent entity transfer through operation of law to the resulting company post-merger."

Thus, non-competition agreements negotiated with employees and/or independent contractors will survive a sale or merger and the company acquiring the business will be able to enforce the terms and conditions of those agreements.

–by L. Michael Bly, a partner in the Dayton-based firm of Pickrel, Schaeffer and Ebeling.

given the employee enough to make the agreement enforceable. If the employee is *at will*, meaning that you have not agreed to employ him or her for a specific period of time or to discharge him or her only for just cause, then continuing the employment is also sufficient consideration for a non-competition agreement.

Q: How can a non-competition agreement injure the public?

A: The public may be harmed if there is an undersupply of the service your employee provides. For example, a physician's group cannot prevent a doctor it employs from treating patients who might not otherwise receive medical help due to a shortage of doctors.

Q: What if my employees refuse to sign?

A: You might consider hiring other employees. You must weigh the risk that an employee might use information to compete against you against the cost of hiring a new employee. If the risk of competition is too great, ask all future employees to sign the agreement as a condition of their continued employment. Ohio law allows you to fire or refuse to hire an employee who does not sign a non-competition agreement.

Q: I need to terminate an employee who I have reason to believe might compete against me. Can I get a non-competition agreement from that employee before the termination?

A: Yes, if the employee agrees and you provide something of value for it, such as severance benefits. However, such an individual is in a very good bargaining position and may demand more than you are able or willing to pay.

Q: Is there any other way I can protect myself if I do not have non-competition agreements with my employees?

A: Yes. Ohio prohibits employees from misappropriating *trade secrets* from former or current employers. Examples of trade secrets include confidential customer lists and pricing information as well as secret formulas and methods.

Q: Can I do anything to stop another employer from hiring my employee to compete against me?

A: Yes. If the other employer knowingly causes the employee to breach a non-competition agreement, you can take legal action against the new employer for unlawful interference with the non-competition agreement between you and your former employee.

Q: Do non-competition agreements transfer if I sell my business or merge with another business?

A: Yes. The Supreme Court of Ohio decided that non-competition agreements you negotiate with your employees survive the sale or merger, and the company acquiring your business has the right to enforce the non-competition agreement. This could be a vital asset when negotiating the sale or merger of your business.

–by Neil E. Klingshirn, partner in the Akron-based firm of Fortney & Klingshirn. Updated by L. Michael Bly, a partner in the Dayton-based firm of Pickrel, Schaeffer and Ebeling.

Employers Can Prevent Doomsday Scenario with Restrictive Covenants

A company's most valuable asset is its customers. Businesses expend a great deal of energy to develop and maintain client relationships. What happens, though, when an employee exits the company to start a competing business and takes valuable clients with him or her? Without adequate safeguards, the results can be devastating.

The best way a business can protect itself from this scenario is through the use of employee non-competition, non-solicitation and non-disclosure agreements (often referred to collectively as "restrictive covenants"). Broadly speaking, a non-competition agreement is a contract that prohibits an ex-employee from competing against his or her former employer for a specific period of time and within a specific geographic territory. A non-solicitation agreement prohibits an ex-employee from soliciting business from, or doing business with, the former employer's customers and vendors. A non-disclosure agreement prohibits an ex-employee from disclosing any of his or her former employer's intellectual property or other confidential information—such as customer lists and pricing information—to any third party.

When used together, restrictive covenants can effectively prevent a doomsday-type scenario where a key employee abruptly leaves a company and begins doing business with his or her former company's clients. Sales is a field that is particularly vulnerable to such a scenario. A salesperson who knows his or her former company's pricing information and who has established relationships with the company's best customers, could lure away those customers with promises of lower prices. Restrictive covenants can help prevent this scenario.

Restrictive covenants are worth their weight in gold when purchasing a business. The business purchaser certainly does not expect to compete with the seller once the sale is finalized, but without the inclusion of restrictive covenants in the purchase agreement, that is exactly what may happen. In this context, restrictive covenants operate to prevent the seller from remaining in the same business or doing business with its old customers once the sale is final.

To be enforceable, restrictive covenants must comply with very specific legal requirements. Courts carefully scrutinize the contents of the written contract to ensure that the terms of the restrictive covenants are reasonable and that all requirements for a valid contract have been met. Proper drafting, therefore, is critical.

In virtually every state, courts require restrictive covenants to be reasonable with respect to both time and geography. What is "reasonable" varies greatly from case to case and is extremely fact-sensitive. Generally speaking, restrictive covenants are reasonable only to the extent that they are necessary to protect the employer's legitimate business interests.

Using the sales example from above, if a company sells products throughout the entire states of Kentucky and Ohio, then a court would likely hold that it is reasonable to restrict an employee from competing within either of those states. By contrast, if the company's sales area included only the Greater Cincinnati region, then that would be the maximum permissible geographic scope of the restrictive covenants.

Restrictive covenants generally apply for the duration of employment and then for a specific number of years following separation of employment. The time covered must be reasonable. Depending on the circumstances, a period of one, three or five years following separation of employment may be appropriate.

–by Nicholas Birkenhauer, a Northern Kentucky attorney practicing at Dressman Benzinger LaVelle psc.

EEOC and Civil Rights Commission Address Workplace Discrimination

Q: What does the EEOC (U.S. Equal Employment Opportunity Commission) do?

A: The EEOC and a similar state agency, the Ohio Civil Rights Commission (OCRC), enforce laws that prohibit employment discrimination based on age (for employees over 40), sex, pregnancy, race, national origin, disability, creed or religion.

Q: Is all discrimination unlawful?

A: No. For example, you can discriminate against a lesser-qualified employee by selecting the better-qualified employee for hire or promotion. You could even discriminate against someone born under the sign of Aquarius without breaking the law.

Why?

Discrimination laws respond to specific, invidious biases that history shows have worked their way into employment decisions to the disadvantage of certain groups of people. These biases lack any valid business justification and have been used to deny people employment opportunities because of the bias.

While a bias against people born under the sign of Aquarius lacks any business justification, it is not so widespread that Aquarians generally are at a disadvantage when it comes to employment opportunities. Congress has thus only authorized the EEOC to investigate and remedy discrimination based on age, sex, pregnancy, race, national origin, disability, creed or religion.

Q: Can I refuse to hire someone who is not qualified?

A: Yes. Moreover, as the employer, you can decide what qualifications are necessary for your job. You cannot, however, use different qualification standards for protected and non-protected class members (for example, women but not men must pass a skills test) or set qualifications that exclude a disproportionate number of protected class members (for example, minimum lifting requirements that disqualify a greater percentage of women than men), where such requirements are not necessary to perform the job in question.

Q: Could I be charged with employment discrimination even if I do not discriminate?

A: Yes. Applicants or employees can file a charge of discrimination with the EEOC or the OCRC even if you based your decision on a legitimate, non-discriminatory reason. Once a charge is filed against you, the EEOC or the OCRC will investigate your hiring practices.

Q: Does the EEOC investigate anything other than discrimination?

A: Yes. The EEOC also investigates charges of *retaliation*. An employee can claim retaliation if:

1) he or she files or helps investigate a charge of discrimination;
2) you take an adverse employment action (fire, demote or discipline the employee); and
3) the employee can show a causal connection between the two.

(For further information about retaliation suits, see, “Know How to Handle Retaliation and Whistle-Blowing,” also in this handbook.)

Q: What should I do if I am charged with discrimination?

A: Consult legal counsel. You need to give the EEOC a thorough explanation of your employment decision. This explanation must balance the EEOC’s need to investigate the charge with your interest in keeping confidential employment decisions confidential. Legal counsel can help you balance these interests.

Make sure you do not give the EEOC a false explanation for what you did. You are better off if you give no reason for taking an adverse employment action than if you give a false reason. If the EEOC discovers that the reason you gave was false, it can find you liable for discrimination on that basis alone.

–by Neil E. Klingshirn, a partner in the Akron-based firm, Fortney & Klingshirn. Updated by Cleveland attorney Gregory Gordillo of Gordillo & Gordillo LLC.

Employers Must Comply with the Americans with Disabilities Act (ADA)

Q: What employers are covered by the Americans with Disabilities Act (ADA)?

A: Private employers, state and local government employers, employment agencies and labor unions with 15 or more employees are covered. Federal employees and employees of federal contractors may be covered under a different law, the Rehabilitation Act of 1973. This act has some different requirements, including a 45-day time limit to contact the appropriate Equal Employment Opportunity counselor about any violations. There is also often coverage under state law; in Ohio, that law largely tracks the ADA and is found at *Ohio Revised Code* §4112. The appropriate avenue to file complaints based on employer actions may vary; therefore, employers should familiarize themselves with not only the ADA but also these other laws with similar requirements.

Q: What employment activities are covered by the ADA?

A: The ADA prohibits discrimination in all employment practices, including job application procedures, hiring, firing, advancement, compensation, training, and other terms, conditions and privileges of employment. It applies to recruitment, advertising, tenure, layoff, leave, fringe benefits and all other employment-related activities.

Q: What is the definition of "disability" under the ADA?

A: The definition of *disability* has changed through the Americans with Disabilities Act (ADA) Amendments Act of 2008, effective as of January 1, 2009.

The ADA Amendments Act retains the definition of disability as a physical or mental impairment that substantially limits one or more major life activities. However, the new act makes major changes to the way that definition of disability is to be interpreted.

The ADA Amendments Act states that the Equal Employment Opportunity Commission (EEOC) regulations that defined "substantially limits" as a "significant restriction" set too high a standard and are inconsistent with Congressional intent. Pursuant to the act, the EEOC revised its definition of "substantially limits." The new definition requires a lower degree of functional limitation than the previous standard. Rather, "substantially limits" is to be construed broadly in favor of expansive coverage. An impairment does not need to prevent or severely or significantly restrict a major life activity to be considered "substantially limiting."

The act also explicitly rejects U.S. Supreme Court decisions that applied a strict and demanding standard for disability.

Among the major changes in the act are:

- The effects of mitigating measures (medications, hearing aids, etc.) other than ordinary glasses or contact lenses now cannot be considered in assessing whether a person has a disability.
- An impairment or condition that is in remission or episodic in nature (cancer or depression, for example) now is a disability if the impairment or condition substantially limits a major life activity when it is active.

- The definition of *major life activities* is now expanded to include major bodily functions such as immune system functions, circulatory and reproductive functions, endocrine system functions, bowel, bladder and digestive functions, and circulatory functions, among others.

The act emphasizes that the definition of disability must be interpreted broadly and should not require extensive analysis. This act's more expansive definition means that employers will now have to engage in the interactive process to identify accommodations for a broader range of employees with disabilities.

The act also retains the definition of disability that includes those who have a "record of" disability and those who are "regarded as" having a disability. The act provides that a person who is discriminated against because of an actual or perceived impairment meets the "regarded as" definition of disability unless the impairment is either transitory or minor. The act also clarifies that an employee who is "regarded as" disabled is not entitled to a reasonable accommodation.

Q: Can a person with a psychiatric diagnosis be excluded from coverage for other reasons?

A: People who have disabilities but pose a "direct threat to health and safety" that cannot be eliminated by reasonable accommodations are not covered by the ADA. People with mental or other disabilities cannot be excluded based on general, stereo-typical assumptions about dangerousness. Any threat must be based on sound medical judgment and individualized, objective evidence of factors such as the duration of the risk, the nature and severity of the potential harm, the likelihood that harm will occur, and the imminence of the harm. Of course, a person with a disability must be able to perform the essential job functions with or without reasonable accommodations in order to be covered by the ADA.

There are several *exclusions* from coverage. People who use controlled substances for unlawful purposes, including those who take any prescribed drug without the required supervision of a licensed health care professional, do not have a disability under the ADA. However, the ADA protects people who participate in or have completed a supervised drug rehabilitation program and no longer use illegal drugs. The ADA also excludes sexual compulsions, preferences and disorders; compulsive gambling, kleptomania or pyromania; or psychoactive substance use disorders resulting from current use of illegal drugs.

Alcoholism, but not on-the-job drinking or working while alcohol-impaired, is a covered disability.

Q: Does the ADA protect people who do not have disabilities, but have a relationship to or association with a person with a disability?

A: Yes. The ADA prohibits discrimination based on "relationship or association" in order to protect people from actions based on unfounded assumptions that their relationship to a person with a disability would affect their job performance, and from actions caused by bias or misinformation concerning disabilities. For example, the ADA would protect a person with a disabled spouse or child from being denied employment because of an employer's unfounded assumption that the applicant would use excessive leave to care for the disabled spouse or child. It also would protect a person who does volunteer work for people with AIDS from a discriminatory employment action motivated by that relationship or association.

Q: Can a potential employer make inquiries about an applicant's disabilities?

A: Employers may not ask any questions about the presence or nature of a disability on job applications or during job interviews. Instead, the employer should define the essential functions and conditions of the job and then ask the applicant about his or her qualifications to perform the job. Employers *can* ask disability-neutral questions such as questions about job history (*e.g*., gaps in employment). For more detailed information about what questions are appropriate for employers to ask, consult the Job Accommodation Network's website: www.jan.wvu.edu, or contact that organization at (800)526-7234. (The Job Accommodation Network in the United States is a service of the President's Committee on Employment of People with Disabilities.)

Q: Does a person with a disability lose the right to get a reasonable accommodation for the disability if he or she fails to disclose the existence of a disability during the hiring process?

A: No. Employees may disclose that they have a disability after many years on the job and request reasonable accommodation at that time. Of course, an employer is only required to make accommodations for *known* disabilities of applicants or employees.

Q: Once a person with a disability has been offered a job, can the employer require a "post-offer medical examination"?

A: Yes, as long as all applicants in the job category, and not just those suspected of having a disability, are required to be examined. After a "conditional job offer" has been extended, there are no limits on inquiries about the presence or nature of a disability. However, the employer may only withdraw a job offer if the applicant cannot perform the essential functions of the job *with or without reasonable accommodations.*

Q: Does an employer have the right to require documentation of the employee's disability and the need for accommodations?

A: Once on the job, the employer may ask questions that are "job-related and consistent with business necessity." When an employee asks for reasonable accommodations, the employer is entitled to information to substantiate that request and to work out an effective accommodation. If the disability is obvious, documentation should not be required.

Q: What is a reasonable accommodation?

A: Reasonable accommodation is a modification or adjustment to a job or work environment that will enable a qualified applicant or employee with a disability to participate in the application process or to perform essential job functions. It includes adjustments in policies or procedures and other modifications to assure that qualified people with disabilities have rights and privileges in employment equal to those of non-disabled employees.

Q: What kinds of actions are required to make reasonable accommodations?

A: Examples of reasonable accommodation include making facilities readily accessible and usable by a person with a disability; job restructuring; modifying work schedules; acquiring or modifying equipment; reassigning an employee to a vacant position for which the person is qualified; or providing private or quiet work space. To find a list of possible reasonable accommodations for people with physical and psychiatric disabilities, consult the Job Accommodation Network's website at: www.jan.wvu.edu.

Q: Are there limitations on the duty to provide accommodations to employees?

A: Yes. Employers are not required to lower quality or quantity standards in order to make an accommodation, nor are they required to provide personal use items such as glasses or hearing aids. Employers are not required to create new job positions, or to find a position for an applicant who is not qualified for the position sought.

In addition, an employer is not required to make an accommodation if it would impose an undue hardship on the business. *Undue hardship* is defined as "an action requiring significant difficulty or expense" when considered in light of the overall resources, size, nature and circumstances of the particular employer in relationship to the cost or difficulty of providing a specific accommodation.

Q: How might my employees enforce their rights under the ADA?

A: Employees likely will try to resolve disputes with the employer before taking formal action. Sometimes questions about the existence of a disability or the necessity for an accommodation may be resolved if the employee provides the employer with documentation. If informal measures fail, federal law requires that the person with a disability file an administrative complaint before a lawsuit can be filed under the ADA, though this may not be required under other statutes.

An administrative complaint with the U.S. Equal Employment Opportunity Commission (EEOC) must be filed within 300 days of the date the violation occurred. Ohio law also allows the filing of a complaint with the Ohio Civil Rights Commission (OCRC). Such a complaint must be filed within six months of the date the violation occurred. If either agency investigates and determines that there has been a violation, the agency can negotiate a resolution or sue in court. If the agency (either the EEOC or the OCRC) fails to negotiate or concludes that there is no discrimination, the EEOC will issue a letter to the complainant, who may then sue in court.

Possible remedies include: hiring; reinstatement; back pay; court orders to stop discrimination; or orders to provide reasonable accommodation. Compensatory damages may be awarded for actual monetary losses and for future monetary losses, mental anguish and inconvenience. Punitive damages may be awarded as well, if an employer acts with malice or reckless indifference. Attorneys' fees also may be awarded.

The administrative agencies can be contacted at:

U.S. Equal Employment Opportunity Commission (call to find out which office covers your county):

Cleveland Field Office
Anthony J. Celebrezze Federal Building
1240 E. 9th Street Suite 3001
Cleveland, Ohio 44199
(800)669-4000

Cincinnati Area Office
John W. Peck Federal Office Building
550 Main St., 10th Floor
Cincinnati, Ohio 45202
(800)669-4000

Ohio Civil Rights Commission
1111 E. Broad Street, Suite 301
Columbus, Ohio 43205
(There are six regional offices. Call (888)278-7101 to find out where to file.)

–printed with permission of the Disability Rights Ohio, located in Columbus. Updated by William Puckett, Esq. and Kevin Truitt, Esq. of Disability Rights Ohio.

Employer Guide to the
Amended Americans with Disabilities Act

On January 1, 2009, the Americans with Disabilities Act Amendments Act of 2008 (ADAAA) went into effect. The final regulations to the ADAAA were published by the Equal Employment Opportunity Commission (EEOC) on March 25, 2011. Congress passed the ADAAA in response to federal court rulings that it believed substantially weakened important protections of the original Americans with Disabilities Act (ADA). The amendments (intended to restore the "spirit and intent" of the original ADA legislation) greatly expand the field of employees who may be deemed disabled and, therefore, protected under the law. Employers need to be even more careful when making decisions affecting applicants and employees who may have physical or mental impairments.

Q: What is a "disability" according to the ADAAA?

A: The ADAAA retained the three-prong "disability" definition from the ADA of: (1) a physical or mental impairment that substantially limits one of more major life activities; (2) a record of such impairment; or (3) being regarded as having such an impairment. In assessing what constitutes a "disability," the ADAAA requires courts construe that term "to the maximum extent permitted" under the law. This is significant because various other ADAAA revisions increase the number of employees protected by the definition of "disability." The definition now includes any impairment that is episodic or in remission. Therefore, a condition, like cancer, that is not currently impairing the individual would still be a disability if it would substantially limit a major life activity (MLA) "when active."

Q: Are impairments considered "disabilities" if they are controlled?

A: Under a prior U.S. Supreme Court decision, *Sutton v. United Air Lines, Inc.*, physical and mental impairments were not considered "disabilities" if controlled by "mitigating measures," such as medication or corrective devices (*e.g.*, hearing aids or prosthetics). The ADAAA explicitly states that unless they are eyeglasses or contact lenses, such measures may *not* be considered when analyzing whether the impairment substantially limits an MLA. The employer must now consider whether the impairment is a disability *without* considering how much the mitigating measures correct the disability. Previously, certain employees whose impairments (*e.g.*, asthma, diabetes or epilepsy) were controlled by medication and treatments could be excluded from coverage because their condition was not severe enough. Now, those employees are likely protected as "disabled."

Q: How does the ADAAA define "major life activities"?

A: To be deemed disabled, an employee must have an impairment that substantially limits "one or more major life activities." According to the ADAAA, these activities include, but are not limited to: caring for oneself, performing manual tasks, seeing, hearing, eating, sleeping, walking, standing, sitting, reaching, breathing, lifting, bending, speaking, learning, reading, concentrating, thinking, communicating and working. Further expanding the definition of "MLA," the ADAAA adds "the operation of a major bodily function" to the list, specifically enumerating coverage for function of the immune system; special sense organs and skin; normal cell growth; and digestive, genitourinary, bowel, bladder, neurological, brain, respiratory, circulatory, cardiovascular, endocrine, hemic, lymphatic, musculoskeletal and reproductive functions.

The Regulations specify that whether an activity is considered an MLA is not determined by whether such activity is of central importance to daily life, nor should the term "major" be interpreted to create a demanding standard.

Q: What does the ADAAA consider to be a "substantially limiting" impairment?

A: The ADAAA rejects the U.S. Supreme Court's stringent interpretation of the phrase, "substantially limits a major life activity," which required an impairment to prevent or severely restrict an activity of central importance to the individual's daily life. While the ADAAA rejects that pro-employer definition, it provides no alternative standard and retains the term "substantially limits" rather than adopt one that properly denotes the necessary functional limitation. Instead, the ADAAA requires the EEOC to define "substantially limit," which likely will be less strict. The EEOC Regulations state that "substantially limits" must be construed broadly in favor of maximum coverage under the terms of the ADAAA, and that, like the term "major," it is not meant to be a demanding standard. Specifically, under the EEOC regulations, an impairment is a disability if it substantially limits an individual's ability to perform an MLA compared to most people in the general population. According to the Regulations, this determination should not require extensive analysis or the presentation of scientific, medical or statistical data.

While no concrete standard for "substantially limits" is provided, the Regulations suggest that it may be useful to consider, as compared to the rest of the population, the degree of difficulty, effort and time required for the individual with a disability to perform the MLA; the pain experienced when performing the MLA; the length of time performance of the activity can be sustained; and/or the way the impairment affects operation of a major bodily function. Further, negative effects of medication or treatment may also be considered when determining whether an impairment is substantially limiting.

Q: What happens under the ADAAA if an employer discriminates against someone "regarded as" having a disability?

A: The ADAAA also makes it easier to prove an employer discriminated against someone it wrongly "regarded as" having a disability. Under the original ADA, an individual bringing suit needed to prove that the employer regarded the employee as being substantially limited in a major life activity. This was a difficult standard to meet. Now, the individual only has to show that the employer perceived the individual as having a mental or physical impairment, regardless of whether the impairment substantially limits, or is perceived to limit, a major life activity.

Q: I understand that it will be harder for employers to defend ADA claims. Does any part of the new ADAAA favor employers?

A: The ADAAA does clarify that "regarded as" claims cannot be based on impairments that are minor or "transitory," *i.e.*, expected to last less than six months. Whether an impairment is both transitory and minor, however, must be determined objectively and cannot be based on the employer's subjective belief. In using this defense, employers must also remember that it does not apply to the "actual disability" or "record of disability" prongs of the statute. In addition, the ADAAA makes it clear that employers do not have to provide a reasonable accommodation to individuals who are "regarded as" disabled. Finally, the ADAAA prohibits "reverse discrimination" claims. Thus, a non-disabled employee may not claim discrimination if a disabled employee is favored in an employment decision.

Q: What should our company do as a result of the changes?

A: If you have 15 or more employees, consider the following steps to prepare for the ADAAA:

- Review and, if necessary, revise any applicable handbook policies, interactive process questionnaires and disability-related employment information.
- Train HR personnel, supervisors and interviewers on the ADAAA and how it applies to their daily operations.
- Be prepared to consider offering accommodations to a broader range of employees. There are three categories of reasonable accommodation: (1) those required to ensure equal opportunity in the application process; (2) those that enable the individual with disabilities to perform the essential functions of the position held or applied for; and (3) those that enable the individual with disabilities to enjoy the benefits and privileges of employment to the same degree as individuals without disabilities.
- When addressing specific disability determinations and accommodations concerns, include supervisors, HR personnel and legal counsel in the analysis and apply the revised disability laws.
- Manage litigation risks *proactively* by consulting now with your legal advisers to counteract the inevitable rise in the number and expense of disability lawsuits.

–by attorney Christine T. Cossler, a partner in the Cleveland firm of Walter Haverfield LLP.

Law Bans Employers from Using Genetic Information To Make Employment Decisions

Perhaps you currently employ someone whose chronic disease has caused your group medical insurance rates to skyrocket. You would probably like to avoid hiring such a person in the future. If you learn which of your potential hires is prone to develop a chronic illness in the future, or that one of your employees has an increased risk of getting a disease, disorder or condition in the future, can you legally use that information to make employment decisions? The answer is "no."

The Genetic Information Non-Discrimination Act (GINA), effective November 21, 2009, makes it unlawful for employers with 15 or more employees, employment agencies, labor organizations and insurance carriers to discriminate against persons based upon genetic information indicating a predisposition to chronic diseases. Among other things, GINA prevents employers from making employment decisions based upon a concern that an applicant, employee or dependent with a genetic predisposition for certain chronic medical conditions will place a financial burden on the employer's group medical insurance plan. Like most employment laws, GINA also prohibits employers from retaliating against employees who claim discrimination based upon the use of genetic information and from harassing an individual because of his or her genetic information.

What, exactly, is *genetic information*? Genetic information is information gained from 1) an individual's genetic tests; 2) genetic tests of family members; and 3) an individual's family medical history. GINA makes it unlawful for employers to use such information as a basis for discharging or refusing to hire any applicant or employee, or for otherwise discriminating against an employee with respect to employment compensation, terms, conditions or privileges.

GINA also makes it unlawful, with some exceptions, for employers to request, require, or purchase genetic information, or to otherwise acquire genetic information about an employee. For example, employers are not allowed to require employees to submit to genetic testing, although such tests may be allowed as part of a wellness program, medical monitoring as required by OSHA, or employer-sponsored medical examinations where the employer does not have access to the information.

The law also makes it illegal for insurance carriers (including self-insured employers) to discriminate against persons based upon genetic information that indicates predisposition to chronic diseases. Likewise, GINA prohibits health insurers from requesting or requiring an individual to take a genetic test. This means that health insurers may *not* raise premiums or deny coverage based on genetic information.

As a practical matter, GINA does not significantly impact most employers, but in order to make sure you are in compliance with the law, you should:

- separate your confidential medical and health records from all other records *and* limit access to these records as required by the Americans With Disabilities Act;
- ask health care providers to provide only *non-genetic* health information (pre-employment physicals, return to work exams, etc.) about your employees;
- keep in mind workers' compensation records may have genetic data and treat them appropriately;
- take steps to make sure you do not *inadvertently* receive genetic information about your job applicants or employees.

In addition to addressing employment-related use of genetic information, GINA increases penalties for federal child labor law violations under the Fair Labor Standards Act (FLSA). Specifically, GINA increases the fine from $10,000 to $50,000 for *each* violation that causes death or serious injury to any employee who is under 18 years old. GINA increases other child labor law violations from $10,000 to $11,000 and increases the penalty for willful violations of FLSA minimum wage and overtime provisions from $1,000 to $1,100 for each violation.

The Equal Employment Opportunity Commission (EEOC) is charged with enforcing the employment provisions of GINA, and the Department of Labor is responsible for enforcing the health insurance provisions. The EEOC issued final regulations implementing the employment provisions of GINA on Nov. 9, 2010. The regulations became effective on Jan. 10, 2011. The Commission has also issued question-and-answer documents addressing the final regulations.

–by Patricia F. Weisberg, a partner in the Cleveland firm, Walter Haverfield LLP.

Know How To Handle Retaliation and Whistle-Blowing

Q: Why should I worry about retaliation suits?

A: If employees engage in *protected conduct*, they can claim *retaliation* for later discipline or termination. If successful, they can recover significant monetary damages.

To survive the threat of retaliation claims employers must:

1) recognize protected conduct when they see it;
2) respond properly to the protected conduct; and
3) base all adverse employment decisions on legitimate business reasons.

Q: What is retaliation?

A: The gist of a retaliation claim is that an employer "gets back" at an employee for doing something that is protected by law. To win a retaliation claim, an employee must prove that:

1) he/she engaged in protected conduct;
2) he/she was demoted, disciplined, fired or otherwise suffered some adverse employment action; and
3) his/her protected conduct was a cause of the adverse employment action.

Q: Is whistle-blowing the same thing?

A: Not quite. Whistle-blowing is a form of protected conduct (*i.e*., reporting an employer for alleged violations of law or safety regulations). For an employee to win a retaliation suit against an employer, the employer would have to respond to the whistle-blowing or other protected conduct by doing something that adversely affected the employee's job (such as demoting or firing that employee). In addition, whistleblowers can sometimes recover rewards even if they have not suffered any adverse employment action by their employer. For example, an employee (or anyone else) who blows the whistle on an employer that is defrauding the U.S. government may be able to act as a relator on behalf of the government and be paid, as a reward, a percentage of any amount recovered as a result of blowing the whistle on the fraud.

Q: What are some other examples of protected conduct?

A: Other examples of protected conduct include:

1) asking for overtime pay;
2) filing a complaint with the U.S. Department of Labor;
3) reporting sexually harassing conduct;
4) serving for the armed forces or reserve; and
5) applying for medical benefits or leave.

A less obvious example occurs when an employee complains about general working conditions on behalf of others, even if the conditions comply with the law. Federal labor law prohibits retaliation against an employee who engages in such *concerted activity*.

Q: How do I know what conduct is protected?

A: Get to know your employees' rights. When employees exercise their rights, they engage in protected conduct. They also engage in protected conduct by doing things valued by the public, such as reporting wrongdoing or serving their country or community.

Q: What should I do if my employee engages in protected conduct?

A: 1) Do not get angry.
2) Address the complaint made by the employee.
3) Make future employment decisions as if the employee had not engaged in the protected conduct.

Q: Does this mean I can't fire someone after he or she does something protected?

A: Not at all. It means you cannot fire someone *because* he or she did something protected. So long as your reason for terminating an employee's employment is legitimate, you have not broken the law. The problem for employers is that retaliation suits let juries second-guess your motives. If, for example, you terminate your employee very shortly after that employee engages in protected conduct, juries will be inclined to believe that the protected conduct caused the termination.

Q: What if the employee engaged in so-called protected conduct with no basis whatsoever. Can they really sue me?

A: Maybe not. The U.S. Supreme Court once ruled that an employee could not win a suit claiming retaliation for complaining about sexual harassment where the alleged harassing conduct was such that a reasonable person would not consider it to be sexual harassment. Therefore, the court held, the employee had not engaged in protected conduct at all and therefore could not pursue a retaliation claim.

As a practical matter, if it appears that the employee has engaged in protected conduct, respond to the conduct in good faith, without getting angry or straying from sound business justifications for any employment action. Theoretically, you can lawfully discipline an employee for making a completely groundless, bad faith complaint. You should, however, contact legal counsel beforehand and expect a challenge from the employee.

Q: How can I survive the threat of a retaliation suit?

A: 1) Recognize protected conduct and respond to it properly.
2) Always base employment decisions on a good business reason. Test yourself by asking whether you would do the same thing if the employee had *not* engaged in the protected conduct.
3) Document (write down) the reasons leading up to adverse employment actions. If the reason is discipline for poor performance, write down the fact of poor performance before you discipline the employee.
4) Finally, consult legal counsel in a close case. Legal counsel can show you how to demonstrate your good intent and negate the suggestion of unlawful retaliation.

Remember, if it looks like you got mad and then got even, you are fair game for a retaliation suit.

–by Neil E. Klingshirn, partner in the Akron-based firm of Fortney & Klingshirn. Updated by Gregory A. Gordillo, principal in the Cleveland firm of Gordillo & Gordillo LLC.

The Need for Layoffs: Legal and Practical Considerations

One of the most difficult parts of managing a business is downsizing. In an economy where the daily headlines report layoffs by the thousands, this responsibility is not made any easier. There are a few items that employers should remember while contemplating and carrying out layoffs.

First, consider whether there are feasible alternatives to laying off employees. For example, the same goals may be achieved by reducing overtime allowances, temporarily shutting down or shortening work hours, instituting a salary or hiring freeze, implementing an across-the-board salary reduction, or asking employees to take voluntary early retirement or leaves of absences. If the employer decides to enter into a separation agreement with an employee, consult an attorney. Such agreements require the existence of certain provisions in order to be enforceable. If employees have an employment or union contract, the employer needs to verify that these options are available.

If layoffs are inevitable, consider the type of employment relationship the employer has with its employees. Is there an employment contract or union agreement, or do employees have some reasonable expectation of continued employment? If so, determine the need to give advance notice and whether there is a specified procedure that must be followed in laying off employees.

Evaluate whether it would be wise to let employees know of the possibility of layoffs prior to making any final decisions. Doing so will give employees time to find new jobs, which may reduce resentment. Morale and productivity may decrease when employees are notified of this possibility, but if the rumor-mill starts, morale and productivity may sink even lower. Employees will perform better if they feel they can trust their employers to keep open lines of communication.

The employer should take the time to thoughtfully plan how to carry out the layoff. Layoffs must be conducted in a way that is not discriminatory. In determining which employees will be laid off, use objective, job-related criteria like seniority or job knowledge. Be consistent in how these criteria are implemented. Review the impact on protected classes of people, such as minorities and employees over forty years of age. Protected classes should not bear the most severe impact of a layoff. Have legitimate business reasons for the layoffs and maintain documentation to support these reasons. Also, have a clear idea of what the company will look like post-layoff and make sure the layoffs planned will mirror that idea. The employers should also keep in mind that laid off employees will likely file for unemployment compensation benefits, which will affect employers' premiums.

In delivering the bad news to the employees, employers should be respectful and honest in explaining why the employees are laid off. Statements made regarding the need for layoffs should be consistent. When making announcements, address important issues such as severance, vacation payout, health care, job search assistance and the employer's policy on providing references. In addition, management should be prepared to handle employee reactions to the notice.

Finally, one of the most frequent mistakes employers make in laying off employees is forgetting about the remaining employees. Anger and job insecurity can hinder job performance and morale in the remaining workforce. Employers should make sure the retained employees understand the need for the layoffs and that the decision to do so was given due consideration. Doing so will hopefully help move the company back in the right direction.

–by Stacy V. Pollock, an attorney with the Columbus firm, Downes Fishel Hass Kim LLP.

How You Conduct a RIF Can Reduce Your Risk of Being Sued

The economic crisis is taking its toll on employers. Businesses large and small are slashing payroll and laying off employees. Even government offices, faced with crippling budget cuts, are sending employees home on furlough. No employer wants to be in a position of needing to reduce its workforce, but more and more employers are facing this grim reality due to economic conditions. An involuntary reduction in force (RIF) can be an effective tool for reducing workforce and shedding costs. RIFs also can lead to significant liability.

The primary exposure to liability associated with a RIF is a claim of discrimination or retaliation. A typical scenario is for a terminated employee to allege that his employer selected him for the RIF not because of the reasons given by the employer, but because of his age. Indeed, an employee terminated during a RIF can maintain a claim of age discrimination merely by showing that he was: (1) 40 years old or older; and (2) replaced by a sufficiently younger person.

Employers are best able to defend against such a claim when they can show that, despite the former employee's ability to provide enough evidence of age discrimination to make a good case, the RIF was carried out according to valid selection criteria and was designed to keep the most qualified employees. To successfully use this defense—or, more importantly, to avoid a lawsuit in the first place—you must carefully plan the involuntary RIF. Any employer considering a RIF should do the following:

1) *Write a list of business reasons*. The first step is for top management to identify in writing the business and/or financial reasons for the RIF, including economic savings and efficiency increases.
2) *Identify the goals of the RIF*, such as labor costs to be eliminated or the number of positions to be terminated.
3) *Consider alternatives*. Consider less drastic alternatives to achieve your goals such as elimination of temporary positions, shortened workdays, voluntary pay reductions, reduction of overtime, voluntary leaves of absence, and salary or hiring freezes.
4) *Draft selection criteria*. If no viable alternatives exist, the next step is to generate a written internal statement of well-defined selection criteria for termination. Always consult legal counsel to help determine appropriate selection criteria. A mistake here could lead to significant liability down the road.
5) *Develop a selection procedure*. Identify the decision-making sequence and the persons responsible for those decisions. Involve your HR department.
6) *Ensure RIF policies are followed*. Make certain that all written RIF policies are known and followed by the decision-makers administering the RIF.
7) *Abide by employment contracts*. Be aware of any employment contracts that may remove an employee from the sphere of "at-will" employment and be sure to terminate in accordance with the terms.
8) *Consider severance packages coupled with written releases*. Releases can protect you from future claims, but they must be carefully drafted in order to be legally enforceable. Consult legal counsel before offering a severance package. The use of a valid release is, by far, the most effective means to reduce risk.

–by Nick Birkenhauer, an attorney associated with the Crestview Hills, Kentucky firm of Dressman Benzinger LaVelle psc.

Consider Risks, Rewards of Employee Furloughs

Although economic conditions remain difficult, many businesses are banking on a turnaround and making plans accordingly. This often includes a desire to retain valuable personnel who will become indispensable if demand improves. But what if those employers cannot afford to maintain current payroll costs?

Fortunately, layoffs are not the only option in this situation. For some employers, cost-saving measures like furloughs—*i.e.*, mandatory, unpaid leaves of absence—may make more sense. With employees who are paid by the hour, such arrangements are simple because their compensation rises and falls with the time they spend working. When it comes to salaried exempt employees, however, the practical and legal issues become more complicated.

Under the federal Fair Labor Standards Act, most of the exemptions regarding minimum wage and overtime premium payments require that the employees be paid on a salary basis. That is, they must receive a predetermined amount that is not subject to reduction based on the number of hours worked. So, a salaried exempt employee who usually works 40 hours must be paid the full amount even for a week in which he or she works just one hour per day. Otherwise, the employer may lose the exemption.

An exception exists for weeks in which salaried exempt employees perform *no* work whatsoever. Relying on this provision, some employers have instituted periodic weeklong furloughs to reduce their payroll expenses. The catch is requiring and ensuring that the employees do not work at all during the furlough week. Even checking emails or phone messages, as many employees do while on vacation, can trigger a requirement that the entire week's salary be paid.

Pay cuts have also become common, and some employers have tried to soften the blow with corresponding reductions to the business hours of affected employees. Thus, salaried exempt employees working 40 hours per week could move to a 32-hour schedule at 80 percent of their regular salary. The federal Department of Labor has indicated its approval of such arrangements if made prospectively as a change to the employees' regular work week (provided that the resulting salary remains above $455 per week). The changes need not be permanent; however, occasional reductions or adjustments based on the ebb and flow of business will likely cause the business to forfeit the exemption.

Wage and hour law is highly technical, and other factors like employment agreements or union contracts can complicate matters even further. Employers should consult with counsel before implementing any of these measures.

Of course, furloughs and schedule reductions may cause morale problems in the workforce. Yet the other options may be termination or inheriting numerous extra responsibilities from downsized co-workers. Employers should take care to explain their overall situation, as well as their efforts to position themselves for the improvement that everyone hopes will come.

–by Justin D. Flamm, an attorney in the Cincinnati office of Taft Stettinius & Hollister LLP.

It's Just Not Working Out:

How to Terminate that Problem Employee

Q: When can an employer terminate an employee?

A: The type of employment relationship determines whether termination is an option, and the process that should be followed leading up to the termination. For example:

- Under an at-will employment relationship, an employer is permitted to terminate an employee for cause or for no cause at all. However, an employer is not permitted to terminate an employee for an unlawful reason. These reasons include discrimination, use of legally mandated leave like Family Medical Leave, or the filing of a workers' compensation claim. If there is an employee handbook, the handbook should make clear that employment is at-will. If the handbook suggests otherwise, the employee may argue that he or she had an implied right to employment.
- If the employee signed an employment contract with an employer, any contractual provisions regarding termination should be followed, including any progressive discipline before termination.
- If the employee is a member of a union, the employer must follow the collective bargaining agreement entered into with that particular union. The agreement will likely set forth very specific circumstances by which an employee may be terminated and procedures for terminating an employee.

Q: What should an employer keep in mind when considering the termination of an employee?

A: If an employee is at risk of being terminated for poor performance or for certain actions, employers should consider the following before proceeding with termination:

- First ask, "Does the employee have a legitimate reason for his/her actions or poor performance?" If the employee has a qualifying disability, employers are encouraged to discuss with the employee the concerns and whether an accommodation would be reasonable for both parties. The employee may have protected rights to an accommodation under the law.
- When considering terminating an employee, one key is to document performance and discipline issues. The employer should: consistently document the events and situations leading up to the termination as they happen; and document conversations with the employee, including who was present, when the conversation took place and what was said. The employer should also prepare a summary of the meeting and have the employee sign an acknowledgment of the conversations and the employer's actions. This acknowledgement does not mean that the employee agrees with the employer's decision.
- The employer should consider whether the termination is consistent with how other situations have been handled in the past. While the employer is not necessarily bound by its past practice in handling similar situations, consistency is recommended in order to avoid claims of discrimination and retaliation. In termination, consider whether employees within protected classes (*i.e.*, age, race, sex, national origin, pregnancy) are treated the same as employees outside protected classes under similar circumstances.
- Employers must review any termination standards and/or procedures that may be set forth in a collective bargaining agreement, employment contract or employee

handbook. There may be notice requirements or progressive discipline procedures that must be in place prior to termination.

- Terminated employees may file for unemployment compensation. Employers will need to demonstrate that the employees were terminated for "just cause." If unemployment compensation benefits are granted, employers should be prepared to see an impact on their premiums.

Q: How should an employer terminate an employee?

A:

- One goal an employer should have when actually terminating an employee is to avoid giving inconsistent statements about why the employee was terminated. The employee should be told the reason for his or her termination without the sugarcoating. This reason must be consistent with the documentation leading up to the termination.
- If possible, have a witness present at the termination.
- Remind the departing employee of any confidentiality or non-compete agreements.

Q: What must an employer consider after terminating an employee?

A:

- Employers with 20 or more employees who offer group health benefits are required to offer terminated employees temporary extension of health benefits (known as COBRA benefits) where coverage would otherwise end. Employers should notify their plan administrators within 30 days of an employee's termination.
- It is generally permissible for an employer to provide negative employment references regarding a former employee to a prospective employer. Any negative references, however, should only contain honest statements given in good faith, and employers should not seek out a prospective employer of a former employee in order to give a negative employment reference. To avoid any potential liability with providing references of a terminated employee, employers often only provide dates of employment and positions held.

–by Stacy V. Pollock, attorney with the Columbus law firm, Downes Fishel Hass Kim LLP.

What You Should Know about Severance Payments

Q: Is there a law that requires employers to provide severance pay?

A: No. An employer has no obligation to provide severance pay.

Q: I have in the past paid severance to employees that I had to fire. Do I have to give the same severance to others?

A: If you create a severance plan, employees covered by the terms of the plan are entitled to the benefits provided by the plan. However, you can create, modify or abolish a severance plan as you see fit. Most employers, particularly small employers, choose to have no severance plan at all.

In your case, the issue is whether you created a severance plan by having paid severance in the past. The mere fact that you gave severance payments to other employees in the past will not, by itself, create a severance plan. However, if you have written policy that says which employees will receive severance, how much and when, such employees could make a claim for severance benefits. In such a case, you should consult legal counsel.

Q: I am willing to pay severance, but I want my employee to promise not to sue me in exchange for it. Can I do that?

A: Yes. So long as you do not have a plan in place that requires you to pay the same severance without getting a release, or so long as your plan conditions severance payments on a release of rights (*i.e*., a promise not to sue), you can condition severance benefits on your employee's promise not to sue.

Q: Why do I have to wait 21 days for the employee to accept the severance pay? Can she accept it before that time?

A: The 21-day waiting period must be honored only if you want the employee to release you from her claim for age discrimination. That is, a court will enforce an employee's promise not to sue for age discrimination under the federal Age Discrimination in Employment Act only if the employer gave the employee 21 days to consider the offer and, among other things, advised the employee in writing to review the release with an attorney. This is to prevent employers from forcing an employee to make a decision about releasing her rights with a "gun to the head." Instead, the employee has 21 days to consider whether or not to accept the release. If the employee wants to accept the offer before the end of the waiting period, however, she can do so.

Q: What happens to the waiting period if my employee counter-offers, asking for a better package?

A: Technically, once the employee asks for a better package, she has made a *counter-offer*, which the law treats the same as a rejection of your original offer. Once the employee rejects your offer, it is no longer available unless you renew it.

Q: How much should I offer as severance?

A: In theory, an offer to pay an employee to release his or her rights is the same as an offer to buy a car or rent an apartment. As long as you offer what the thing is worth, the rational employee should be willing to accept it. Roughly speaking, an employee's claim is worth what the employee would receive if he or she took the claim to court and won, discounted by the uncertainty of winning, and further discounted by the amount that the employee would have to pay in attorneys' fees and court costs to win the claim.

Q: When should I negotiate a severance package with an employee?

A: Severance typically will not come up until an employer makes a decision to terminate employment. At that point, put an offer on the table to start the discussion and negotiate to the best of your ability.

Another point to discuss severance is, ironically, at the beginning of employment. A valued prospect may be able to obtain an up-front commitment for severance pay in an employment agreement. If the price of severance is reasonable compared to the value of obtaining an employment agreement, consider agreeing to it. In addition, severance pay can be structured to cover some or all of a period of non-competition. If so, courts are much more willing to enforce the non-competition agreement, since the employee is receiving something to live on during the non-competition period.

Q: Are there any rules of thumb for how much severance an employer will pay?

A: Not really. Again, an employer generally has no obligation to provide severance payments. Experience shows that employers rarely offer severance pay to hourly workers. Employers who offer severance will typically provide one week per year of service to employees below the officer or executive rank, and up to a month per year of service to executives and officers. In addition, some severance plans cap benefits at a specified level.

For most small employers, severance pay comes up only in exchange for a release of rights or to help a valued employee make a transition to new employment after losing his or her job through no fault of their own. In those cases, you should look at what is fair and appropriate, and what the employee will accept.

–by Neil E. Klingshirn, partner in the Akron-based firm, Fortney & Klingshirn. Updated by Cleveland attorney Gregory Gordillo of Gordillo & Gordillo LLC.

Employer Responsibility

Chapter 7

Business Owners Shoulder Responsibility for Employed Drivers

Q: My company owns several motor vehicles that are sometimes used by my employees. Is the business responsible for all accidents involving these vehicles?

A: An employer's responsibility for the operation of a vehicle by an employee is determined by the principle known as *respondeat superior* (literally, "the superior must answer"). *Respondeat superior* means that an employer should be responsible for the negligence of an employee if the employee's actions fall within the course and scope of the employment.

Q: Aren't all acts performed by an employee during work hours done in the course and scope of the employment?

A: No. An employee can stray from the scope of employment, and under such circumstances, the employer may not be responsible for the employee's negligence. For instance, a vehicle may be given to an employee with the understanding that he/she will make a delivery and then return directly to the business place. If the employee strays from the delivery and takes the vehicle to perform a personal errand, the employer may not be found responsible for the employee's negligence while on the errand. For instance, if, after making the work delivery, the employee leaves the city to visit his/her out-of-town mother, the employer will not be responsible for the negligent operation by the employee during the unauthorized trip.

Q: What if I allow my employees occasionally to use a vehicle to drive to lunch?

A: Usually, an employer is not responsible for this kind of trip if the employer is not gaining a special benefit from the employee's use of the vehicle. If, however, the employee is on call during the lunch period, the employer may be found responsible for the employee's negligence. Similarly, if the employee has been instructed by the employer to pick up lunch for other employees, the trip may be determined to be business-related *because* it benefits the employer and the business.

Q: If I <u>require</u> my employee to drive the vehicle home at night so I do not have to pay for parking, what is the extent of my responsibility?

A: Since the employee is required to drive the vehicle to and from work, the employer is responsible for the employee's negligence in the operation of the vehicle during those trips to and from work. Taking the vehicle home and then back to work is part of the employee's regular duties. The employer would not, however, be responsible for any personal trips the employee might take in the vehicle during the employee's off hours.

Q: What if the employee lets someone else drive the car? Is the business liable?

A: An employer who does not give the employee permission to allow another to operate the vehicle usually will not be found responsible for the negligence of the non-employee.

Q: What if I allow an employee to use the company vehicle for his or her own purpose even though I know the employee is a poor driver?

A: Liability for an accident involving an employee in these circumstances would not have anything to do with the employer/employee relationship. Instead, a person giving permission to the unsafe driver to operate a vehicle can be found responsible for the negligence of the employee on a theory of *negligent entrustment*. A person who allows another to use a vehicle when he or she knows that the driver is incompetent or inexperienced can be held responsible for that driver's negligence.

Q: If I allow an employee whom I know to be a good driver to operate the business vehicle on that employee's personal errand, will I be found responsible for the employee's negligence on that trip?

A: No. Because the vehicle is being used outside of the business relationship, the principle of *respondeat superior* does not apply. The employer is not responsible for non-business-related acts of an employee. Furthermore, if the employer knows the employee to be a good driver, the theory of negligent entrustment does not create a basis for liability. An employer is not negligent when giving a good driver access to a vehicle. Mere ownership of a vehicle does not create any liability for the independent actions of another.

Q: Even if the business might be liable for an employee's negligent driving, doesn't that employee also have responsibility?

A: Yes. The negligent employee is also accountable for his or her own negligent acts. Any lawsuit or claim brought by the injured party will likely be brought against both the employer and the employee. Upon learning that a claim is brought, both the employer's insurance carrier and the carrier for the employee should be advised of the claim to determine whether or not more than one insurance policy applies to the claim.

–by Lynn A. Lazzaro, a Cleveland-area attorney in private practice.

Know the Extent of Your Responsibility for Employees' Injuries

Q: I own a business where my employees are occasionally injured on the job. Am I directly responsible for their injuries?

A: Generally, no, as long as you comply with the Ohio Workers' Compensation Law. Participating employers have created and maintained a state fund by paying workers' compensation premiums to the State of Ohio. The Bureau of Workers' Compensation administers the fund, and an employee who is injured in the course of his or her employment may apply for and receive benefits out of the fund from the Bureau of Workers' Compensation. That employee may not make a claim directly against the employer. The two-fold purpose of this system is to insulate participating employers against employees' claims for injuries, while providing benefits to injured employees from an independent fund regardless of fault of either employer or employee.

Q: Are there any situations where I might still be liable to my injured employee?

A: Yes. You may be held responsible if you do not comply with the Ohio Workers' Compensation Law. Also, you may be liable even if you *do* comply with that law, but have injured your employee by committing an *intentional tort*.

Q: What is an "intentional tort"?

A: Under current Ohio law, an employer is liable for an intentional tort if the employee can prove the employer committed an act with the intent to injure the employee or with the belief that the injury was substantially certain to occur.

Ohio law presumes the following are intentional torts: when an employer deliberately removes a safety guard on equipment or deliberately misrepresents a toxic or hazardous substance, and an injury or illness occurs as a direct result.

Insurance

Q: Will the commercial general liability policy I carry on my business cover an intentional tort claim that might be brought by my employee?

A: This depends on the language of the policy, and upon a court's interpretation of that language. Many commercial policies contain provisions that specifically exclude "intentional torts" from the employer's insurance coverage.

Employers should review their current commercial liability policies with their insurance agents and with their attorneys to determine if full coverage exists for such claims.

Q: I have heard that the workers' compensation benefits are available only for an employee's physical injuries. Can an employee therefore sue my business for purely psychological injuries?

A: Yes. The workers' compensation laws generally allow compensation only for injuries and occupational diseases sustained in the course of and arising out of a worker's employment. They do not, however, prevent an employee who has suffered purely psychological injuries as a result, for example, of a robbery at her employer's business, from bringing legal action against her employer for negligence.

–by Jack L. Neuenschwander, retired partner of the Piqua firm of McCulloch, Felger, Fite & Gutmann Co., LPA. It was updated by Douglas J. Schockman, an attorney with the Columbus firm of Lane Alton & Horst.

Spousal and Child Support Issues Affect Business Owners

Q: I am a happily married business owner, but I just received paperwork ("withholding notice orders") instructing me to withhold child support and spousal support each time my employee receives a paycheck. I've also been instructed to send the money withheld to the Child Support Payment Central for distribution to the employee's ex-spouse. Who needs this extra paperwork! Can I ignore the order and/or terminate the employee?

A: No. You must read the orders carefully and you must comply with the orders. There is an address and phone number on the orders of the support enforcement agency to which you may direct any questions you may have. If you fail to withhold income in accordance with the provisions of the notices and orders you receive, you may have to pay the accumulated amount that you should have withheld, and/or you may be found guilty of contempt of court, and/or you may have to face other penalties, including fines. Also, if you fire, refuse to hire or discipline any employee because support withholding has been ordered, you will be subject to legal penalties, including responsibility for funds that should have been forwarded, and fines.

Q: Can't my employee just arrange to pay the spousal and/or child support directly to his or her ex-spouse?

A: Generally, the employee does not have a choice. The law generally requires that where the *payor* (in this case, your employee) is employed, the withholding process will be used. Also, any support paid directly between the spouses generally will not be counted as payment of the support obligation, but will be considered a gift. The withholding process provides an orderly and accountable way to ensure that support is paid in a timely manner. Spousal support, but not child support, may now be paid directly to a former spouse. Still, if a court order requires wage withholding, the employee does not have the option to pay spousal support directly to the former spouse.

Q: I received withholding paperwork for an individual who performs services for my business in an independent contractor capacity. This person is not an employee, so we do not withhold taxes from her paycheck, and she receives a 1099 tax form rather than a W-2 form. Do I have to withhold and forward support for this individual?

A: No. If this person truly is an independent contractor, she should be considered as *self-employed*, and she will need to set up an account at a financial institution from which the support payments can be withheld and forwarded.

If you receive withholding paperwork for an individual who you believe to be an independent contractor, however, do not just ignore the paperwork. Rather, you need to immediately contact the Child Support Payment Central, the individual's attorney, and/or your own business attorney in order to clarify the situation.

Q: If I receive withholding orders for more than one employee, do I have to forward a separate check for each one?

A: You can combine all of the payments into a single check to the Child Support Payment Central. However, the check should be accompanied by a written list of names, Social Security numbers, case/support order numbers and the amount withheld for each of your employees.

Q: I have several employees in the process of ending their marriages. How can I be supportive without becoming involved in the intimate details of their domestic relations dilemmas?

A: Divorce is a difficult lifestyle change even in the most amicable of circumstances. Encourage your employees to consult professional legal counsel and the counsel of a mental health professional to guide them through this difficult time. Many group health insurance policies have resources for these circumstances. You can direct your employee to these resources to keep from becoming too involved. Your employees occasionally may need to be absent from work to attend court hearings, depositions, mediation sessions, and/or appointments with attorneys or counselors.

Your employees may need your assistance in gathering information regarding their salary history and benefits because full disclosure about financial matters is required by the court. Sometimes, a business may be joined as a party to the divorce, and/or may receive a restraining order, and/or may be required to provide information directly to opposing counsel or the court. If this happens, you may wish to consult with either your employee's attorney or your own attorney to learn more about your rights and responsibilities.

–by Laura S. Zeldin, Esq. Updated by Pamela J. MacAdams, a partner in the Cleveland firm, Morganstern, MacAdams & DeVito Co., LPA.

Who Has Responsibility for Ice and Snow Injuries?

Q: I own a house and my business owns several real estate properties. I am concerned about business and personal responsibility for slip-and-falls on ice and snow that might occur on those properties. Can I or my business be found liable?

A: Not unless you are found to be *negligent* or fail to exercise *ordinary care*. Ordinary care is judged by what a reasonable and prudent person would have done under the same circumstances.

Every person has a duty to look out for his or her own safety. A business or individual may also have a duty to look out for the safety of others. This duty can come about by written agreement or by law. Before an injured person can recover damages, that person must show that something the business owner or individual did or failed to do caused the injury. The person must also show that the business or individual "owed a duty" to that injured person.

Q: If someone slips and falls on ice or snow <u>naturally</u> covering the sidewalk outside my house, can I be held responsible for that person's injuries?

A: Almost certainly not. People walking on ice and snow in front of your house presumably know that they might slip and fall. Ice and snow are natural hazards in Ohio's climate. Because snow or ice accumulations are often sudden, it would be impractical to hold responsible every homeowner who failed to clear his or her sidewalk.

Q: What if a customer slips on ice and snow in the parking lot of my company's store?

A: It has long been the law in Ohio that a land or business owner does not ordinarily have a duty to remove natural accumulations of ice and snow. This is true even if the person injured is a customer of the business being visited. Furthermore, the business owner does not have a duty to warn customers of any dangers associated with ice and snow on the sidewalks, walkways or parking area. The reason is that, in Ohio's climate, ice, snow and temperature changes are expected hazards. The courts have found that it is impossible and impractical to place a duty upon a land or business owner to anticipate and at all times correct for these natural occurrences.

Q: Can the business owner ever be found responsible for a customer's slip-and-fall on ice and snow?

A: Sometimes. Everyone who has seen an Ohio winter knows the dangers of ice and snow. All customers on a business property in the winter, therefore, must take responsibility for protecting themselves from these dangers. Usually, the business owner has had no part in creating the danger that causes injury to the customer. A business owner cannot ensure the safety of all persons coming onto his or her property.

However, when a business owner creates a *greater* danger than was brought about naturally, then the business owner may be found liable for any injuries and damages which result. For instance, perhaps a property owner knows of a broken gutter and allows it to spill water onto a sidewalk in front of the entrance to his or her building. The water freezes and forms an unnatural ice accumulation. In such a case, the owner may be held responsible for this negligence because the ice condition arose artificially due to a gutter that the building or business owner should have repaired.

Q: What if my company's building is an apartment building? Does the company as a landlord have a greater duty than the other business owners to clear ice and snow from sidewalks for the tenants?

A: Landlords have no greater duty than any other business owner to remove natural accumulations of ice and snow from common walkways and structures unless they have an agreement or provision in the lease agreement that requires the removal. Like other business owners, a landlord will be found responsible if his or her negligence creates a condition which is unnatural. Washing down an entranceway to a building on a sub-zero day would be an example of negligence causing an unnatural accumulation.

Q: If, by agreement with tenants, the owner of a strip mall agrees to keep sidewalks and passageways open and clear of ice and snow, would that agreement mean the owner/ landlord could be held responsible for a slip-and-fall of a tenant or visitor?

A: Possibly. An individual or an entity (such as a business) can be held responsible for injuries which occur when that individual or entity has assumed a duty by agreement to keep sidewalks, parking lots and entrances open. When the individual or business owner/landlord takes on that duty, he or she must take "reasonable measures" to ensure that the job is performed. However, the law does not expect the area to be kept totally free and clear. Rather, the law expects the individual or entity assuming the duty to make "reasonable efforts" to keep the area clear. No amount of maintenance can totally ensure against injury and damage.

Q: What if the slip-and-fall occurs on a public sidewalk in front of the business and the city has an ordinance instructing all landowners to keep their sidewalks free and clear from snow and ice accumulation? Is the business responsible for all slip-and-falls which occur on the public sidewalk?

A: No, not as a result of the ordinance. Although the owner of a property does not own the public sidewalk, the ordinance may require that sidewalks be kept free from snow accumulation and open to the public. This is for the convenience of the city. This does not mean that the business owner is liable for injuries resulting from his or her failure to remove the snow and ice. The ordinance does not create a basis for liability. Rather, the ordinance usually creates a penalty for failure to clear the sidewalk in a reasonable time. Typically, the city would fine the business if it failed to comply with the law.

–by Lynn A. Lazzaro, a Cleveland-area attorney in private practice.

Individual Supervisors May Be Liable for Violation of Discrimination Laws

Q: One of my company's supervisors recently asked me if she could be held liable if an employee should bring a suit claiming discrimination. What should I tell her?

A: Ohio discrimination laws make it unlawful for an employer to discriminate in hiring, firing, and terms and conditions of employment on the basis of race, color, religion, ethnicity, national origin, gender, disability (handicap) or age. According to the Supreme Court of Ohio, the concept of *employer* includes not only the entity that employs a person, but also individuals who make (or sign off on) the employment decisions affecting an employee. In short, if a supervisor's action (or inaction) adversely affects an employee, both the supervisor and the employer may be held liable.

As a result of the Supreme Court of Ohio's decision, you can expect that discrimination suits have been and will be brought against not only the employer company, but also individual defendants ranging from corporate officers to line supervisors. Multiple defendants compound defense costs, and *may* mean a company will need to hire different law firms to represent different employees who have been sued. If the employer has a policy indemnifying the named supervisors or an agreement requiring the employer to defend and pay damages assessed against an employee, then it may be possible to consolidate the various legal defenses so that they can be handled by one law firm. However, the interests of the employer and the supervisor(s) may not be the same. For example, a supervisor may claim to have been acting pursuant to an "unwritten policy" of the employer, a position which the employer denies, but which makes it liable. Conversely, the employer may have a claim against the supervisor. In either case, the individual supervisor must be represented by separate counsel.

Q: Does my company's liability insurance for employee lawsuits cover my supervisors?

A: It is not standard that such coverage extends to individual supervisors, but many insurance companies now offer insurance coverage for employment claims and may include options extending coverage to at least lawsuit defense costs for management employees. Otherwise, unless the supervisors have an indemnification agreement with the employer, they will be required to hire and pay their own lawyer(s), unless they have their own insurance coverage (which is unlikely). Insurance policies should always be reviewed to determine if any coverage applies. Supervisors should find out from their own insurance agents whether such coverage is available under their homeowner's insurance, an umbrella policy, or a special rider to their existing coverage.

Q: What should I do?

A: Employers (including officers, managers and supervisors) should do the following:

1) review insurance coverage and determine what actions are covered and excluded; for those items covered, the insurance company may require the employer to have certain practices and procedures (including human resources auditing policies) in place;
2) conduct periodic training of all management employees to educate them on company policies and procedures, the restrictions imposed by employment laws and management techniques to lawfully address employee issues;
3) review and improve their documentation of employment-related decisions;

4) review whether, and to what extent, individual managers and supervisors are, or should be, indemnified for employment decisions;
5) define the chain of commands and clarify through written job descriptions the scope of authority of each management position; and
6) implement in-house complaint procedures providing for alternate recipients of employee complaints within management, prompt investigation and resolution of complaints, and assurance of nonretaliation to claimants and persons assisting in investigations.

–by Linda C. Ashar, an attorney practicing in Vermilion, Ohio.

Conflict of Interest Policies Are Crucial for Non-Profits

The non-profit world is changing. The IRS, federal, state and local governments are all taking a closer look at the operation, management and actions of non-profit corporations.

One of the best ways to protect your non-profit organization is by adopting and implementing a conflict of interest policy. Conflict of interest policies provide a way to address the inevitable issues that arise between board members, staff and outside interests.

Many non-profits believe that their board members can never provide services or be paid for providing services to the non-profit organization. While this may be true in very specific contractual relationships with government entities, generally speaking board members are permitted to contract with their non-profit organizations so long as any contract between a board member and the non-profit is in the best interest of the non-profit.

A good conflict of interest policy will help a non-profit organization balance the issues of fair market value, independent judgment and faithfulness to the non-profit corporate entity and mission.

At a minimum, a board's non-profit policy should establish a process by which independent board members review and determine whether or not a contract with a board member is in the organization's interest. Not only should interested board member(s) abstain from voting, but they should not be involved in any of the discussions or analysis.

Care also should be taken to ensure that alternative and competitive bids are considered and that non-interested board members are fully informed of all options and costs related to the contract.

A good conflict of interest policy also should address gifts, honorarium, and other things of value given to staff and board members. While it may be appropriate for a staff member to accept holiday cookies from a client due to the nominal value and unlikely persuasive effect such traditional gifts have, the same would not be true of an all-expense-paid vacation.

The problem many organizations run into is where to draw the line between benign tokens of appreciation and gifts that could raise concern. Some organizations ban all gifts, but this can have the unfortunate effect of offending customers and clients who do not understand why a plate of cookies is refused. A well-considered conflict of interest policy can help avoid these types of issues.

In addition to addressing gifts, a good conflict policy should address business opportunities, intellectual property, trade secret and confidentiality issues, and it should spell out what will happen if the policy is violated.

The policy also should set forth a system for evaluating and approving conflicts. This usually requires staff conflicts to be reviewed by the executive director and board, and executive director conflicts to be reviewed by the organization's audit or finance committee.

Taking the time now to review and update your conflict of interest policy can protect your organization from future problems and better prepare you for the likely coming changes in non-profit oversight.

–by Jeffrey J. Fanger, the managing member of the Cleveland law firm of Fanger & Adelman LLC.

Understand Implications of Ohio's CDL Disqualification Law

Ohio's new CDL (commercial driver's license) disqualification law was passed to comply with a federal government mandate requiring all states to impose more severe sanctions upon commercial drivers for Operating a Vehicle under the Influence of Alcohol or Drugs (OVI), whether or not a commercial vehicle was being driven at the time of arrest. Businesses that employ people to drive commercial vehicles should be aware of these potential penalties and increased insurance costs.

If a commercial driver is arrested for OVI while driving a non-commercial vehicle, and a breath, blood or urine test reveals a blood alcohol content (BAC) at or above the legal limit, the CDL will be suspended under an Administrative License Suspension (ALS) for a minimum of 90 days. A refusal to submit to a breath, blood or urine test will result in a minimum one-year disqualification of the CDL. Lifetime disqualifications may be imposed due to previous convictions for OVI. Although the law provides for limited privileges to drive a non-commercial vehicle, there is no provision in the law that allows for limited privileges to operate a commercial vehicle.

An ALS must be appealed within 30 days of the date of the initial court appearance. If the appeal is successful, driving privileges, both commercial and non-commercial, may be restored. If unsuccessful, the individual cannot drive a commercial vehicle during the period of the suspension. The court may grant limited privileges to drive a non-commercial vehicle after a mandatory period of time (commonly referred to as a *hard suspension*) within which no privileges can be granted.

If an individual is subsequently convicted of OVI, regardless of the outcome of the ALS appeal, the BMV must impose a one-year disqualification of a CDL. A previous OVI conviction may result in a lifetime CDL disqualification.

If an individual is arrested for OVI while operating a commercial vehicle and a blood, breath or urine test reveal a BAC at or above the legal limit for commercial operators (approximately one-half of the legal limit for non-commercial operators), the CDL must be immediately surrendered to the peace officer. A one-year disqualification of the CDL is mandatory on the first offense. A lifetime disqualification is mandatory for a second offense.

A refusal to submit to a breath, blood or urine test upon arrest for OVI has harsh consequences for individuals holding a CDL. The law provides that, in addition to a one-year disqualification for first-time refusals and a lifetime disqualification for a second refusal, the refusal, in and of itself, is a separate criminal offense.

Operating a commercial vehicle with any discernible amount of alcohol will result in the driver being placed out of service for a 24-hour period whether or not OVI charges are filed.

The new law imposes grave consequences upon CDL holders. Just being arrested for OVI, regardless of whether or not a conviction results, can foreclose the ability to return to commercial driving. Business owners will suffer from increased insurance premiums and the costs associated with hiring and training replacement drivers.

–by Jon J. Saia, managing partner with the Law Offices of Saia & Piatt and chair of the DUI Committee for the Ohio Association of Criminal Defense Lawyers.

Anti-Harassment Policies Key To Limiting Employer Liability

Sexual harassment claims and lawsuits continue to multiply throughout Ohio and the nation. Under both Ohio and federal law, however, unlawful workplace harassment is not limited to claims based on sex. Harassment on the basis of race, religion, color, national origin, age or disability is also prohibited. Businesses may be held liable not only for harassment by supervisors and managers, but also for harassment by co-employees or even customers. To combat unlawful harassment and to minimize their potential liability for such claims, employers should develop and implement effective anti-harassment policies and complaint procedures.

Unfortunately, no anti-harassment policy or complaint procedure will relieve an employer from liability for harassment by supervisors or managers that takes the form of a *tangible employment action*, such as firing, demoting or denying a raise to an employee who resists his or her supervisor's advances. Under these circumstances, the employer will be held strictly liable for the supervisor's actions. Even here, however, the presence of a well-publicized and consistently enforced policy against harassment may at least limit or preclude the employer's liability for punitive damages.

On the other hand, where the harassment does *not* involve a tangible employment action by the employee's supervisor but merely creates a "hostile environment," an appropriately designed and implemented anti-harassment policy and complaint procedure may allow the employer to avoid liability completely for such "hostile environment" claims.

According to recent federal and state decisions, even in cases where it is the employee's supervisor or manager who is creating the unlawful hostile environment, the employer will not be held liable for such harassment if it can prove:

1) the employer exercised reasonable care to prevent and promptly corrected any harassing behavior; and
2) the complaining party unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise.

A "supervisor" in this context is a person who can hire, fire, promote or discipline. The United States Supreme Court decided a case, *Vance v. Ball State University*, on June 24, 2013, that addressed the issue of whether the term "supervisor" also extends to someone who oversees an employee's work and assigns daily tasks, or if a person with this oversight is merely a co-worker. The U.S. Supreme Court determined that an employee is a "supervisor" for liability purposes *only* if the employer has given that person the power to take tangible employment actions against the victim of workplace harassment.

Further, an employer may be held liable if the harassment incident is severe (such as a sexual assault), even if the incident happened only once and the employer had a policy against sexual harassment and responded immediately and effectively to the employee's complaint. Nevertheless, the existence of an appropriate policy and complaint procedure should at least limit the employer's liability for punitive damages in such a circumstance.

Although the law in this area is still evolving, an employer with an effective anti-harassment policy and complaint procedure may enjoy greater protection from liability in cases involving co-employee or customer harassment than in cases of supervisory harassment. Prompt and effective action in response to an employee's complaint of harassment by a co-worker or customer may completely insulate the employer from any type of liability. Indeed, some courts have held that the employer may be liable for co-worker or customer harassment *only* if it knew or should have known of unlawful harassment, and its actions upon learning of the harassment were so inadequate as to show indifference to that harassment.

–originally prepared by Columbus attorney Bradd N. Siegel, and updated by Sara H. Jodka, an attorney in the Columbus firm of Porter Wright Morris & Arthur, LLP, and a member of the OSBA's Labor & Employment Law Section.

Keep Your Employees—and Your Business—Healthy

Employers large and small are adopting employee wellness programs. And why not? If the reality even begins to match the promises, employers have everything to gain, from managing health care costs to reducing on-the-job injuries and absenteeism. If that were not enough, intangible benefits, from increased productivity to improved employee relations, have employers jumping on the bandwagon.

When you calculate the possible benefits of starting a wellness program for your own employees, however, you should factor in a possible increase in workers' compensation costs due to employee injuries sustained while engaging in wellness activities. Before starting your own wellness program, you should know what the law says about workers' compensation coverage for employer-sponsored recreational or fitness activities.

Ohio law says that, if an employer sponsors a particular recreational or fitness activity and the employee is injured while performing that activity, the employee's injury will be covered by workers' compensation insurance unless the employee signs a recreational waiver. Most employers understand this potential liability and make sure they ask their employees to sign waivers for activities that are clearly employer sponsored. But what about employer-sponsored wellness programs? Are they considered to be "employer sponsored" for workers' compensation purposes? Should you ask each of your employees to sign a waiver for any and all of these programs?

Employers generally do not think of wellness programs as employer sponsored, and with good reason. After all, many of these are individual, off-site fitness activities, and employers may reasonably assume that waivers are unnecessary. Is it possible, however, that workers' compensation insurance still might cover the injury of an employee who participates in such an activity? After all, the employee might say: "My employer asked me to engage in this fitness activity as part of the company's wellness program. I did not sign a waiver. Therefore, workers' compensation should cover my injury." Does the employee have a valid case?

When is an activity "employer sponsored"?
Typically, an activity is likely to be employer sponsored if:

- the employer paid for or otherwise organized the activity;
- the activity was conducted on the employer's premises (or the employer paid the cost for rental of the premises);
- the employer supervised the activity;
- the employer paid the entry fee;
- the employer received an economic or intangible benefit;
- the employer purchased uniforms or equipment; and
- the activity was made up of only employee participants.

Based on the above factors, it may be unclear whether wellness program activities are employer sponsored in the usual sense. Employers may not be directly supervising, paying for, or housing these activities, buying uniforms or equipment, or even paying entry fees. Most employers, however, do expect to receive tangible and intangible benefits from activities associated with their wellness programs.

A 2010 case arising out of the Summit County Court of Appeals demonstrates the complications that may arise when an employee is injured during an employer-sponsored event. In this 2010 case, an employee was injured when she participated in an employer-sponsored relay race that was not expressly part of a "wellness" program. The court held that the employee was not entitled to workers' compensation benefits because the injury did not occur "in the course of" her employment. The court, however, distinguished this 2010 case from several others where employees' injuries were found to be covered by workers' compensation because the primary purpose of those other events was to improve employer-employee relations. Since the events resulted in some benefit to the employer as a result of the employees' participation, the court found that employees' injuries sustained during the events should be covered.

Waivers: Should they be required?

If an Ohio employer requires an employee to sign a waiver of workers' compensation benefits for recreational or fitness activities, is that employer acknowledging sponsorship of such activities? If the employer decides it is not necessary to require a waiver, what happens if an employee is injured while engaging in a physical fitness activity? Might the employer then be liable for workers' compensation benefits?

What if an employee chooses to take an aerobics class at a local fitness center as part of the wellness program? If the employee gets injured while participating in the class, is the injury covered by the employer's workers' compensation policy because the employee was participating in the class as part of an employer-sponsored wellness program? The employer had no control over the type of activity the employee selected, the employer did not pay for the cost of the class, and the employer did not supervise and was otherwise disinterested in the type of activity selected by the employee. Yet, the employee claims that he would not have participated in the class without the wellness program. Will the employer's objective (that of creating healthier employees and improved employee relations) make the employee's selected activity more likely to be considered an employer-sponsored event covered by workers' compensation?

A wellness program may be just what your business needs. By starting such a program, your efforts may pay off in both tangible and intangible ways. You may well see medical insurance cost savings, reduction in absenteeism, and even improved employee morale. As with other business decisions you make, however, it is wise to consider ALL of the ways that wellness programs might impact the employment relationship.

–by Patricia F. Weisberg, a partner in the Cleveland firm, Walter Haverfield LLP.

Helpful Hints for Office Holiday Parties

Q: What issues should employers keep in mind when planning office holiday parties?

A: Office holiday parties can be an excellent opportunity to recognize the hard work of employees throughout the year and to entertain clients and customers. However, recent years have seen an increase in litigation brought against employers when the parties get out of control or an intoxicated employee harasses or causes injury to someone else.

Q: What sorts of liability can result from these events?

A: While well-intentioned, these events can be a source of claims, including dram shop law violations, harassment claims, workers' compensation claims and wrongful death actions.

- Dram shop laws allow a person who is injured as the result of another's intoxication to sue the individual or business that sold the alcohol. Generally, employers are not liable under dram shop laws for merely hosting a party. However, liability may be extended if the intoxicated person is a minor or if the employer knew an employee was intoxicated and continued to serve the employee alcohol.
- Harassment claims, and particularly sexual harassment claims, may result when one employee (or even a non-employee) becomes intoxicated and makes inappropriate advances or comments toward another employee.
- Workers' compensation covers only employee injuries sustained within the scope of employment. If an employee is intoxicated, the injury does not necessarily result from actions taken within the scope of employment. If an employer maintains a drug-testing policy that includes testing for cause and otherwise complies with an Ohio workers' compensation statute addressing drug testing issues, there will be a presumption that the injury is not compensable. If attendance at an office party is mandatory, however, some injuries that involve alcohol may be considered work related, and therefore, compensable. If clients or vendors are invited to the party, it is more likely to be a mandatory work function.
- Wrongful death actions may be brought by the estate of a deceased employee to recover from the person who caused the death. An employer who was responsible for the employee's intoxication while within the scope of employment may be sued for wrongful death.

Q: How can employers protect themselves?

A: All employers should have a drug and alcohol policy stating that employees will be subject to discipline, up to and including termination, for the use, sale or possession of alcohol or illegal drugs on company premises or while working. The policy may permit alcohol to be consumed at employer-sponsored functions, but the policy also should specifically state that at no time should alcohol be consumed to excess. Many employers choose not to serve alcohol at holiday parties or have the parties during the day to reduce the expectation that alcohol will be served. Here are a few hints for employers hosting holiday parties where alcohol will be served:

- Remind employees about the company alcohol policy and harassment policy and remind supervisors that they are still responsible for enforcement of both policies. Also remind employees that any gifts or cards should be workplace-appropriate.

- Consider designating a manager or supervisor to refrain from drinking and to keep an eye out for over-consumption.
- Limit the availability and/or amount of time that alcohol is served and stop serving alcohol at least one hour before the end of the party. Consider using drink tickets.
- Have the holiday party on a weekday night. Employees who know they have to work the next day might be less likely to over-indulge.
- Do not serve "hidden" alcohol such as spiked eggnog or punch.
- Serve starchy foods that absorb alcohol rather than salty or sweet foods that make people thirsty.
- Have a cash bar to avoid using company funds for alcohol and do not allow supervisors to buy drinks for employees.
- Hold events at sites not affiliated with the employer.
- If you elect to have an open bar, hire bartenders to serve the alcohol. Encourage the bartenders to refuse to serve anyone who is intoxicated and to inform a management official if anyone is visibly intoxicated.
- Have bartenders require identification proving that the individual is over the age of 21 and refuse to serve to serve anyone under the age of 21. Employees under the age of 21 should be informed prior to the party that, if they drink at the party, they will be subject to discipline up to and including discharge.
- Provide cabs or establish a designated driver program.
- Do not make attendance at holiday parties mandatory and make sure that employees who attend know they may leave at any time.
- Invite spouses/partners/significant others.
- No mistletoe.
- Maintain a professional dress code.
- Review company insurance policies for alcohol-related exclusions.

Taking a few of these precautions can go a long way toward preventing liability.

–by James B. Yates, Esq., SPHR, and Sarah E. Pawlicki, Esq., SPHR, of the Toledo law firm of Eastman & Smith, Ltd.

Can I Say That?

Legal Basics Every Advertiser Should Know

Whether you advertise a lot or a little, locally or nationally, in print or electronically, on billboards, in social media, on the Internet, radio or television, you naturally hope your advertising campaigns will draw attention to your goods or services. But keep in mind that, in addition to gaining the attention of the consumers you *want* to reach, you also might capture an entirely different and unwelcome audience if you are not careful in developing your message.

Your competitors watch your ads as closely as you watch theirs, and they have some power to keep you on your toes. Short of being sued by a competitor for false advertising, though, who else might be watching? The Federal Trade Commission (FTC), the Better Business Bureau, your (or another) state's attorney general, the Food & Drug Administration (depending on your business), and various watchdog groups. (These days, if you're in the business of food or drinks, many different watchdog, agency and government groups are paying special attention to the claims you make.) These groups are vigorously ensuring that what you say is truthful and fair, and not harmful to the consuming public.

If you stick with the following general principles, however, the potential challengers to your advertising will, for the most part, be satisfied:

- Advertisements must be truthful and not unfair or deceptive.
- Claims of fact, survey numbers, statistics and the like must be substantiated, *i.e.*, backed up by competent and reliable data or testing. The level of the substantiation depends on the type of claim.
- Comparative ads are fine, but do not misrepresent either your attributes or your competition.
- An endorser must be a true user of your product or service and the testimonial must be representative of the typical experience a consumer can expect from use. This includes bloggers and celebrity spokespersons who campaign for you through their own social media profiles. Further, if you are "materially" connected to someone who pushes your product or service, both you and they need to ensure that certain disclosures suggested by FTC guidelines are made.
- Want to run a special sweepstakes promotion? Know that there are particular rules in each state that must be followed, including some that require registration and bonding.

Of course, many industries are specially regulated, and their advertising efforts require extra care and compliance. If you are not sure about these requirements, contact your Better Business Bureau or the FTC (or visit www.ftc.gov, which provides helpful guidance), or consult a lawyer familiar with advertising issues. Do not rely on your luck or the chance of "not getting caught." Not only is it expensive to find out what *not* to do the hard way through litigation or an agency action, it might result in more PR than you planned—though not the positive kind you were positioning to get.

–by Jill P. Meyer, an attorney with the Cincinnati office of Frost Brown Todd LLC.

Is Your Business Prepared to Handle a Data Security Breach?

Is your firm prepared to respond quickly to a data security breach and to notify as required by law? Adopting a data breach response plan ensures the best response. The following steps will assist you in creating a response plan that will assure that your firm complies with legal obligations to your customers and employees and minimizes potential adverse effects on your firm.

- **Designate a Response Coordinator and Team.** Appoint a team of key personnel from IT, operations, marketing, legal and public relations to be responsible for your initial risk assessment. Identify which of the team members will be the response coordinator. The team should meet at least every six months to evaluate the plan and consider any changes necessitated by changes in operations, services or new service providers.

- **Evaluate Data Collection Practices.** Analyze the type of data your firm collects, which data is personal or sensitive, and how it is used. Consider whether the data collected can be minimized and evaluate how it is protected. Balance the push to collect more data for customer service improvement and as a source of revenue with the associated data-keeping risks.

- **Consider the Impact of the Use of Cloud Services and Social Media on Data Security.** Carefully review the written agreements with cloud service providers to determine your firm's rights and the provider's responsibilities with respect to data your firm has placed in the cloud. Evaluate your firm's social media practices and the nature of company information uploaded to social media platforms in the context of your proprietary information. What do your employee policies say about the use of social media? Limit access to login and password information for your firm's sites.

- **Adopt a Data Breach Action Plan that Includes the Following Steps:**
  - **Plug the Hole.** The response coordinator and team should immediately review your system and operations to determine how the breach occurred and what data was affected, and to make modifications necessary to prevent further breach of your system. If a third-party processor controls the data, coordinate the necessary investigation and remedial steps.

  - **Assess the Damage.** Determine what data was affected, its nature and form (encrypted/unencrypted, electronic/paper) and who was impacted. For most firms, state law will determine the notification obligations based upon the residence of the data subjects. If your firm has customers from states other than Ohio, it will be necessary to review the data breach notification laws of those states as well. Certain industries are governed by federal laws in this area. For example, the Health Information Portability and Accountability Act (HIPAA) and the Health Information Technology for Economic and Clinical Health (HITECH) Act govern health care providers that are covered entities and business associates of those entities. These laws also regulate notification obligations in the event of a data breach. Check with your insurance carrier to determine if the losses from the breach are covered by insurance.

  - **Evaluate the Impact of the Breach.** Even though the data may be unencrypted personal information, consider whether the breach has resulted in, or is reasonably believed to cause a material risk of, identity theft or fraud to the person or property. Ohio and some other states require such an evaluation as part of the notification obligation. Other states, however, will require notification in every case**.**

- **Notify Promptly**. Ohio law requires notification by mail or telephone to be provided as quickly as possible, but not later than 45 days following breach discovery or notification. Alternative mass notice methods may be available depending on the extent of the breach and the size of your business. A data breach response plan should include a draft form of notification letter that can be modified to suit the facts of the specific breach incident. Determine whether you are required to notify law enforcement or any regulator or other government official, or if it may be beneficial to do so. In some cases, law enforcement personnel may ask you to withhold disclosure or notification to avoid compromising the investigation or jeopardizing homeland security; the law permits you to comply with this request.

  The notice should describe the incident generally and the type of customer information that was disclosed. It should also include a description of corrective steps that will be taken to prevent future breaches. Include the telephone number of a contact at the firm and remind customers to pay close attention to their bank accounts and credit reports over the next 12-24 months. They should be advised to report any incidents of suspected identity theft to the firm. Describe fraud alerts and explain how customers may place a fraud alert on their credit report. Also, explain how to obtain a free annual credit report and remind customers of the FTC's online guidance about what a consumer can do to protect against identity theft, along with the FTC's website address and toll-free number.

–by Jane Hils Shea, a member of Frost Brown Todd LLC in its Cincinnati office and chair of its Privacy and Information Security Practice Area.

Protecting the Manufacturer:

Limiting Obligations through Indemnity Agreements

Let's say you run a manufacturing company. Your product vendors will worry about protecting themselves against products liability or infringement lawsuits. Ohio law gives vendors an implied right of indemnification unless there is an agreement between the manufacturer and its vendors to address the issue. For this reason, you should clearly and specifically define, in a written indemnification agreement, your company's obligations to vendors and the procedures to be followed when a vendor seeks indemnification.

The indemnity provisions should specifically describe your product liability responsibilities. You can reasonably exclude from liability the claims of any third party that are based on any product alteration or modification the vendor may make or that may arise due to the vendor's product representations that differ from the manufacturer's representations. Therefore, your agreement should state that your company will have no indemnification obligation if a vendor makes warranties that are inconsistent with your manufacturing company or takes any other action that voids the manufacturer warranty. The agreement should also provide that the vendor will indemnify your company if the cause of the injury in a products liability suit was due to vendor conduct with respect to the product.

The agreement also should state that your company will indemnify and hold harmless a vendor for any patent, copyright, trademark, or other intellectual property right infringement. The agreement should limit your company's liability if a vendor's or third party's modification to the product has infringed rights. Also, the agreement should state that, if your company is sued for infringement caused by the vendor, the vendor will indemnify your company.

Defining the acts or occurrences that require manufacturer indemnification is important, but the true value of an indemnification agreement comes from defining the manufacturer's rights and liability limitations, and the procedures to be followed if a vendor seeks indemnification. As a manufacturer, your company should consider:

- *Explicit notice requirements.* The agreement should state that the manufacturer will not be liable unless it receives written notice of a pending claim within a specified period of time.
- *Settlement and payment procedures.* The agreement should state that all settlement negotiations and decisions will be made by the manufacturer. This prevents a vendor from settling too quickly or inadequately. The agreement should also state that no indemnity payments will be made until all litigation is final, all appeals exhausted, all settlements finalized, and the vendor actually pays all amounts.
- *Costs*. Costs to be reimbursed should be spelled out. Typically, these include amounts to satisfy judgments or settlements, attorneys' fees and other costs of defending against a claim. However, the agreement should limit the payment obligation to amounts not recovered by the vendor from its own insurance.

Before entering into an indemnification agreement, you should review your manufacturing company's insurance policy to ascertain whether indemnity payments will be reimbursed to you. Other vendor agreements should also be reviewed to ensure no conflicts.

While purchase orders, distribution agreements and other agreements between a manufacturer and vendor typically contain indemnity provisions, such provisions are often inadequate. A manufacturer is best protected by a separate agreement aimed at defining its rights, limiting its liability and outlining the procedures to be followed when vendors seek indemnity.

–by Jordan C. Butler, an attorney with Mallory Law Office, LLC in Columbus.

Employee Management: Rights and Benefits

Chapter 8

The New FMLA Rules:

Employer Opportunities and Obligations

On November 17, 2008, the Department of Labor (DOL) published new regulations to implement the 2008 "military leave" amendments to the Family and Medical Leave Act (FMLA). The new rules became effective on Jan. 16, 2009, and also make significant changes to the original FMLA regulations and forms. Generally, the new rules (29 Code of Federal Regulations [CFR], Part 825) allow employers the opportunity to obtain more information from employees and healthcare providers regarding FMLA requests, but employers will also assume new obligations to inform employees of their FMLA rights. On Feb. 6, 2013, the DOL published amendments to the military leave regulations. These amendments were effective March 8, 2013. An online version of the new regulations and the DOL's accompanying commentary—all 700 pages—is available at http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=26631&Month=2&Year=2013.

Significant changes include:

Military family leave. Section 585(a) of the National Defense Authorization Act of 2008 (NDAA) amended the FMLA to provide two new leave entitlements. A new form also exists to certify this leave (Form WH-385).

- **Military caregiver leave:** Eligible employees who are family members of covered service members will be able to take up to 26 workweeks of leave in a single 12-month period to care for a covered service member with a serious illness or injury incurred in the line of military duty, or a serious illness or injury aggravated by service in the line of duty. "Covered service members" now include covered veterans, *i.e.*, those who were discharged under conditions other than dishonorable discharge within five years of the first date of the requested leave. In calculating the five-year look-back period, the new amendments exclude the time period between Oct. 28, 2009, and March 8, 2013.
- **Qualifying exigency leave:** Twelve weeks of FMLA leave is available to eligible employees when a military family member is on active duty serving in the National Guard or Reserves or the regular armed forces in a foreign country (29 CFR §825.127). Exigency leave may be limited to a specific time period, depending on the reason (*e.g.*, 15 days for exigency leave to bond with a military member on rest and recuperation leave).

Eligible employee. The new regulations retain the same essential definition for *eligible employee.* An eligible employee generally is one whose employer employs 50 or more employees within a 75-mile radius and who has been employed for at least 1,250 hours and for one continuous year before the beginning of the requested leave. When there is a break in service of seven years or more, however, the time prior to the break is not counted toward the 12-month requirement unless the break is due to military service or where the employer agrees to count the prior service voluntarily (§825.110). There are special eligibility rules for teachers and airline flight crews.

Serious health condition. The new regulations retain the original broad definition ("…an illness, injury, impairment or physical or mental condition that involves inpatient care … or continuing care by a healthcare provider …") except:

- A serious health condition involving "continuing treatment" by a healthcare provider now requires the employee to make an in-person treatment visit with a healthcare provider within seven days of the first day of incapacity and a follow-up visit within 30 days of the first day of incapacity (except for extenuating circumstances).
- A chronic serious health condition requires at least two visits to a healthcare provider per year. (§825.115).

Employer notice requirements. The new regulations impose new requirements on employers to notify employees of FMLA-related rights, and the regulations contain three new form notices to employees. (§825.302 and 825.303).

- **General notice:** Employers must display a new poster of FMLA rights in the workplace (Form WH-1420). The new regulations allow electronic posting of the general FMLA notice provided all employees and applicants have access to the electronic posting.
- **Notice of eligibility & rights and responsibilities:** Upon receiving an employee's request for leave, employers now have five business days to notify the employee regarding eligibility for FMLA leave. If the employee is ineligible, the notice must state at least one reason and must include a notice of FMLA rights and responsibilities (Form WH-381).
- **Designation notice:** Once the employer has sufficient information to determine if the leave is FMLA qualifying, it must notify the employee of the designation within five business days. With this designation, the employer must also advise the employee if it will require a fitness-for-duty certification to return to work, as well as provide a list of essential job functions if the employer will require certification of the employee's ability to perform the essential job functions (Form WH-382).
- **Penalties:** An employer's failure to comply renders it liable for monetary losses as a result of such failure (§825.301).

Employee notice requirements. The new regulations also make changes to employee notice requirements (§825.302 and 825.303):

- **Compliance with employer policy:** Employees must now comply with an employer's usual and customary notice/procedural requirements for requesting leave. The new regulations permit an employer to delay FMLA leave if an employee fails to provide timely notice without reasonable excuse. Additionally, employers may deny FMLA leave if an employee fails to respond to an employer's reasonable inquiries for sufficient information to determine whether the requested leave is FMLA qualifying.
- **Timing:** The revised regulations continue to require employees to provide at least 30 days' notice if the need for leave is foreseeable and, if not foreseeable, as soon as practicable. The new regulations define "as soon as practicable" as the same or the next business day.

Medical certification. The new regulations significantly change the process of medical certification and allow employers to obtain better medical information verifying an employee's need for leave. New forms for this purpose can be found at Appendix B of the new regulations.

- **Timing:** The new regulations require the employer to request certification within five days of an employee's notice of the need for leave. Employees must provide a completed certification within 15 days.
- **Content:** The new regulations provide two new certification forms (380-E and 380-F). Changes include a requirement to identify the healthcare provider's specialization, medical facts regarding the patient's condition, and whether intermittent or reduced schedule leave is medically necessary.

- **Incomplete and insufficient certifications:** If the certification is returned to the employer incomplete, the employer must notify the employee in writing of the deficiency, and the employee has seven days to cure it, or the leave may be denied.
- **Authentication of certification:** The new regulations allow an employer's healthcare provider, HR professional, leave administrator, or management official—but *not* the direct supervisor—to contact the employee's healthcare provider directly to authenticate or clarify the certification (§825.307).
- **Confidentiality of records:** Employers must maintain confidentiality of medical records submitted to justify FMLA. Employers must comply with confidentiality requirements of the Genetic Information Non-Discrimination Act (GINA) to the extent that FMLA records contain "family medical history" or "genetic information."

Light-duty work. An employee unable to perform the essential functions of a job due to his/her serious health condition may not be required to take light-duty work. The new regulations prohibit an employer from charging periods of light-duty work against an employee's FMLA entitlement. During any period of light-duty assignment, the employee's FMLA restoration rights are temporarily suspended (§825.220).

Waiver of FMLA rights. The new regulations specifically permit employees to settle and release past or potential FMLA claims without approval of the DOL or a court of competent jurisdiction (§825.220).

The changes to the FMLA regulations and forms are significant. Employers must immediately review the regulations and promptly take actions to implement the changes including: 1) revise existing FMLA policies to incorporate the changes; 2) train human resources and supervisory employees regarding the changes and the impact of such changes in their duties; and 3) implement the new and revised forms. Failure to do so will expose employers to unnecessary FMLA liability and relinquish an opportunity to use the new tools to better manage protected leave under the FMLA.

–originally prepared by Gary S. Batke, an attorney with the Columbus office of Bailey Cavalieri LLC. Updated by Toledo attorney Margaret J. Lockhart.

Asserting Employers' Rights To Manage Employee Leave

One of the most challenging issues facing employers is how to effectively manage employees' absences in a way that maximizes productivity on the one hand and minimizes the potential for legal liability on the other. The Family and Medical Leave Act (FMLA) requires employers with 50 or more employees to provide eligible employees with 12 weeks of unpaid leave:

- for birth and care of the employee's newborn child;
- for placement with the employee of a child for adoption or foster care;
- for the employee's serious health condition;
- to care for the employee's immediate family member's serious health condition; or
- for qualifying exigency leave (when certain family members are called for or are on active duty in support of a contingency operation).

Employees are eligible for leave if they 1) worked for their employer for at least 12 months; 2) worked at least 1,250 hours over the past 12 months; and 3) work at a location where the company employs 50 or more employees within 75 miles.

The FMLA also requires employers to provide their employees with up to 26 weeks' leave to care for family members (spouse, child, parent or next of kin) who are covered military service members or veterans, and who are suffering from certain serious injuries or illnesses.

Even employers not covered by the FMLA may be required by the Americans with Disabilities Act to provide a leave of absence in certain circumstances as a reasonable accommodation of an employee's own disability. State law also may require employers not covered by the FMLA to allow employees to take maternity leaves.

The FMLA requires employers to determine when an employee is permitted to take time off. Employers' challenge is to lawfully limit employees' time off to only what the law requires. Following are some ways that employers can address this challenge:

- Develop a written policy. Employers must have a policy in an employee handbook that complies with the FMLA. The policy should correctly define who is and who is not eligible for leave under the FMLA and the circumstances under which leave can and cannot be taken. The policy also should list the employee's obligations for requesting leave and verifying the need for leave. To prevent an employee from stacking paid leaves provided by the employer on top of unpaid leaves provided by the FMLA, the policy should state that the employee will have to take paid leave, such as vacation or paid sick leave, at the same time as the unpaid family or medical leave.
- Determine whether the employee is eligible. Not all employees are eligible for leave under the FMLA because they may not have worked long enough or enough hours for the employer. When an employee requests time off, the employer first should determine whether or not the employee is actually eligible for leave under the FMLA.
- Request medical information. The employer should require the employee to have his or her doctor give the employer the information needed to correctly determine whether or not the employee (or the employee's immediate family member) has a health condition that entitles the employee to the leave. Ensure that employees are given at least 15 calendar days to return and complete any certification.
- Notify the employee that the leave is family or medical leave. If the employer determines that the employee is eligible for the leave and the leave qualifies under the FMLA, within five business days after having enough information to determine whether leave qualifies

as FMLA leave, the employer must notify the employee in writing of that determination, even if the employee is entitled to take paid time off under the employer's sick leave policy or some other policy. Otherwise, the leave may not count against the employee's 12-week leave allotment.

- Do not count FMLA-qualifying absences as "occurrences" under no-fault attendance policies. The FMLA prohibits employers from penalizing employees for using the leave the law allows them to use. The U.S. Department of Labor takes the position that policies that assess "points" against employees for absences regardless of the reason violate the law when an employee is assessed a point for an absence he or she was allowed to take under the FMLA.
- Make sure managers are trained about the kinds of absences that count as FMLA-qualifying absences and the circumstances under which the managers should contact a human resources professional or administrator who is acquainted with the employer's obligations under the FMLA.
- Ensure that no retaliation is taken against employees for requesting or taking FMLA leave.
- Realize that, even if an employee is not eligible for leave under the FMLA, and even if the employer is not large enough to be covered by the FMLA, the employer still may be obligated to allow the employee to take time off if the condition is a disability under the ADA and the time off is a reasonable accommodation.

Employees' rights under the FMLA and the ADA are not without limits. To effectively manage employees' absences, employers should learn not only what rights the law gives to employees but also what rights the law does *not* give to employees.

–originally provided by attorney D. Lewis Clark Jr., and updated by Meghan E. Hill, an attorney with the Columbus office of Squire Sanders (US) LLP.

Privacy in the Workplace: Laws Govern Email, Locker Searches, Drug Testing, Etc.

Q: Do employees have any rights to privacy on the job?

A: Yes. As a general rule, employees are entitled to a "reasonable expectation of privacy" and to be free from wrongful intrusion into their private activities. This standard, however, requires considering all the circumstances surrounding the employer's conduct. In particular, courts will examine how and why an employer took its actions. Moreover, an employee will have to prove that the employer's actions resulted in mental suffering, outrage or shame, and that the employee was a person of "ordinary sensibilities." In other words, the standard is based on the perception of a "reasonable person" and not an overly-sensitive employee.

When applying the reasonable expectation of privacy standard, courts vigilantly protect against conduct by an employer that intrudes on the privacy of an employee's body. Thus, employers have been found liable for violating employee privacy rights when surveillance cameras have been placed in employee restrooms. In addition, bodily searches frequently will cross the line from permissible to impermissible intrusions. But if a legitimate business purpose exists for such a search, employers will not be found liable for privacy invasions. An example of such a legitimate purpose would be searching a prison guard to ensure nothing is smuggled to prisoners.

An employee's reasonable expectation of privacy can be substantially reduced by well-communicated employer policies. By unmistakably notifying employees that they are subject to monitoring, surveillance, inspections, searches and testing necessary to enforce company rules and policies concerning conduct and performance, employers can substantially diminish an employee's privacy rights.

Notwithstanding an employer's efforts to create policies that permit wide-ranging intrusions into employee privacy, some lines cannot be crossed. Employers should exercise special care concerning an employee's medical information and other confidential matters. That special care should include policies that restrict access to the information so that only those with a legitimate business need will know about it.

Q: What rules must I follow if I want my employees to take drug tests?

A: The first rule should be to consult with your legal counsel. The legal and business considerations behind submitting employees to drug tests are quite complex. Generally, the rules vary depending on whether the employer is the government or a private employer and whether the employer is a party to a collective bargaining agreement.

Public employers frequently are bound by the same or similar laws prohibiting private employers from unlawfully discriminating against employees. Employees subjected to drug testing commonly complain that they are selected on an unlawfully discriminatory basis. Thus, all employers should ensure that any drug testing is conducted on some basis other than age, disability, sex, race, national origin, ancestry, or religion. Public employers, however, must also make sure that drug testing comports with the Fourth Amendment to the United States Constitution. This means that, unless unusual circumstances exist, a public employer must have a reasonable suspicion of drug or substance abuse based on specific grounds for conducting the drug test that can be articulated. The most common exceptions to this rule arise when the public employee holds a position that affects public safety or security. In these cases, the government may perform drug testing under less rigid standards of selection.

Drug testing by Ohio employers must comport with the state's statutes and common law. Generally, these laws require that drug testing be administered on a nondiscriminatory basis. Some laws, however, address more specific issues related to drug testing. For example, one statute prohibits employers from requiring applicants or employees to pay the cost of the drug testing. In addition, Ohio statutes limit what medical records relating to the drug tests may be released by the employer. If the employer is subject to the U.S. Department of Transportation regulations, those regulations may *require* drug testing of employees and specific methods of testing. Indeed, the regulations include procedures for collecting urine samples, transporting the samples to testing laboratories, evaluating test results, providing quality control measures for laboratories, keeping records and using certified laboratories.

Finally, employers with collective bargaining agreements may be subject to unique rules arising from the collective bargaining agreement that addresses drug testing. The National Labor Relations Board has held that, before an employer may implement an employee drug testing program, the employer must first bargain with the union because drug testing is a mandatory subject of bargaining. Thus, subsequent testing must comply with the terms set forth in the collective bargaining agreement.

Q: Do employees have any privacy rights concerning their off-the-job activities?

A: Most employees in Ohio are considered *at-will* employees whose employers can terminate their relationship for no reason or any lawful reason. Therefore, discipline or discharge for purely private activities off the job is often *not* considered wrongful. It is, however, a developing area of the law. Whether an employer can monitor off-duty conduct often depends on the employer being able to show a legitimate business purpose for the monitoring, and that the behavior being monitored was connected in some way to the employee's job. For example, an employer who requires an employee to refrain from smoking cigarettes outside of the workplace or work hours might not be violating the employee's privacy since there is a legitimate business interest in containing health care costs. Or, an employer who disciplines a school bus driver for an off-duty DUI violation might be thought to have a legitimate work-related reason for doing so. Even if a termination is not considered wrongful, the Ohio Department of Job and Family Services (ODJFS) may be required to award the employee unemployment benefits. Generally, the ODJFS does not award benefits to employees terminated for just cause. Under ODJFS standards, a termination may be found to be "without just cause" if there is no *actual* connection to the employee's job.

Q: I'm concerned about the kinds of email my employees are sending. Am I legally allowed to read and/or pass along the contents of their email messages?

A: Generally, the law favors the employer in matters of privacy when it involves use of the employer's equipment, such as computers and phones. Even when there is no written policy, a court would likely decide that the employee should not expect messages generated in the workplace to be regarded or protected as private. Even though there is a federal law protecting email messages from interception and disclosure, the law provides exceptions for the provider of that service, which is usually the employer. However, an employer that intercepts messages for non-business purposes may be liable to the employee for an invasion of privacy. Moreover, although the monitoring may be lawful, repeating or disclosing the message may not. Perhaps the best way to ensure that employee email messages can be lawfully read is for the employer to regularly and effectively communicate a documented policy to employees that makes clear the right of the employer to monitor email.

Q: Can I search my employee's desk or locker?

A: Only under certain circumstances. Employees of privately-owned companies are generally thought to have a reasonable expectation of privacy in their offices, desks and lockers, especially when employees are permitted to use their own locks. That right may be negated, however, if the employer has a written policy stating that such areas may be searched or if access to such areas is generally available to other employees or personnel. Public employees enjoy the benefit of the United States Constitution's Fourth Amendment prohibiting "unreasonable searches and seizures." Consequently, a public employer must go to greater lengths to justify a search. In certain circumstances, a public employer may need a warrant to conduct a search.

–by Gregory A. Gordillo of Gordillo & Gordillo LLC in Cleveland, and Maribeth Deavers, partner in the Columbus firm of Isaac Brant Ledman & Teetor, LLP.

Laws Govern Surreptitious Telephone and Video Tape Recording

Q: I recently learned that one of our vendors has regularly been tape recording telephone conversations with our purchasing department without our knowledge. Is that legal?

A: Yes. Ohio law allows telephone conversations to be tape recorded as long as one party to the conversation knows and consents to its being recorded. The law does not, however, allow the tape recording to be used for an improper purpose. For example, the vendor cannot use the tape recording to extort money or bribe your employees. Also, the vendor is not permitted to tape record a conversation between two other people without their permission.

Other states may have different consent requirements, so if the conversation involves people in more than one state, all parties' permission may be required before you can record.

Q: Do the same rules apply to cellular telephone conversations?

A: As with regular phone conversations, you can record any cellular phone conversation in which you participate as long as you do not use the recording for an improper purpose. Federal law, however, makes it a crime to intercept and/or publish a cellular phone conversation between other people without the consent of all parties to the conversation.

Q: What if people are having the conversation out in the open or in public?

A: Consent is not required for recording in-person conversations where the speaker doesn't have a reasonable expectation of privacy. For example, if two of your employees are talking openly about business information at a busy restaurant or on the sidewalk, a third party (like a reporter) could record their conversation without breaking Ohio law. This may be important to raise in employee training or employee handbooks, particularly where that individual may have access to sensitive business information.

Q: What about the police? Can they tap our phones?

A: Only if they have obtained a search warrant signed by a judge—or if you give them permission.

Q: Can we tape record our employees' telephone conversations at work without telling them?

A: The answer may depend on what the particular employee's job is, but, generally, employers cannot record their employees' telephone conversations without first letting them know they are going to do so. This may be a topic to cover in an employee handbook.

Q: What about videotaping our employees' activities in our building? Can we do that without telling them?

A: Again, it is always prudent to let your employees know that their activities at work may be recorded. You have to be careful not to videotape private activities of your employees; for example, you should not place cameras in the restrooms.

Q: All of that seems like a hassle. What's the harm if we record conversations or activities without following those guidelines?

A: Ohio law provides for both criminal and civil liability for interfering with people's privacy in this way. Illegally recording an in-person conversation or telephone communication is a felony offense. Outside of a criminal record, you could be exposed to some hefty costs in a civil suit. Anyone whose conversations have been recorded or disclosed in violation of the law can file a civil lawsuit to recover the greater of 1) actual damages, 2) $200 a day for each day of violation, or 3) $10,000 punitive damages, attorney's fees, court costs and any other relief that the judge considers appropriate.

–originally provided by Kenneth A. Zirm of the Cleveland law firm, Ulmer & Berne LLP, and supplemented by John C. Greiner and Amanda Penick of the Cincinnati law firm, Graydon Head & Ritchey LLP.

Protecting Against Sexual Harassment Lawsuits

Fifteen years ago, the U.S. Supreme Court issued two very important rulings on cases that offered employers all over the country a blueprint for protecting themselves against sexual harassment claims. These cases, one involving a Florida lifeguard whose supervisors touched her inappropriately and made offensive remarks and the other regarding a Chicago salesperson who refused a supervisor's unwelcome and threatening advances, are as valid and important today as they were when they were decided more than a decade ago.

Employers would be wise to revisit the high court's decisions in *Faragher v. City of Boca Raton* and *Burlington Industries v. Ellerth.* While the central issue in these cases involved vicarious liability of employers for sexual harassment by supervisors, the court used the decisions to clarify what constitutes sexual harassment and to outline what employers should do to defend against sexual harassment claims.

Specifically, in cases where no tangible employment action—such as discharge, demotion or undesirable reassignment—has occurred, the court said, an employer can defend itself by proving that:

- it exercised reasonable care to prevent sexual harassment;
- it promptly investigated and took prompt remedial action when harassment was found to have occurred;
- the plaintiff-employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise.

This affirmative defense, the court said, is not available for sexual harassment that culminates in a tangible employment action.

Faragher and *Burlington* offer practical advice. These and other court rulings and guidelines previously issued by the U.S. Equal Employment Opportunity Commission make the steps an employer should take to protect against lawsuits quite clear.

First, the employer should adopt a written policy prohibiting sexual harassment. While the Supreme Court seemed to suggest that employers with small workforces might not need them, all employers would be well advised to have formal policies. It is wise to make a sexual harassment policy part of a broader anti-harassment policy that also prohibits racial harassment and illegal discrimination generally. The policy should define harassment, clearly state that it is prohibited, set forth a complaint procedure, and make it unmistakably clear that persons properly using the policy will be protected against retaliation.

Second, the policy should be publicized to all employees. This includes posting the policy, including it in personnel manuals and training employees about the policy and how it will be enforced. To highlight its importance, an employer might periodically include a copy of the policy with employees' paychecks so no one can later claim he or she was unaware of it.

Third, the complaint procedure must not require that the complainant file his or her complaint with or have it handled at any stage by the accused harasser. Moreover, the complaint procedure must not be directly or indirectly controlled by the accused harasser.

Fourth, the complaint procedure must deal seriously with both the complaint and the complainant. Response must be prompt, but it must also allow the employer enough time to perform a serious investigation. When the allegations are serious enough, such as when the complainant feels physically threatened, the complaint procedure should allow some temporary remedy or protection while the employer conducts the investigation.

Fifth, the accused's rights should be fully respected, and he or she should be given full opportunity to prove or explain his or her actions.

Sixth, the complaint procedure should make it unmistakably clear that the employer will not tolerate retaliation against the individual making a good-faith complaint, even if the complaint is found to be without merit. The employer should, however, reserve the right to discipline employees making complaints they know to be false.

Finally, the employer should take disciplinary action that is appropriate for the circumstances and the complainant should be informed as to what action, if any, is taken. Appropriate corrective actions range from termination to a written warning or reprimand.

Throughout the process, the employer should keep the investigation as confidential as is reasonably possible—on a "need-to-know" basis. However, it usually is not possible to keep the investigation entirely confidential, and this should be made clear to the complainant.

At any stage of the investigation, the employer, if in doubt, would be wise to contact legal counsel. Sexual harassment is not only wrong, it can be extremely costly. Losing a lawsuit can easily cost six and possibly seven figures; winning it still costs a great deal more than avoiding it altogether. The money spent for a phone call reviewing the facts with counsel is far less than the cost of getting enmeshed in a lawsuit, win or lose.

–by Thomas H. Barnard, a shareholder with the Cleveland law firm of Ogletree Deakins Nash Smoak & Stewart PC. Reprinted by permission of Cleveland Enterprise.

The "Seven Habits" of Harassment-Free Companies

It seems like a no-brainer. Why would anyone in today's workplace sexually intimidate or harass a co-worker? It certainly could not happen at your business!

Your employees may not always agree with or approve of one another, but at least they treat each other with respect.

Right? It is until you overhear a racy joke, see an inappropriate email, watch a supervisor crowd a subordinate's space—perhaps even manhandle him or her—or hear through the grapevine that an employee will not take another's "no" as final. Then you start to get a bit nervous. How liable is your company for the sexual harassment actions of your employees? As an employer, you can defend yourself in a lawsuit by proving that:

- you exercised reasonable care to prevent and correct any sexually harassing behavior;
- you promptly investigated any complaints of sexual harassment and took remedial action;
- the complainant unreasonably failed to take advantage of any preventative or corrective opportunities provided by the employer.

With apologies to Stephen Covey, here are seven "habits" you, as an employer, should develop to protect your company against sexual harassment:

1) **Write it down.** Adopt a written policy prohibiting sexual harassment. The policy should define harassment, clearly state that it is prohibited, set forth a complaint procedure, and make it clear that persons properly following the policy will be protected against retaliation.
2) **Pass it around.** Post the policy, include it in personnel manuals and train employees about the policy and how it will be enforced. Periodically distribute a copy of the policy with employees' paychecks so no one can later claim he or she was unaware of it.
3) **Protect the accuser.** Make sure that an employee can file a complaint without it being handled by the accused harasser. The complaint procedure must not be directly or indirectly controlled by the accused.
4) **Protect the accused.** The accused's rights should be fully respected, and he or she should be given the opportunity to prove or explain his or her actions.
5) **Take complaints seriously.** Your response must be prompt, but give yourself enough time to thoroughly investigate. When the complainant feels physically threatened, he or she should be protected while the investigation is being conducted.
6) **No retaliation.** The complaint procedure should make it clear that there will be no retaliation against the individual making a good-faith complaint, even if the complaint is found to be without merit. The employer should, however, reserve the right to discipline employees knowingly making false complaints.
7) **Give it teeth.** You must take appropriate disciplinary action for the circumstances and the complainant should be informed as to what action, if any, will be taken. This might range from a written warning or reprimand to termination.

Throughout the process, keep the investigation as confidential as is reasonably possible—on a "need to know" basis. Your attorney can probably provide additional assistance that will help you avoid a lawsuit.

–by Thomas H. Barnard, a shareholder with the Cleveland law firm of Ogletree Deakins Nash Smoak & Stewart PC and former chair of the OSBA's Labor and Employment Law Section.

Plan for Potential Strike When Negotiating in Collective Bargaining

In general, people are the most essential resource for businesses. Personnel costs usually account for a significant portion of a business's expenses, so there can be a lot at stake when a business negotiates a collective bargaining agreement with a union for its employees. While all participants expect an amicable resolution in collective bargaining, that does not always happen. Businesses need to plan for a potential strike early in the negotiation process. The following are some issues to consider in strike planning:

- Prioritize the functions of the business. Determine which matters must continue to be addressed and which functions can be temporarily tabled. Keep in mind that the first few days of a strike are the most difficult.
- Assign managers to handle core business functions.
- Prepare a letter to be sent to employees in the event of a strike, reminding them that they will receive no pay and benefits if they are on strike. This letter should explain the cost they will incur for health insurance, if applicable.
- Inform employees that they do not have to strike even if fellow employees choose to do so. Employees have the right to engage or refrain from engaging in strike activities. Make arrangements for employees and managers to arrive safely at work during a strike.
- Communicate with customers.
- Arrange for workplace security. Contract with a security firm if necessary. Make sure that law enforcement personnel are aware of the situation. Prepare to collect keys and to change locks and security codes if necessary. Take steps to ensure that employees' access to computers is limited if a strike appears imminent. Have duplicate keys to facilities and vehicles. Maintain backup data from computers at an off-site location.
- Prepare to address media inquiries. There should be one spokesperson for the business.
- Make suppliers and contractors aware of the strike. Make arrangements to ensure that deliveries will continue.
- Maintain a line of communication with union representatives.
- Be prepared to seek an injunction to limit the location and number of pickets.
- Determine sources of workers to fill in during the strike. Make arrangements to train replacement workers, if necessary.
- Make sure managers understand the law's limitations. Employer representatives should refrain from making any unlawful threat during negotiations or a strike.

It is rare that either unions or employers want a strike, but it is always a possibility when employees engage in collective bargaining. Obviously, strikes can be very disruptive, but an employer can discourage a strike or minimize its impact if preparations for a work stoppage are made before a strike is imminent.

–by Marc A. Fishel, a partner in the Columbus law firm of Downes Fishel Hass Kim LLP.

Members of the Military Have Civilian Job Protections

As thousands of military reservists are called to active duty, they will leave their civilian jobs for months or even years. A 1994 law called the Uniformed Services Employment and Reemployment Rights Act (USERRA) applies to virtually all employers and gives reservists and other service members a wide range of job protections. Active duty, reserve duty, and required training activities in all branches of the armed forces are covered, even if the employees volunteered for duty.

Q: What obligations does USERRA impose on employers?

A: Employers must allow leaves of absence for military service, up to a cumulative total of five years for each employee. USERRA does not require paid leave, but employees can maintain their existing health care coverage for up to two years. If the military leave lasts more than 31 days, employers can shift 102 percent of the health care premium to the employee (like COBRA benefits). For shorter absences, the allocation of health care costs cannot be changed.

Pension plans and a wide range of other employee benefits also are covered by USERRA. For example, military leave time counts toward eligibility for benefits under the Family and Medical Leave Act (FMLA), according to applicable regulations.

When the military service ends, employers must provide prompt re-employment to employees who are honorably discharged. Narrow exceptions exist if re-employment is impossible, unreasonable, or would cause undue hardship to the employer.

Q: What is the "escalator principle"?

A: After World War II, the United States Supreme Court ruled that a returning soldier "does not step back on the seniority escalator at the point he stepped off. He steps back on at the precise point he would have occupied had he kept his position continuously during the war." This principle is incorporated into USERRA.

Thus, where it is reasonably certain that an employee would have been promoted if not for his or her military leave, the employer may have to award that promotion (or another job with similar pay and status) when the employee comes back. Employers also must provide training for employees who are unqualified for the "escalator position."

The escalator principle does not always require a promotion, however. If an employee on military leave would have been laid off along with other employees, the regulations allow reinstatement to layoff status.

Q: What are the potential penalties for violations of USERRA?

A: USERRA can be enforced through individual lawsuits. The Veterans' Employment and Training Service (known as VETS), which is part of the Department of Labor, also investigates USERRA complaints by employees.

For proven violations, employers may have to reimburse employees for lost pay and benefits. These damages can be doubled if the violation was willful. Additionally, employers may be required to pay an employee's reasonable attorney fees and other litigation expenses.

–by Justin D. Flamm, a partner in the Cincinnati office of Taft, Stettinius & Hollister LLP.

Accommodating Religion in the Workplace

Religion permeates our society, and the workplace is no exception. Under the same laws that prohibit race and sex discrimination, employers cannot hire, fire, or discipline based on an employee's religion. When faith conflicts with work, however, employers can face challenging decisions.

Worship services and prohibitions of Sabbath work can cause scheduling problems. Likewise, religious beliefs may clash with certain job duties. In one case, a convenience store manager's religion prohibited her from selling pornographic magazines that the store carried. Another employer faced a lawsuit over its directive that an employee stop telling customers to "have a blessed day."

Federal and Ohio laws require reasonable accommodations for religious practices and beliefs. Employees are not always entitled to the accommodation of their choice, however, and a court may find an accommodation to be "reasonable" even though the employee is unhappy with it. Accommodations are never required if they would cause the employer "undue hardship." This exception is not overly demanding; anything more than a minimal cost usually constitutes undue hardship.

Potential accommodations include revising work schedules, trading shifts with other employees, and reassigning objectionable job duties. If those efforts would increase the employer's overtime expenses or would prevent projects from being completed, the undue hardship exception may apply. For unionized employers, seniority provisions in a labor contract usually trump an inconsistent request for accommodation.

An employer's skepticism about the validity of a particular organized religion or religious belief seldom changes the legal analysis. Because faith is such a personal matter, courts rarely pass judgment on sincerely held beliefs. The legal definition of "religion" is broad, and it extends far beyond mainstream churches. In one extreme example, a court ruled that a white supremacist group was a religion under federal law.

The *employer's* religion also may cause conflict. Several companies have been hit with large verdicts for trying to impose management's religious beliefs on employees with different beliefs (or no beliefs at all). An exception exists for religious organizations, such as a parochial school that considers religion when hiring teachers.

Reasonableness and undue hardship are fact-sensitive legal standards, so an employer receiving a request for religious accommodation should consider ways to resolve the employee's conflict. Although religious practice may yield to business necessity in many cases, employers should consult with counsel before rejecting an accommodation.

–by Justin D. Flamm, a partner in the Cincinnati office of Taft, Stettinius & Hollister LLP.

Accountable Business Expense Reimbursement Plans

Most employers do not expect employees to cover business expenses. Typically, employers will reimburse employees for business expenses. However, there are important tax issues to consider based on whether the reimbursement arrangement is an *accountable plan* or *non-accountable plan*.

To be an accountable plan, an employer's reimbursement arrangement must require the following:

1) Expenses must have a business connection and must be incurred while performing services as an employee of the employer.
2) The employee must adequately account to the employer for the expenses within a reasonable period of time.
3) Any excess reimbursement or allowance must be returned to the employer within a reasonable period of time.

To "adequately account" for expenses, an employee must give the employer a written record. The employee must record each expense at or near the time it was incurred. The employee also must provide evidence of the business expense (such as receipts, cancelled checks, and bills).

The definition of "reasonable period of time" depends on the facts and circumstances of the situation. The IRS has issued safe harbors treating certain actions as taking place within a reasonable period of time (*i.e*., adequately accounting for an expense within 60 days).

If an employer's reimbursement arrangement is an accountable plan, the employer should include the reimbursements in Box #12 of the Form W-2. If the employer does this, the employee will not have to pay income or employment taxes. Furthermore, the employer will not have to pay employment taxes on the reimbursed amount.

A non-accountable plan is a reimbursement or expense allowance arrangement that does not meet all three requirements of an accountable plan. Any reimbursement paid to any employee under a non-accountable plan must be reported in Box #1 of the employee's Form W-2 as taxable wages. The employer must withhold income taxes and employment taxes for reimbursements made under a non-accountable plan. Furthermore, the employer must pay the employer's portion of payroll taxes on those amounts.

Reimbursing employees for business expenses under an accountable plan is better for both employers and employees from a tax perspective than reimbursing employees under a non-accountable plan. An employer's properly adopted and memorialized (*e.g*., through minutes) employee expense reimbursement accountable plan allows employees to avoid income and employment taxes on reimbursements and allows the employer to be exempted from its portion of employment taxes.

–by Jason A. Rothman, an attorney with the Cleveland office of Ogletree, Deakins, Nash, Smoak & Stewart, P.C.

Auditing Your Employee Benefits

Providing employee benefits to employees and retirees is critical to the success of any company. While employee benefits are necessary to attract and retain strong employees, they are also one of the fastest growing elements of a company's cost structure. Here are some points you should consider to maximize benefits while reducing costs.

All Plans

1) **Review and update your plan documents.** Make certain that your plans are regularly updated to remain compliant with the Employee Retirement Income Security Act (ERISA), the Internal Revenue Code, the Health Insurance Portability and Accountability Act (HIPAA) and other federal laws that apply to benefit plans. Even non-mandated documents, such as investment policy statements, should be reviewed and updated at least annually.

2) **Review and follow your plans.** If you are an employer, read your plan at least annually to determine whether the benefit provided is worth the cost. If you are a trustee or other fiduciary, read the plan documents so you know what the plans provide; only based on this type of review can you administer a plan properly.

Pension Benefits

1) **Consider whether you wish to maintain a traditional defined benefit plan versus a 401(k) plan.** Few companies offer traditional defined benefit pensions to employees because the employer bears ongoing cost risks. Most companies offer 401(k) plans to allow employees to prepare for retirement. A 401(k) plan allows an employer to fix its cost, while the employee bears the gains and losses. The employee benefits from a 401(k) account by having a readily portable benefit when moving to a new job. Finally, even if you are considering keeping a defined benefit plan, consider whether you wish to convert to a cash balance plan that may allow you to fix your costs. The risks of converting to a cash balance plan have been eliminated by amendments to ERISA.

Health Benefits

1) **The Patient Protection and Affordable Care Act (PPACA) has changed the world.** Review your health plan to determine what you need to do to comply with the changes mandated by PPACA, the bulk of which will be noticed in 2014 and many of which need to be anticipated now. In particular, consider how changes to benefits will impact "grandfathered" status.

2) **Shop for health benefits.** Employers need to "shop the market" to reduce costs to employers and employees. The fees charged for managing self-insured plans will need to be weighed against the costs of buying insurance. Using consultants or participating in chamber-sponsored plans can help employers to obtain better benefits at lower costs. Before deciding to opt out of PPACA and pay the resulting PPACA penalties, you should check with a consultant to review risks.

3) **Structure plans to address health benefit cost increases.** Health care costs have generally risen faster than inflation. Employers should consider avoiding open-ended promises of providing health care "for life," either in individual employment agreements or in collective bargaining. Such promises can result in unsustainable cost structures.

Instead, employers should consider retaining the right to “modify, amend or terminate” benefit plans.

4) **Consider coordinating retiree health costs with Medicare.** When providing retiree health benefits, employers should consider coordinating benefits with Medicare. The Equal Employment Opportunity Commission recently ruled that this practice is not age discriminatory. Employers can transfer health costs for age 65 and older retirees to the federal government while providing benefits to younger retirees. Such coordination is not available, however, for active employees.

Keep in mind that, although employee benefits involve substantial costs, they are critical to most employees. Controlling and monitoring costs will benefit both you and your employees.

–by Jack F. Fuchs, a partner in the Cincinnati office of Thompson Hine LLP.

Workers' Compensation

Chapter 9

Workers' Compensation: Basics of Coverage

Q: Who are covered "employers" for purposes of workers' compensation?

A: The workers' compensation statutes define *employer* broadly to include every person, firm or corporation which employs one or more employees under a contract of hire, whether that contract is oral or written. All such employers are required to obtain workers' compensation coverage. An application for coverage may be obtained from any local Bureau of Workers' Compensation (BWC) service office, or through the Ohio BWC website, www.ohiobwc.com.

Q: Who are covered "employees" for purposes of workers' compensation?

A: "Employees" are equally broadly defined to include any person in the service of any person, firm or corporation. An *employee* for workers' compensation purposes also includes household workers who earn $160 or more in any calendar quarter.

Q: Are independent contractors "employees" for workers' compensation purposes?

A: No. Independent contractors are responsible for obtaining their own workers' compensation coverage. An employer must be careful, however, to ensure that persons performing work for them are truly independent contractors before relying upon this exception. Generally, the question of whether someone is an independent contractor involves a case-by-case determination focusing on which party had the right to direct and control the work (*i.e.*, manner/details of work, hours of employment, method of payment).

Q: What insurance is required? What is available (e.g., private carriers, state fund, assigned risk pools, etc.)?

A: Ohio is a *monopoly* state, meaning that private insurance is not permitted for workers' compensation. All employers must either participate in the state insurance fund or be self-insured. The privilege of self-insurance is restricted to employers having more than 500 employees, who have done business in Ohio for more than two years, and who can demonstrate to the administrator of the BWC that they have sufficient financial wherewithal to satisfy and pay workers' compensation costs directly.

Q: Is group rating available?

A: State Fund employers do have the option of participating in workers' compensation group rating programs which, in many cases, will substantially decrease their workers' compensation costs. Such groups consist of at least 100 members engaged in similarly conducted businesses, which participate in group rating in order to increase their aggregate payroll and take advantage of rate reductions (workers' compensation premiums are based upon a percentage of the employer's payroll).

Q: What are some of the risks of non-coverage?

A: In general, employers who comply with the law by paying workers' compensation premiums are not liable for damages for any injuries sustained by an employee on the job. If the employer has not obtained coverage, however, this broad immunity does not apply, and the employer may be sued in a civil action for negligence. Moreover, certain potential common law defenses are denied to non-complying employers. Last but not least, non-complying employers are subject to charges by the BWC for the full costs of any claims which are filed, together with back premiums and penalties.

–by Brian P. Perry, an attorney with the Cincinnati firm of Dinsmore & Shohl, LLP, where he represents employers in workers' compensation and related matters.

Workers' Compensation: Basics of Litigation and Benefits

Q: What is the litigation process for a contested workers' compensation claim?

A: Once a claim is filed, the initial determination is made by a Bureau of Workers' Compensation (BWC) claims representative or, in the case of a self-insured employer, by the employer. The BWC claims representative will review all the information submitted and issue a tentative order either allowing or disallowing the claim. If either the injured worker (claimant) or the employer disagrees with the BWC decision, each may file an appeal, which will result in a hearing before a hearing officer of the Industrial Commission of Ohio.

Once at the Industrial Commission, a series of up to three hearings may be held, depending upon whether either party files a further appeal. Industrial Commission hearings are informal, and the rules of evidence (rules followed in a formal court of law) do not apply. After the Industrial Commission has issued its final decision, both the claimant and the employer have the right to file an appeal to the court of common pleas. Once before the court of common pleas, the rules of evidence apply, and a decision is made to allow or disallow the claim by either a judge or a jury (if either party demands a jury), without reference to the prior administrative decision.

Q: Assuming that the claim is allowed, how long must an employee be off work before he or she will receive temporary total disability compensation?

A: No compensation is paid for the first week after an injury, unless the employee is totally disabled for a period of at least two weeks, at which time compensation will be paid retroactive to the first day of disability.

Q: What is the basis for calculating an award of temporary total compensation?

A: An employee receives compensation based upon a percentage (generally 66 $^{2}/_{3}$ percent) of his or her prior weekly earnings. For 2013 injuries, the maximum rate for temporary total compensation is $827 per week.

Q: How long can temporary total compensation be received?

A: As long as the claimant's condition remains temporary, temporary total compensation can continue indefinitely. Temporary total compensation can be terminated, however, based upon any of the following circumstances: 1) where the employee returns to work; 2) where the employee's treating physician releases the employee to return to work; 3) when work within the physical capabilities of the employee is made available by the employer or another employer (*e.g.*, a light-duty offer); and 4) where the claimant's treating physician and/or an Industrial Commission hearing officer finds that the claimant has reached maximum medical improvement (MMI).

Q: Other than temporary total compensation, what other sorts of compensation benefits are available?

A: Twenty-six weeks after he or she receives the last payment of temporary total compensation, an employee may be eligible for a *permanent partial award*, calculated based upon a percentage of bodily impairment assessed by a physician under the American Medical Association (AMA) guidelines. If, due to his or her industrial injury, an employee either cannot find work within his or her restrictions, or is required to accept work at a lesser rate of pay, the claimant may be entitled to wage loss compensation payable at 66 $^{2}/_{3}$ percent of the difference, subject to a statutory maximum. If an injury has resulted in the loss of—or in the loss of use of—a body part, the claimant is entitled to a scheduled award, payable at the maximum rate for a specified number of weeks, depending upon the body part affected. If the claimant is rendered permanently and totally disabled from continued employment as a result of the industrial injury, he or she will be entitled to permanent total disability benefits, payable for the remainder of his or her life. Finally, where an employee dies as the result of a work-related injury or occupational disease, his or her dependents may be eligible to recover death benefits, as well as statutory funeral expense.

Q: Can a workers' compensation claim be settled?

A: Yes. Claims involving self-insured employers may be settled by agreement of the parties, subject to approval by the Industrial Commission. Where a State Fund employer is involved, the injured worker may apply for a settlement of the claim through the BWC, generally subject to the approval of the employer. Once a full and final settlement has been entered into, the entire claim is closed, including future medical benefits.

–by Brian P. Perry, an attorney with the Cincinnati firm of Dinsmore & Shohl, LLP, where he represents employers in workers' compensation and related matters.

Workers' Compensation: When Is an Injury or Disease Compensable?

Q: What is an "injury" for workers' compensation purposes?

A: In general, *injury* includes any injury received in the course of, and arising out of, the injured employees' employment. However, the workers' compensation statute specifically provides that *injury* does not include:

1) psychiatric conditions, *except* where the condition has arisen from an injury or occupational disease;
2) injury or disability caused primarily by the natural deterioration of tissue, an organ or part of the body; or
3) an injury or disability incurred when an employee is participating *voluntarily* in an employer-sponsored recreation or fitness activity, *provided* that the employee has signed a waiver of compensation for injuries sustained in such activities.

Q: What are some other potential defenses to workers' compensation claims?

A: Several circumstances may preclude compensation for an injury, even where the injury may have occurred on the employers' premises. These potential defenses include the following:

1) *Purposely self-inflicted injuries*;
2) *Intoxication*;
3) *Horseplay and fighting*: Injuries sustained as a result of horseplay or fighting are not compensable where the injured employee instigated or participated in the horseplay or instigated the fight.

Q: Are injuries sustained during work-related travel compensable?

A: The compensability of a travel-related injury depends on the nature of the travel involved. Under the so-called *going and coming* rule, where an employee has a fixed place of employment, an injury sustained while traveling to or from that place of employment is not compensable. However, where travel is an integral part of the employment, and creates a risk greater than the typical commute, an injury sustained during the travel will be compensable (*e.g.*, a traveling salesperson with no fixed place of employment).

Q: What about injuries in other common employment situations?

A: Based on the case law that has developed over the years, the following rules exist concerning the compensability of injuries occurring in other common situations:

1) *Parking lot injuries*: The going and coming rule ends once the employee reaches the employer's premises. Thus, where an injury occurs in a parking lot owned or controlled by the employer, it will generally be compensable. Where the lot is not owned or controlled by the employer, however, this rule will not apply.
2) *Lunch hour and break time injuries*: In general, injuries occurring on the employer's premises are compensable. This rule of compensability extends to injuries sustained while an employee is on a lunch break or other break authorized by the employer. An injury sustained off-premises on a lunch hour, however, is generally not compensable, whether the break is paid or unpaid.

Q: Are stress-related conditions compensable?

A: Recall that purely psychological conditions are not compensable unless they arise from a work-related injury. Thus, a mental condition caused by work-related stress is not compensable. *Physical* conditions caused by work-related stress are treated differently. Where work-related stress causes a physical injury (*e.g*., a stress-related heart attack), the injury will be compensable where it is shown that the employee was subject to pressures greater than those occasionally experienced in most types of employment.

Q: Is the aggravation of a pre-existing injury compensable?

A: In general, the “substantial” aggravation of a pre-existing condition is a compensable injury for workers’ compensation purposes. Such an aggravation must generally be proven by objective diagnostic studies or clinical findings.

Q: What is an “occupational disease”?

A: An occupational disease is defined under the Workers’ Compensation Act as a disease contracted in the course of employment, wherein the nature of the employment puts an employee at risk of contracting the disease to a greater degree and in a different manner than would be true of a member of the general public. A common occupational disease is carpal tunnel syndrome, caused by overuse of the hands in a job that requires extensive manipulative use of the hands.

Q: Is the aggravation of a pre-existing disease compensable?

A: No. Unlike the aggravation of a pre-existing injury, the aggravation of a pre-existing disease condition is not compensable, since the statute requires that the disease be contracted in the course of the employment in order to be compensable.

–by Brian P. Perry, an attorney with the Cincinnati firm of Dinsmore & Shohl, LLP, where he represents employers in workers’ compensation and related matters.

Workers' Compensation: Related Issues

Q: Are there any penalties against the employer for unsafe working conditions?

A: Yes. Where an employee is injured as a result of the employer's failure to comply with a specific safety requirement, the employee is eligible for an additional award amounting to 15 percent to 50 percent (depending upon the circumstances) of the maximum compensation payable for the life of the claim. Such awards are commonly referred to as "VSSR" (*violation of specific safety requirement*) awards, and are charged directly to the employer.

Q: What is a specific safety requirement?

A: A VSSR award may be paid based upon the violation of a safety statute or administrative regulation. The specific safety requirements of the Industrial Commission are printed in the *Ohio Administrative Code*. There are specific safety requirements for each of the following categories: workshops and factories; elevators; metal casting; steel mills; laundering and dry cleaning; rubber and plastic industries; window cleaning; and construction.

Q: Are there any other exceptions to the broad immunity provided to employers who possess workers' compensation coverage?

A: Unlike actions based on a theory of negligence, the immunity from liability provided to employers having workers' compensation coverage does not extend to so-called *employment-intentional torts*.

Q: What is an "employment-intentional tort"?

A: Unlike negligence, an employer is not immune from liability where that employer has intentionally injured an employee. However, in order to recover under such a theory, the plaintiff must prove that the employer acted with deliberate intent to injure the employee, or with knowledge that an injury was substantially certain to occur.

Q: Is there a workers' compensation discrimination statute?

A: Yes. No employer may discharge, demote, reassign, or take any punitive action against an employee because the employee filed a workers' compensation claim or testified in a workers' compensation proceeding. If successful in a civil suit, the employee is entitled to be reinstated in his or her position with back pay and/or lost wages, plus attorneys' fees.

Q: What happens when a third party's negligence causes the injury?

A: Where an employee recovers workers' compensation benefits as a result of injuries sustained due to the negligence of fault of a third party, a right of *subrogation* exists. This right entitles the self-insured employer (or the BWC administrator on behalf of the State Fund employer) to recover a share of the amounts of workers' compensation benefits paid from monies received by the claimant from the third party at fault (minus costs and attorneys' fees). Subrogation rights exist under the current statute even when the injured employee does not file a lawsuit against the third party, but instead, for example, enters into a settlement. The statute places upon the injured worker the burden of notifying the employer/administrator of potential third parties from whom the injured worker might seek compensation. Moreover, no settlement or award can be final unless the employee has provided the employer or BWC administrator with appropriate notice and an opportunity to assert its subrogation rights.

–by Brian P. Perry, an attorney with the Cincinnati firm of Dinsmore & Shohl, LLP, where he represents employers in workers' compensation and related matters.

Ohio Workers' Compensation System Addresses Needs of Injured Employees

Q. How does workers' compensation address injured employees' income loss?

A: Instead of lump sum payments such as might be awarded in lawsuits, your injured workers receive indemnity benefits to address their particular losses. Generally, weekly indemnity benefits are paid as a percentage of the injured worker's average earnings (usually two-thirds) subject to a maximum weekly rate. Various forms of compensation available in Ohio address the different losses that might result from an injury over the life of a claim.

For example, an injured worker who is temporarily unable to return to work receives temporary total disability compensation. An injured worker who cannot return to his/her regular job, but returns to a lower paying job, can receive "wage loss compensation" that may be paid for more than four years at two-thirds of the difference between pre-injury and post-injury earnings.

Vocational rehabilitation costs may be paid under the workers' compensation system to an injured worker who must acquire new skills to return to the work force. The injured worker receives a weekly stipend while participating in rehabilitation. If, after completing rehabilitation, the employee must take a lower paying job, he or she may be eligible for another form of wage loss compensation. For most employers, the costs for rehabilitation are paid by the workers' compensation system.

An injured worker who is permanently removed from the work force because of an injury may be entitled to permanent total disability compensation. This is a lifetime benefit paid when an injured worker can no longer perform any form of sustained, remunerative employment. When an injured worker dies as a result of the work-related event, the surviving spouse would receive compensation for life or until remarriage. Any children would receive benefits until they reach age of majority.

Finally, a benefit that is unrelated to economic loss, called permanent partial disability compensation, compensates the injured worker for impairment to, or loss of, a body part.

Q. Are medical costs paid for in a workers' compensation claim?

A: Yes. Subject to schedules, medical benefits are paid on behalf of the injured worker to healthcare providers. There is no co-pay and no balance billing is permitted.

Q. How long does workers' compensation protection last?

A: The Ohio system is designed to protect the injured worker for as long as reasonably necessary. A claim remains "open" for five years from the last payment of compensation or benefits.

Q. Can an injured worker settle a claim?

A: Yes. In Ohio, claims may be settled in whole or in part. The workers' compensation system is funded entirely by employer money, so an employer has a say as to whether a claim may be settled. Many employers choose not to agree to a settlement because they have already purchased years of valuable protection for their injured workers through premiums paid to the State Insurance Fund.

–by Robert A. Minor, an attorney and principal with the Columbus office of Vorys, Sater, Seymour and Pease LLP.

Employers Should Understand Limits on the Use of Non-Lawyers in Workers' Compensation Claims and Other Areas of the Law

Employers should carefully consider when utilizing non-lawyers (usually third-party administrators) to represent their interests in workers' compensation administrative hearings. Non-lawyers have restriction on their activities while representing an employer, and failure to recognize and comply with these restrictions may be considered the unauthorized practice of law in Ohio. Unauthorized practice of law is defined as "the rendering of legal service for another by any person not admitted to practice law in Ohio." Gov. Bar. VII (2)(A). The Supreme Court of Ohio has limited the practice of law to licensed attorneys "… to protect the public against incompetence, divided loyalties, and other attendant evils that are often associated with unskilled representation.[2]"

The Supreme Court of Ohio has held that there are limitations on non-lawyers in administrative hearings in *Cleveland Bar Assn. v. CompManagement, Inc.* (2006) 111 Ohio St. 3d 444, 2006-Ohio-6108. In this case, a third-party administrator's employees were appearing at administrative hearings and representing employers in defense of their workers' compensation claims. Allegations were brought by the Cleveland Bar Association that this activity represented the unauthorized practice of law by non-lawyers. Specifically, the Court held that:

1) Allegations of acts of unauthorized practice of law must be supported by either admission or other evidence of specific act(s) or conduct.

2) Third-party administrators may:
    a) make actuarial determinations regarding settlement;
    b) act as a messenger for the employer with regard to settlement issues;
    c) file settlement documents; and
    d) communicate to the hearing officer the employer's area(s) of concern relating to a particular claim.

3) Third-party administrators may NOT:
    a) conduct an examination of a witness or comment on credibility of a witness;
    b) make or give any legal interpretation or comment about evidence;
    c) give legal opinions or advice; and
    d) provide representation for a fee at a workers' compensation hearing without providing other services.

In response to the Supreme Court of Ohio's decision, the Ohio Industrial Commission adopted the Resolution Standards of Conduct in R04-1-01, which outlines prohibitive activities of non-lawyers when appearing before the Industrial Commission or Bureau of Workers' Compensation. These Standards of Conduct preclude the following activity by non-lawyers:

1) To examine or cross-examine any witness, including the claimant;
2) To cite, file or interpret a statute, law, or administrative provisions or rulings;

[2] *Cleveland Bar Assn. v. CompManagement Inc*. (2004) 104 Oho St. 3d 168, 2004-Ohio-6506.

3) To make and give legal interpretations with respect to testimony, affidavits and medical evidence in the form of reports or testimony, or file any brief, memorandum, reconsideration or other pleading beyond the forms actually provided by the Commission or Bureau;
4) To comment on or give opinions with respect to the evidence or credibility of witnesses, the nature and weight of the evidence, or the legal significance of the contents of the claim file;
5) To provide legal advice to anyone including employers;
6) To give or render legal opinions, or cite case law or statutes to anyone including employers before, at or after the time when claims are initially certified or denied certification as valid claims by the employer upon presentation of claim applications by employees; or
7) To provide stand-alone representation at a hearing by charging a fee specifically associated with such hearing representation without providing other services.

Basically, a non-lawyer can not act in any manner like an attorney when appearing before the Industrial Commission. Non-lawyers can offer general claims assistance as long as that assistance does not involve legal analysis skill or legal advocacy that includes examination of claimant or witnesses, arguing reliability of evidence or defense of claims or medical records.

In addition to workers' compensation matters, licensed counsel must represent a corporation in judicial proceedings.

Non-lawyers may have limited representation of employers in matters before the Unemployment Compensation Board of Review Commission and the Ohio Department of Job and Family Services. Non-lawyers are also permitted to prepare and file complaints with the county board of revision.

In conclusion, non-lawyers in workers' compensation proceedings have limits on their activities and abilities to represent an employer. If an employer is faced with a workers' compensation claim that involves witnesses, legal arguments, or a dispute over evidence, that employer should retain the services of a licensed attorney. Likewise, an employer who has been named in a lawsuit must retain an attorney to represent the company.

–by Cathryn R. Ensign, attorney and owner of Cathryn R. Ensign, LLC.

Workers’ Compensation Drug and Alcohol Testing Law

Effective October 12, 2004, Ohio law establishes a *rebuttable presumption* against an employee who makes a workers’ compensation claim if he/she either tests positive for alcohol or drugs or refuses to be tested. A rebuttable presumption is a legal conclusion that is thought to be valid until evidence to the contrary is provided. In lay terms, this means that, if an employee tests positive or refuses to be tested for alcohol or drugs following a work-related accident, the employer may be able to prove that drug or alcohol use contributed to or caused the employee’s injury. The employer could thereby avoid the costs of such a claim.

In order for employers to take advantage of this law, a notice of the rebuttable presumption *must be posted* in their place of business. The notice must be the same size or larger than the Bureau of Workers’ Compensation (BWC) compliance certificate that must be posted, and it must be in the same location as the current BWC postings. A copy of the required notice may be downloaded and printed from the BWC’s website at www.ohiobwc.com.

While the law does not require businesses to implement drug testing, it is a very effective method of reducing an employer’s exposure from a costly claim for injuries or death where the employee was under the influence of drugs or alcohol at the time of a workplace accident.

Be advised, however, that the posting of the BWC notice of this law is only the starting point. The rebuttable presumption is effective after a workplace injury only if specific steps are taken within a certain amount of time after the injury occurs. If alcohol is suspected as a cause of the accident, a “qualifying” test must be given within eight hours of the injury. If non-prescribed drugs are suspected, the qualifying test must be given within 32 hours of the injury. If the injured employee refuses to take a test, and assuming the required notice has been posted, the employee’s refusal triggers the rebuttable presumption. Note, however, that in order to trigger the presumption, the test must be offered within the timeframes mentioned above.

Employers must address many other issues and requirements if they wish to take full advantage of the law. For example, unless a police officer or a doctor requests the drug or alcohol test, an employer must have “reasonable cause” to believe the injured employee was under the influence of alcohol or drugs at the time of the accident. Otherwise, the test may not qualify under the law. Therefore, the employer will need to collect evidence to show that the test was justified. Direct evidence of possession, consumption or distribution may be available, but employers also will need to train supervisors to collect evidence in the form of their own observations and records, witness statements and other evidence that can confirm symptoms, behavior, patterns of conduct, attendance, work and safety rules violations, and the like. For example, two witnesses smelling alcohol on an employee’s breath meets the reasonable cause to test requirement.

For further information regarding these issues, the BWC has a very informative and useful website at www.ohiobwc.com.

–by James D. (Chip) Viets, Of Counsel, and James M. Vonau, partner, Decker, Vonau, LLC.

Protecting the Business When an Employee Is Injured on the Job

Small businesses usually avoid significant experience with the Ohio Bureau of Workers' Compensation (Ohio BWC). However, when an employee is injured on the job, all employers must know how to proceed.

What must our business do if an employee is injured on the job?
Individual situations may be simple or complicated, but there are several things every employer should do regardless of the circumstances:

- Designate a person to meet with the injured employee as soon as practicable. This meeting may be held at any location convenient for the employee and the person you have designated to represent your business. The designated person should thoroughly investigate, getting all details in writing from the employee, including the names of witnesses and when, where and how the injury occurred. Witnesses should also be interviewed and provide their statements in writing. Written, signed statements guard against forgotten or changed stories.
- During this initial meeting, you should also ask the employee to sign a medical authorization form. This form is available on the Ohio BWC's website (www. ohiobwc.com). The signed authorization will allow you to communicate with the employee's doctor and to keep updated on the employee's medical progress.
- Determine whether the injury arose within the course and scope of employment. An employee may participate in the workers' compensation system if he or she is injured within the course and scope of employment, regardless of fault. However, you may dispute the employee's assertion that the injury arose within the course and scope of employment. An employee may not be eligible for benefits if the injury was a result of the employee's own medical condition, intoxication, etc. Before making this determination, it is wise to consult with an attorney.

How do we contest a claim?
If you decide to contest an injured employee's claim for workers' compensation benefits, you should contact an attorney or your third-party administrator. However, understand that an attorney can advise you about having an independent physician evaluate the injured employee and potential legal issues. The attorney can also question the employee and witnesses on your behalf during workers' compensation hearings, and can make legal arguments.

How should we treat our continuing relationship with an injured employee?
If the injured employee is capable of performing some work but has some physician-imposed restrictions, you might consider assigning temporary light-duty work. Even without a signed medical authorization, you can ask a treating physician if the employee can perform light-duty responsibilities. Before assigning an employee to a light-duty position, however, you should get approval from the employee's physician.

If an employee is completely off work due to an at-work injury, a supervisor should stay in touch with the employee at home concerning recovery and work status. Employees are more likely to stay at home longer if they are not communicating with the employer. The goal is to get the employee back on the job as soon and as safely possible.

If the employee will be totally disabled for an extended period of time, you may consider entering into a wage continuation agreement. In this agreement, you agree to continue paying the employee's wages to avoid having the employee seek compensation through the workers' compensation system. You should consult with an attorney before offering a wage continuation agreement to ensure that legal requirements are met and that the employer's interests are protected.

–by Stacy V. Pollock, an attorney with the Columbus law firm of Downes Fishel Hass Kim LLP.

Can Wellness Programs Help Limit Workers' Compensation Costs?

Employers large and small are adopting employee wellness programs to help manage health care costs and reduce on-the-job injuries and absenteeism. But an employer still must take employees as they are and can do little if an employee is generally not in good health.

Three recent court rulings demonstrate novel ways in which an unhealthy worker can impact an employer's workers' compensation cost.

In July 2008, the Oregon Supreme Court ruled that an obese worker's gastric bypass surgery was covered under workers' compensation because the procedure was necessary to treat a job-related knee injury. The employee originally injured his knee in 1976 and reinjured it in 1999 while working for a new employer. Doctors concluded his weight would prevent successful treatment, but the company opposed the employee's request for weight loss surgery on the basis that the obesity existed before the 1976 work injury. The court ruled that the gastric bypass surgery was "directed at" the knee injury; medical evidence demonstrated that the weight loss surgery was necessary for successful knee surgery.

Likewise, in 2009, the Indiana Court of Appeals required a pizza shop to pay for a 380-pound employee's weight loss surgery to ensure the success of a back operation for a work-related injury. The Workers' Compensation Board concluded that, when added to his work accident, the employee's weight situation created a "single injury" that made him eligible for both the weight loss and back surgery.

In 2010, a New York appellate court affirmed a workers' compensation board's approval of an employee's gastric bypass surgery. The sedentary lifestyle resulting from the accident caused the employee to gain a substantial amount of weight. Medical evidence substantiated that the employee's obesity exacerbated his back and knee pain and could be alleviated by weight loss surgery. More recently, an Illinois law firm announced on the Internet that one of its clients, an employee, was awarded the cost of bariatric weight loss surgery as a basis for evaluating and treating his underlying spine injury.

While there are no cases directly on point in Ohio, a 1994 Supreme Court of Ohio decision, *State ex rel Miller v. Industrial Commission,* offers insight into how Ohio might address the issue. In *Mille*r, the employee was severely overweight before her injury and asked that her weight loss program be covered by workers' compensation. The court held that obesity did not have to be an "allowed" condition for the employee to be entitled to the weight loss program. The court did, however, hold that the treatment's goal must be to improve or cure the allowed condition rather than to simply provide relief.

The problem for employers is difficult and extends beyond weight loss surgery. One can easily see the extension of this reasoning to other medical conditions and diseases, and where a sedentary lifestyle following an accident negatively impacts the health condition.

Improving the health of our workforce and controlling workers' compensation costs are honorable goals, but employers must not violate the many employment laws protecting individuals with disabilities. They may not refuse to hire or otherwise discriminate against disabled individuals, even if it results in significant costs.

Employers should remember that the original intent of the workers' compensation system was to create a compromise between employers and employees. Employees receive a defined benefit for any job-related injury regardless of fault, and employers receive protection from high damage awards. While the system works well most of the time, court decisions like those above show the difficulty of controlling these costs.

–by Patricia F. Weisberg, head of the Workers' Compensation Practice in the Cleveland firm of Walter Haverfield LLP.

Complying with State and Federal Laws

Chapter 10

United States Department of Labor and
State of Ohio Resources

In a small handbook such as this, it is impossible to cover all of the subjects that apply to you in your business life, particularly those dealing with federal compliance issues. However, the U.S. Department of Labor (DOL) provides a great deal of legal information for small businesses through its website at (www.dol.gov/elaws/).

Through this site you can access explanations of a wide range of federal statutes and regulations administered by the Department of Labor, and determine whether or not various laws and guidelines apply to your business by clicking on www.dol.gov/elaws/firststep/. The Department of Labor's Office of Small and Disadvantaged Business Utilization (OSDBU) also has a Small Business Resource Center you can access by visiting www.dol.gov/oasam/programs/osdbu/sbrefa/main.htm.

Contacting the Department of Labor:

By Mail

U.S. Department of Labor
200 Constitution Ave., NW
Washington, DC 20210

By Phone

National Toll-Free Call Center. Live assistance is available Monday through Friday from 8 a.m. to 8 p.m. Eastern Time by calling (888)9-SBREFA / (888)972-7332, TTY: (877)889-5627.

Small Business Regulatory Enforcement Fairness Act of 1996

The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) places obligations on federal agencies and provides rights to small businesses. Also, under SBREFA, the U.S. Small Business Administration (SBA) has established an Office of the National Ombudsman as well as SBA Regional Fairness Boards. The Department of Labor's Office of Small and Disadvantaged Business Utilization (OSDBU) oversees the Department's SBREFA activities.

For information about the rights provided to small businesses under SBREFA, contact the DOL Office of Small and Disadvantaged Business Utilization (OSDBU) at (202)693-7299, or toll-free at (888)9-SBREFA (888-972-7332). You may also obtain information on SBREFA from the SBA online at www.sba.gov/advocacy/825/12285.

If you wish to comment directly to SBA on the enforcement actions of any DOL agency, you may contact the SBA National Ombudsman's office at (888)734-3247 or online at www.sba.gov/ombudsman/1816. You also may call your local DOL Regional Office, or the DOL Office of Small and Disadvantaged Business Utilization (OSDBU) at (202)693-7299.

A listing of U.S. DOL offices that service the state of Ohio can be found at www.dol.gov/dol/location.htm.

OHIO STATE GOVERNMENT AGENCIES

Director
Ohio Department of Commerce
77 South High St., 23rd floor
Columbus, OH 43215-6123
PH: (614)466-3636
Email: Directorsoffice@com.state.oh.us

Bureau Chief
Ohio Department of Commerce
Division of Industrial Compliance and Labor
Bureau of Wage and Hour Administration
6606 Tussing Rd.
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What You Should Know about Securities Laws

For anyone who is forming a business, raising capital or soliciting proxies to elect directors and enact important company business, securities laws regulate what information must be provided and how it is communicated. Many people are probably familiar with the long, fine-print disclosure statements provided by their broker before they buy stock. But most do not realize that it is not only large businesses that are required to provide information under securities laws. These laws also govern the information required to be provided by small, closely held businesses. The kind of information required and how it must be communicated is based upon the nature of the solicitation and the sophistication of the investors.

Small business owners and operators should be alert to the circumstances in which securities laws can apply to their companies. Because securities laws are actually a collection of federal and state statutes, regulations, rules and interpretations, you, as a business owner, will need the services of an experienced attorney in order to identify the least costly and most effective method of compliance. If you fail to identify obligations under these laws in a timely manner, you may not be able to use some of the simplest methods, leaving much more expensive and time-consuming alternatives. So, if you have any doubt about your compliance with securities laws, ask a lawyer first.

Q: Who are securities laws designed to protect?

A: Securities laws are designed to protect investors by requiring businesses to provide enough information that investors can make informed decisions before committing their capital and making decisions. Because different people have different levels of experience in business, financial matters and certain industries in particular, securities laws require different levels of disclosure. Some solicitations of capital are exempt from filings with any state or federal agency. These exemptions may not require any disclosure. This is because these investors may be actively involved in the management of the business. These investors or their investment advisor may have an education in finance and years of experience in investing in this kind of stock. They may also have a sufficient net worth and/or income to reduce the amount of risk to their home and lifestyle should they lose their investment. In short, *exemptions* may be available for persons who are more able to fend for themselves.

Securities laws are designed to protect investors from taking inappropriate risks. An experienced investor knows that businesses usually raise capital for the purpose of promptly investing in assets or services. When the company spends raised capital, as intended, the investment has been converted to equipment, goods or services. This makes it difficult or impossible for the investor to get back quickly his or her money even if the company wishes to return it. Publicly traded companies make a market in their shares, not the underlying assets, thus making the investment liquid. Few companies have a public market for their shares or other ownership interests. Indeed, most closely held businesses severely restrict the transfer of their stock, because they want to know the persons who will have the power to vote their shares.

Investment in closely held businesses is best suited to people who can afford to lose their investments or can otherwise comfortably afford to maintain their lifestyles without prompt access to their invested capital. It is also suited for persons who manage the day-to-day affairs of the business that is employing their capital. Consequently, securities laws may make it difficult or impossible for a closely held business to even offer to sell its ownership interests to many investors without having investment advisor review each offer and provide counsel.

Q: When will securities laws apply to my business?

A: Know the circumstances in which securities laws are most likely to apply to your business. If you are about to form a corporation, limited liability company, limited partnership or even a general partnership, securities laws can apply. They also apply to raising capital from new or existing owners and investors. Even a *loan* can be a security requiring compliance. While the sale of a franchise is not often considered a security, Ohio and other states have similar laws governing the solicitation and sale of these and other business opportunities that also regulate the information that must be provided. Furthermore, in most circumstances, a business cannot even make initial contact with a potential investor without first complying with securities laws. Therefore, in any of these instances, ask an experienced lawyer early in the planning stages so that you will know who you can solicit and devise a strategy for how to go about it.

Q: I have been preparing to open a new business. I'm only asking a few friends to help me with seed money, and then I'm going to pay them back when I turn the corner. These laws do not apply to me, do they?

A: Yes they can and often do. There is no exemption for friends, and being a friend does not mean the investor has the net worth or sophistication to absorb *illiquidity* or loss of investment.

Q: What are "exemptions" and how do I use them effectively?

A: Securities laws generally require some form of registration with the federal government's Securities and Exchange Commission (SEC) and/or state division of securities. Formal registrations typically involve a significant expenditure of time and fees that are much less cost-effective for small companies than large. Small- to medium-sized businesses rely almost exclusively on various exemptions to registration in order to comply with securities laws. Federal and state exemptions are required in each instance. Some require a simple but timely notice filing with governmental agencies.

Others may not require any filing, but prohibit advertising of any kind and/or prohibit the charging of sales commissions. If you so much as offer securities to those who are not qualified to buy them, or if you fail to file a notice on time, you may lose your exemption and be required to register or refund all of the funds you raised, and have to start over at the beginning.

Q: What happens if I do not comply?

A: As with most laws, securities laws have enforcement provisions. One almost universal remedy an investor may use is to *rescind* the investment, which means you would have to refund all the investor's capital. If the money has already been spent, that can prove to be fatal to the business. There are also civil sanctions, even criminal penalties, especially for willful violations or fraud.

If the failure to comply is inadvertent, often there is an opportunity to correct the mistake without harm to the business. Sometimes merely offering the investors' money back and confirming this in writing will help. However, sometimes these corrective filings require time-consuming and costly disclosures. These costs and the corrective effort can increase over time, so if you learn of a problem, do not delay.

If you are concerned, ask a lawyer. Remember, attorney-client communications and advice are confidential and privileged.

–by Gary M. Harden, an attorney with the Toledo firm, Eastman & Smith, LTD.

Federal Trade Commission (FTC) Enforces "Consumer Protection" Laws

Q: I sometimes see TV ads that I think are misleading, I've heard about telemarketing scams, and I'm reluctant to do business on the Internet. Is there any government agency that tries to protect consumers from unfair or deceptive business tactics?

A: The federal government has enacted a number of consumer protection laws and regulations that are enforced by the Federal Trade Commission (FTC). Its mission is to eliminate from the marketplace all acts or practices that are unfair or deceptive.

Q: What is the FTC?

A: It is an independent federal agency created by Congress in 1914 to combat "unfair methods of competition." In 1938, its mission was expanded to include prevention of "*unfair or deceptive* acts or practices." Under this authority, the FTC has become the premier protector of our nation's citizens against consumer fraud. In addition, Congress has, over the years, given the FTC authority to enforce a wide variety of other consumer protection statutes relating to such matters as product warranties, product packaging and labeling, *truth in lending* disclosures, *fair credit* billing and reporting procedures, and, more recently, telemarketing fraud prevention and children's online privacy protection.

Q: How does the FTC decide what to investigate?

A: An investigation can begin in various ways—for example, by a Congressional inquiry, an FTC staff member spotting something questionable in the marketplace or even with a letter or phone call from a consumer. However, the FTC investigates matters on behalf of all consumers; it does not seek redress for individual consumers.

Q: How does the FTC try to stop unfair or deceptive practices?

A: First, it will investigate. If it concludes that consumers are being deceived, it may ask the guilty party to enter into a so-called *consent order* agreeing to stop the harmful conduct. If the party refuses, the FTC may start a formal proceeding before an administrative law judge; this is similar to a court case, where there is submission of evidence and legal arguments. If the judge finds that the law has been violated, a *cease-and-desist* order is issued. Such an order may be appealed to the full commission. If either party is not satisfied with the outcome, it can appeal to the federal courts.

If an FTC consent or cease-and-desist order is later violated, the FTC may seek monetary penalties and/or an injunction in federal court. Further, in cases involving "dishonest or fraudulent" conduct, the FTC may ask a federal court to order consumer redress, such as monetary restitution to victims of the violation.

In some cases, the FTC will go directly to court. For example, if there is an ongoing consumer fraud, instead of starting an administrative proceeding, the FTC will seek an immediate injunction to stop the fraud before too many consumers get hurt.

The FTC may also issue *trade regulation rules* to prevent unfair or deceptive practices affecting an entire industry. Such rules have the force of law.

Q: Is the FTC involved in issues like Internet fraud prevention or online privacy? In what other areas is it concentrating its enforcement efforts?

A: As part of its mission to protect consumers from unfair or deceptive practices, the FTC's Bureau of Consumer Protection is active in multiple areas. It has, in recent years, increased and tailored its law enforcement efforts to detecting online fraud and related practices. It is the national leader in fighting Internet, telecommunications, and direct-mail fraud, deceptive spam, and violations of Do-Not-Call rules. Part of its focus is on high-tech products and Internet concerns like the dissemination of spyware and online safety for children. It safeguards consumers' financial privacy, investigates breaches of data security, tries to prevent identity theft, and aids individuals whose identities have been stolen. It enforces truth-in-advertising laws—for example, investigating claims for food, over-the-counter drugs or dietary supplements. It runs national campaigns to alert consumers to their rights. It also plays a role in preventing deceptive or unfair loan servicing, debt collection, and credit counseling practices and regulates the credit reporting industry.

Q: To whom at the FTC should I complain about a fraud or about telemarketers who ignore the national "Do-Not-Call" registry?

A: To file a complaint or to get free information on consumer issues, visit www.consumer.ftc.gov or call (877)FTC-HELP (877-382-4357). For complaints specific to the Do-Not-Call registry, visit www.donotcall.gov. The FTC enters Internet, telemarketing, identity theft, and other fraud-related complaints into a secure online database available to hundreds of civil and criminal law enforcement agencies across the country.

Q: If an FTC complaint is made against me or my business, what should I do?

A: You should handle an FTC complaint as if it were a lawsuit. You should refer it to in-house counsel or outside counsel.

Q: How can I get more information about these consumer protection issues?

A: A good source is the FTC's own website, www.consumer.ftc.gov.

–by Mark L. Silbersack, a partner in the Cincinnati office of Dinsmore & Shohl, LLP. Updated by Tammy L. Imhoff, an associate in the same office.

Ohio Law Mandates "Fairness" in Construction Contracting

Q: I have been involved in the construction industry as a contractor and subcontractor for a number of years, and when it comes to contract negotiations, it seems I'm always at the mercy of the owner or general contractor. Does Ohio law protect me in contract negotiations?

A: Effective September 30, 1998, the Ohio Legislature enacted the Fairness in Construction Contracting Act, *Ohio Revised Code* Section 4113.62 (the Act), which makes certain generally-used contract provisions void and unenforceable. The Act came into being because Ohio legislators decided that these commonly used contract provisions were unfair and against public policy.

Q: Can you give me an example of a provision that has been made unenforceable?

A: Owners often require general contractors to provide *payment bonds* to ensure that subcontractors and/or materialmen can still collect payment, even if the general contractor fails to pay. Currently, many general contractors avoid the owners' requirement to post a payment bond by including in their contracts with subcontractors and materialmen a clause waiving the payment bond requirement imposed by the owner. When a general contractor does this, the subcontractor is deprived of a reliable source of payment. Under the Act, such waiver clauses are no longer valid.

Q: On almost every project, it becomes necessary to file a claim for extra compensation because of additional work required by the owner. Oftentimes, there are provisions in contracts provided by owners that take away my right to claim extras. Does the Act address this?

A: It is true that many contracts used by owners include provisions that automatically waive a contractor's and/or a subcontractor's pending claims for extras upon their acceptance of final payment. Because of the bargaining power of the owner, this standardized waiver provision has found its way into many contracts. Indeed, numerous times, contractors and subcontractors, because of the financial pressures of business, have decided to receive final payment, even though this meant their claims for extras would be lost. Under the Act, these one-sided waiver provisions are now unenforceable, provided a contractor or subcontractor has given notice of a claim for extras *prior to* accepting final payment.

Q: I have seen many contracts stating that no damage compensation will be awarded to a contractor or subcontractor for delays in contract performance caused by others. This clause has always struck me as being unfair. Does the Act address this issue?

A: Yes. The Act makes unenforceable construction contract provisions that prevent a party from recovering damage compensation for delays caused by a party other than him/herself. For example, on a large construction project, a subcontractor who mobilizes his crew for performance on a specific date may find that the general contractor's improper coordination of the work has delayed the subcontractor's scheduled performance. Under the Act, the subcontractor may recover compensation for such a delay, even if the subcontractor's contract with the general contractor contains a "no damage for delay" clause.

Q: I am a subcontractor. In the past, I have lost mechanic's lien and bond rights due to a general contractor's failure to pay under a so-called "pay-if-paid" clause. Does the Act address this situation?

A: Yes. A *pay-if-paid* clause in a contract between a general contractor and a subcontractor means the general contractor does not have to pay a subcontractor if the owner has not paid the general contractor. In the past, these pay-if-paid clauses have interfered with a subcontractor's or materialman's ability to file mechanic's liens, liens against public funds, and/or claims against payment bonds. Specifically, all of these various types of claims must be made within defined time periods. Further, to be able to make such claims, a subcontractor or materialman must say that payment is "now due" him from the general contractor. When a contract between a general contractor and the subcontractor or materialman contains a pay-if-paid clause, it may mean that the payment by the general contractor is not due—even though the scheduled time for payment has passed—because the owner has not paid the general contractor.

Before the passage of the Act, in such circumstances a subcontractor or materialman could not claim that payment was due and, therefore, could not file a lien or bond claim. Further, if the owner's delay in payment went past the time required by law to file a lien or bond claim, then the subcontractor or materialman would lose the right to file such claims.

The Act protects subcontractors and materialmen in these situations by saying that a pay-if-paid clause *does not* prevent a subcontractor or materialman from filing a lien or bond claim where the date for payment has been delayed by an owner's failure to pay the general contractor. Simply stated, the Act allows a subcontractor and/or materialman to timely and lawfully file a lien or bond claim where previously he or she could not.

–by William F. Kolis Jr., an attorney in the Avon law firm of Wickens, Herzer, Panza, Cook & Batista.

What Employers Should Know about Ohio's Minimum Wage

On November 7, 2006, Ohio voters passed Issue 2 to include a minimum wage in Ohio's constitution. As of January 1, 2013, most Ohio employers must pay at least $7.85 per hour.

The minimum wage will increase each year by the amount of inflation, as determined by the Ohio Department of Commerce. The rate set by the original amendment in 2006 was $6.85, which has since increased. Importantly, the since the minimum wage was raised through constitutional amendment, the Ohio General Assembly cannot reduce it.

The minimum wage amendment covers the employees of the state and every county, city, township, school district and governmental authority, as well as most, but not all, private employees. Examples of those who are not entitled to the new minimum wage include employees under the age of 16 and employees of a small business (less than $250,000 in annual gross revenues). These employees, however, are entitled to receive the federal minimum wage.

Other exceptions include the following:

1) Employers can pay "tipped" employees (*i.e.*, employees who receive tips as part of their pay) as little as one half of the minimum wage, so long as tips make up the other half.
2) Family-owned businesses do not have to pay the new Ohio minimum wage to their own family members.
3) Employees who work "in or about the property of the employer or an individual's residence on a casual basis" are not covered by the new minimum wage law.

In addition, the state can permit employers to pay wage rates below the new minimum to individuals who have a disability that affects their employment opportunities.

Employers must make sure that they keep a record of each employee's name, address, occupation, pay rate, hours worked *for each day worked*, and each amount paid to an employee.

Employers must keep these records for three years after each employee's last day of work.

Employers must provide these records within 60 days of a request and without charge to the employee or a person acting on behalf of the employee (for example, the employee's lawyer or union representative).

Minimum wage lawsuits can be filed within three years of the violation or (if it was a continuing violation) when the violation ceased. The lawsuit can be a simplified class action, where one employee can sue on his or her own behalf and that of all "similarly situated" employees. The suit can be filed in a county where any one of the employees resides.

If an employer violates Ohio's minimum wage law, the employer must, within 30 days of a finding of the violation:

- pay the employee's back wages;
- pay damages equal to an additional two times the back wages; and
- pay the employee's costs and reasonable attorneys' fees.

Finally, the minimum wage law prohibits employer retaliation against people who provide assistance to employees asserting their rights. Employers who retaliate must pay an amount "sufficient to compensate the employee and deter future violations," or at least $150 for each day that the violation continued.

Legislation implementing Issue 2 provides privacy protections for employees requesting wage information and regulates how minimum wage lawsuits can proceed. That legislation also exempts employees who are exempted from both the Ohio and the federal minimum wage.

–by Neil E. Klingshirn of Fortney & Klingshirn, Akron. Updated by Gregory A. Gordillo, principal in the Cleveland firm, Gordillo & Gordillo, LLC.

Wage-and-Hour Update:

When Must an Employee Be Paid for Travel Time?

Suppose one of your employees travels from job site to job site in a company truck and then takes the truck home in the evening. How much of his drive time is compensable? When, if ever, should an employee be paid for the commute between work and home?

Suppose another employee leaves home in the morning in her personal automobile and returns late in the evening after a one-day job in another state. Is all of her travel time compensable? What if the assignment lasts for more than one day?

The Fair Labor Standards Act, the federal law governing minimum wage and overtime requirements for all *non-exempt* employees, addresses travel time. Those regulations say:

1) An employee's commute from home to work, even in the employer's vehicle, is usually not compensable.
2) Travel that falls "all in a day's work," such as travel from job site to job site during the workday, must be compensated. Even if the employee uses, for example, a company truck to drive from job site to job site, and then returns home with the truck, the travel time from the last job site to home (and from home to the first job site in the morning) is usually not compensable unless the employee is performing work services at home before or after the end of the workday.
3) Travel from home to work in an emergency may be compensable, particularly if the employee reports to a site that is not his or her usual workplace. In this regard, usually an employee who is "on call" and required to report to work to address an emergency should be compensated for the time spent traveling to and from the site of the emergency.
4) If an employee travels out of town, travel time is compensable if:
   - the employee completes the trip in one day, regardless of whether the travel occurs in a company vehicle, personal automobile or public transportation;
   - the trip lasts more than a day, but the travel time occurs during the employee's regular work hours, even if the travel occurs on Saturday or Sunday.

   Travel to another city in a personal automobile or public conveyance (train, bus, plane) that takes place outside of the employee's regular work hours is generally *not* compensable, however, if the trip is longer than a day's duration. If public conveyance is offered to an employee as transportation in this situation and the employee chooses, instead, to use his or her personal vehicle, then the employer may compensate the employee for only the drive time that takes place during the employee's regular work hours (even for travel on Saturday or Sunday). If travel by public conveyance is not offered, all drive time by the employee in his or her personal vehicle maybe considered to be compensable time.

Your attorney or accountant can answer questions about how these general rules apply to you. A mistake in this area can be costly. Employees who have not been properly paid can recover all of the unpaid wages owed to them for up to three years plus liquidated damages in an equal amount and attorneys' fees.

–by Gregory T. Lodge, a labor and employment law attorney with Shumaker, Loop & Kendrick, LLP, in Toledo.

Businesses Should Use Caution When Using Unpaid Interns

Increasingly, recent graduates and "near-grads" are seeking unpaid internships in the "for-profit" sector to gain additional skills, experience and contacts. Depending upon your type of business, using student interns can be very beneficial. Interns can help with research or with developing and implementing new programs, products or services. Also, beyond whatever assistance an intern may provide, employers who use their services gain the satisfaction that comes from imparting knowledge and teaching new skills to those who will soon enter the work force.

Employers need to be cautious, however, when inviting interns to join their businesses. In particular, employers must be careful not to run afoul of federal wage and hour laws when using interns. To help prevent such problems, the U.S. Department of Labor (DOL) has published guidance for employers. Under this guidance, if an internship is structured to be an extension of the intern's academic experience and provides the intern with skills that can be used in a variety of settings, then the program will not likely violate federal law. If, on the other hand, the intern is engaged in the operations of the business or is performing productive work (such as filing, clerical work, or assisting customers), then the internship could be subject to federal minimum wage and overtime requirements.

The DOL has developed six factors that employers must use to determine whether an internship complies with federal wage and hour laws:

- The intern should not displace regular paid workers and should work under close supervision.
- The training that the intern receives should be similar to what would be given in an academic setting.
- The internship should be for the benefit of the intern.
- The employer should not gain immediate advantage from the activities of the intern, and, on occasion, the employer should expect that its operations may actually be impeded by the internship.
- The intern should not be guaranteed a job at the conclusion of the internship. In other words, the internship should not be used as a trial period for persons seeking employment.
- Both the intern and the employer should understand before beginning the internship that the intern is not entitled to wages for the time spent during the internship.

If a proposed unpaid internship meets all of these requirements, the employer will be in compliance with federal law, and the intern will be considered a "trainee" rather than an employee.

If, however, the internship does not qualify for unpaid status according to the factors listed above, then the intern must be paid a minimum wage and, as applicable, overtime pay. The business also could be obligated to pay back wages, workers' compensation and unemployment insurance benefits, and could also be subject to federal and state discrimination laws, back tax liability, fines and significant legal bills. Employers should carefully structure any existing or future unpaid internship programs to make sure that they comply with the above factors in order to avoid legal liability.

–by Scott Lawson, the managing attorney of The Lawson Firm, LLC in Cleveland.

Avoiding Antitrust Problems

For most businesses, facing antitrust claims is like being struck by lightning. The odds of it happening are very small, but the consequences are dire.

Many antitrust claims arise only when a business has acquired, or is in a position to acquire, "market power"—the ability to control price or output in a relevant market. Whether a firm has market power is a fact-specific question that considers, among other things, a firm's market share in the product it sells and the geographic area where its sales are made. The larger a market share, the more likely the company has market power. Most firms can only dream of having the sort of economic clout that justifies a finding of market power.

However, the most serious antitrust offenses (violations of the federal Sherman Act and its counterpart state laws such as Ohio's Valentine Act) do not require a business to have such market power, so no firm is beyond the reach of the antitrust laws.

These most serious antitrust violations involve certain agreements among competitors: *price fixing* (agreements on the prices competitors will charge); *customer allocation* (agreements to stay away from each other's clientele); *market division* (agreements to limit the geographic areas in which firms compete); and *bid rigging* (agreements about what or whether to bid or who will win bids).

The consequences of committing one of these violations are severe. Criminal Sherman Act violations carry potential jail sentences of up to ten years in prison and criminal fines of up to $100 million for corporations and up to $1 million for individuals. Moreover, any person or business that is injured as a result of the violation can recover three times the amount of damage suffered plus attorney fees. Also, experience shows that these cases are among the most expensive to defend.

The federal government takes the investigation and prosecution of antitrust violations very seriously. The Justice Department's Antitrust Division has three field offices in Chicago, New York and San Francisco that are devoted exclusively to identifying, investigating and prosecuting antitrust violations. Like most states, Ohio's Attorney General's Office also has an entire section devoted to pursuing antitrust violators.

In 2012, the Antitrust Division collected about $1.13 billion in criminal antitrust fines and restitution.

Price-Fixing Case Study

United States v. Foley, 598 F.2d 598 (4th Cir. 1979) demonstrates the dangers associated with seemingly idle discussions among competitors about prohibited topics. The head of a real estate agency arranged a dinner meeting of his competitors at the Congressional Country Club in Bethesda, Maryland. After dinner, he told the group that he did not care what they did, but his agency was going to raise real estate commission fees. The evidence about what, if anything, the others said after that was disputed. However, the evidence showed that, after the dinner, the other Realtors raised their rates as well, and that they all knew that a rate increase would not "stick" unless they all went along with it.

Under these circumstances, a jury convicted the defendants of a conspiracy to fix prices, which was affirmed on appeal. Of course, there was much more to the case, but the important thing to observe is that there need not be a specific expression of agreement in order for the crime of price fixing to occur. How much better off these defendants would have been if they had never even discussed the subject of their prices, and, in fact, had declined their competitor's invitation to an unsupervised dinner in the first place.

Individual violators in criminal antitrust cases brought by the Antitrust Division in 2012 received, on average, prison sentences of 25 months.

In Ohio, many antitrust investigations and prosecutions have involved relatively small businesses without “market power.” Electrical contractors, scrap metal dealers, funeral homes, supermarkets, real estate brokers, dairies and steel container manufacturers have been the subject of investigations, many of which have resulted in prosecutions and convictions.

Like a lightning strike, antitrust violations are relatively easily avoided by following a few common sense rules:

1) **Never make any agreements with your competitors about prohibited subjects (your prices, customers, territory or bids).** The law prohibits any kind of agreement on these topics—written, oral, handshakes or even unspoken, informal “understandings.”
2) **Never discuss these prohibited subjects with your competitors.** Juries can infer the existence of agreements from what might seem like innocent circumstances. For example, if you discuss your pricing with a competitor and later both of your prices become similar, someone might infer that you did more than just discuss them, but rather agreed on what they would be.
3) **Instruct all of your employees never to make such agreements or have such discussions.** Even agreements a sales person makes with your competitors’ sales force about the prohibited subjects will bind the company, and the company will bear the consequences.
4) **Adopt a written policy that mandates compliance with the antitrust laws and explains how to do so.** This will help impress upon your personnel the importance of compliance and provide a reference guide.

Application of the antitrust laws can be very complex, but with prudent action, businesses often can achieve their legitimate goals while staying well within the bounds of these laws. Detailed analysis and careful planning sometimes are necessary, but, when it comes to the most serious potential antitrust problems, the rules are fairly clear and easily obeyed.

Following these steps will help you and your business stay out of the storm and avoid the lightning.

–by attorney John J. Eklund, a partner in the Cleveland and Columbus law firm of Calfee, Halter & Griswold LLP. Updated by attorney Maura L. Hughes, a partner with the same firm.

Taxpayers Can Choose Method for Estimating Commercial Activity Tax Payments

As part of the comprehensive tax reform enacted in 2005, a new commercial activity tax is being imposed upon the gross receipts from commercial activity in Ohio. Taxpayers with annual taxable gross receipts of less than $1,000,000 file annual returns, while taxpayers with annual gross receipts in excess of $1,000,000 file quarterly returns.

For taxpayers filing quarterly returns, the returns and payments are due 40 days after the end of the calendar quarter. Many small- and medium-sized taxpayers, however, find it hard to obtain accurate gross receipt figures within this window. The possibility of interest and penalties for reporting inaccuracies only adds to the tension.

Fortunately, taxpayers can choose one of two methods for estimating their quarterly tax liabilities: the *rule estimation procedure* and the *statutory estimation procedure*. Although they work differently, both methods allow a taxpayer to estimate taxable gross receipts during a quarter and to reconcile that estimate at a later date.

Using the rule estimation procedure, the taxpayer can estimate taxable gross receipts based on the actual receipts from the previous quarter. The estimate must be at least 95 percent of the actual taxable gross receipts for the previous quarter, but in no event less than 70 percent of the actual receipts for the current quarter. The taxpayer must then file a reconciliation return before the due date for the next quarter and pay any additional tax due. A taxpayer using the rule estimation procedure and meeting its requirements will not incur penalties or interest when filing a reconciliation return.

The statutory estimation procedure permits a taxpayer to estimate taxable gross receipts for a quarter at 95 percent to 105 percent of the actual number without penalty or interest. The taxpayer files a single reconciliation return at the end of the year, reporting the actual taxable gross receipts for each quarter and comparing them to the estimated receipts. If the estimate falls within the range of 95 percent to 105 percent of the actual receipts for that quarter, no interest or penalty is due (although any shortfall in tax paid must be paid and any excess is taken as a credit for the fourth quarter). If the estimate falls below that range, however, a penalty of 10 percent plus interest will apply. A taxpayer who overpays the tax for one quarter may not use the excess to remedy an underpayment for another quarter; each quarter stands on its own.

A taxpayer may not mix methods during a calendar year. If the rule estimation method is used for a quarter, the taxpayer may not use the statutory estimation method for a subsequent quarter in that year. However, a taxpayer may estimate taxable gross receipts for one or more quarters, using either method, and report actual taxable gross receipts for other quarters during the same calendar year.

Most taxpayers likely will find the rule estimation procedure easier. However, businesses with wildly fluctuating receipts or with anticipated seasonal swings may find the statutory estimate procedure offers better protection. Taxpayers should take the time to determine which method is better for their particular situation.

–by Mark A. Engel, an attorney with the West Chester office of Bricker & Eckler LLP.

Complying with Ohio's Smoking Ban

Ohio's voters passed the statewide Smoke Free Workplace Act in November 2006, and the Ohio Department of Health began enforcement efforts in May 2007. As the mandatory "No Smoking" signs continue to appear all across Ohio, employers must make sure they are complying with the law.

Some have referred to the law as an *indoor smoking ban* because it restricts smoking only in enclosed areas. However, outdoor areas like decks and patios fall under the ban if they are covered overhead and on more than two sides. For example, a partially enclosed deck or patio that has a roof, awning, or even umbrellas may be a mandatory non-smoking area.

As the name suggests, the Smoke Free Workplace Act is directed primarily at places of employment. Yet anyone who performs services for an organization—with or without compensation—is considered an "employee" under this law, so independent contractors and volunteers are likely covered. If those individuals use an enclosed area for work or any other purpose, the smoking ban applies there at all times of day and night. This broad definition of "employee" makes the law applicable to most organizations, and it also applies to enclosed areas into which the public is invited. Business owners still have the option of designating their entire facilities as non-smoking areas, both indoors and out.

Exceptions are narrow and specific to places like nursing homes, hotel rooms and retail tobacco stores. An exception for private clubs has generated controversy, but as a practical matter few organizations are eligible for that exception. In addition to other conditions, the club must be a not-for-profit entity, must be the only occupant of a freestanding structure, and must employ only members of the club.

Employers are responsible for enforcing the law in areas that are directly or indirectly under their control. In addition to removing ashtrays and posting specified signs that include the toll-free reporting hotline, business proprietors cannot allow employees or customers to smoke in prohibited areas. The first violation of the smoking ban is punishable by a warning letter, and subsequent violations may result in fines between $100 and $2,500. Retaliation—which includes terminating or refusing to hire someone who exercises a right under the new law—is also prohibited. Individuals who refuse to stop smoking upon request by a proprietor are subject to fines as well, even in outdoor areas that a business voluntarily declares to be non-smoking.

Because the financial consequences of noncompliance can be serious, businesses are well-advised to comply with the Smoke Free Workplace Act. Enforcement activity has been brisk and will likely continue to be while businesses across Ohio adapt to this law.

–by Justin D. Flamm, a partner in the Cincinnati office of Taft, Stettinius & Hollister LLP.

Environmental Issues

Chapter 11

Environmental Issues Affect Small Business and Real Estate Acquisitions

Q: I'm buying a small business. Are there environmental issues that need to be considered?

A: Yes. Regulation of activities that affect our environment is so pervasive today that it impacts almost every business. The environmental conditions of the real property upon which the business operates and a business' compliance with applicable environmental requirements can have a profound impact on the value of the business, whether it can operate legally, how it can operate, potential current liabilities, and even its future viability. A business that is out of compliance with applicable environmental requirements might face substantial capital, operating and legal costs and expenses to come into compliance, and might face the risks of administrative, civil or criminal enforcement, including the imposition of fines and penalties from regulatory agencies and, under certain circumstances, might even be unable to continue operations. The environmental conditions of the real property may affect the business' current value and, thus, how the business can be financed, insured and marketed. It is important to evaluate the environmental compliance status of any business and the environmental conditions of the property prior to its purchase or lease.

Q: Isn't the fact that the business is operating proof of its environmental compliance?

A: No. Many operating businesses are not in substantial compliance with applicable environmental requirements. The Environmental Protection Agency's (EPA) inspection and enforcement capabilities to directly ensure compliance of all businesses are limited, and environmental laws, like our tax laws, put the burden of compliance directly on the company. When the EPA learns of noncompliance, it may commence enforcement actions and publicize its enforcement activities to deter others from noncompliance. Potential statutory penalties for environmental violations are in the range of $10,000 to $25,000 per day per violation. The thorough assessment of the environmental compliance status of the business is an important step prior to the purchase of any business. Historic chemical or hazardous substances or petroleum releases, unrelated to current compliance issues, can be the source of expensive onsite and offsite cleanup requirements and could even pose potential health concerns to workers, tenants and residents for which the owner may be liable.

Q: In my contract with the seller, the seller has represented the environmental compliance of the business and the environmental condition of the property. Is that enough?

A: That depends. It is certainly valuable to have the current owner or operator of a business represent that the business is in compliance with environmental requirements or that no adverse environmental conditions exist on the real property. That representation alone, however, will not shield a new buyer from its obligations to comply with environmental requirements that the seller did not know of or with which it did not otherwise comply. In addition, the value and duration of the seller's representation of compliance will vary and may not be very valuable if the seller's representation proves to be inaccurate. The seller may not have assets to stand behind its representation, and the buyer would still have the responsibility and may need to bear the cost to bring the business into compliance with applicable environmental requirements or to address the adverse environmental conditions of the property caused by the seller. In general, representations alone should not be a substitute for independent investigation by a qualified professional retained by the prospective purchaser before buying a business or leasing or buying real property.

Q: What can a buyer do?

A: As part of the process in acquiring a business, a buyer can hire a qualified environmental consultant and attorney to perform an *environmental compliance audit*. This environmental "due diligence" is standard in most business and commercial real estate transactions today. While this type of investigation increases the cost of the acquisition transaction, it provides a buyer with the necessary information and assurance that the existing business is in compliance with applicable environmental requirements or will identify those steps necessary to bring the business into compliance, which obligations or liabilities can be addressed in the price, and transactional documents for the sale and purchase of the business. In addition, such an investigation will enhance the property's basis as security for any loan that may be necessary for the transaction.

This due diligence may also entail the separate performance of a Phase I environmental site assessment to determine if environmental site conditions or contamination concerns exist and need to be addressed in the transactional documents. A Phase I assessment generally consists of a review of available records, databases and interviews of knowledgeable individuals about historical site conditions. After a Phase I assessment, it may be appropriate to perform a Phase II assessment that would address specific environmental concerns identified in the Phase I assessment. For example, depending on the age or use of the building, or the historic or future use of the real property, it may be necessary to perform asbestos, lead-based paint or wetland surveys, or to determine if fills, underground storage tanks or other contamination exists that may affect the value, use and development of the property.

Q: Would it be simpler to buy or lease a piece of undeveloped real estate and start a business from the ground up?

A: It may be, but you will want to evaluate the environmental risks associated with the undeveloped real estate that is being purchased or leased as well. Under the federal Comprehensive Environmental Response, Compensation, and Liability Act, also known as the *Superfund law*, owners or lessees of contaminated real estate can be held liable for the cost of returning the property to an acceptable environmental condition even when they did not cause the initial contamination. When buying or leasing real estate, it is important to determine that the environmental conditions on the property do not create unacceptable liability risks, or that such risks are identified and addressed in the transactional documents to acquire or lease the property. An environmental site assessment performed by a trained environmental professional, and evaluated by an attorney, should be used to identify any unacceptable environmental site conditions that might impact the economic viability of the prospective real estate transaction and any associated business operations on such property.

Q: Aren't my chances of being caught by the EPA small? Can't I just ignore all these environmental issues?

A: Most financial institutions will require some degree of environmental investigation prior to participating in the financing of the purchase of any business or real estate. You should expect your financial lending institution to require some environmental investigation before it will agree to lend money to purchase a business or the real estate. As a practical matter, the environmental investigation required as part of most financing arrangements will require you to address the outstanding environmental issues.

In addition, the enforcement risks associated with noncompliance may be significant. While costs of returning to compliance and civil penalties can be substantial, most environmental laws carry stiff criminal penalties as well. These concerns are often significantly compounded by not dealing with such concerns in a timely way. The bottom line is that compliance with environmental requirements today is a well-accepted cost of doing business; it is an unavoidable cost, and it is a cost that can be efficiently managed with the assistance of environmental consultants and attorneys.

–by Brian M. Babb, a partner in the Cincinnati firm, Keating Muething & Klekamp, PLL; Douglas G. Haynam, a partner in the Toledo firm, Shumaker, Loop & Kendrick, LLP; and Dale T. Vitale, chief of the Environmental Enforcement Section of the Ohio Attorney General's Office.

Learn about Two Important Acts for Environmental Issues

Q: What is CERCLA?

A: The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) is the preeminent environmental liability law. This law makes current and even former owners and operators potentially liable for any release of hazardous substances that causes the government or a third party to spend time and money to take care of the contamination problem. Parties that clean up property can use CERCLA to recover their clean-up costs against former owners and operators.

Q: What is SARA?

A: The Superfund Amendments and Reauthorization Act (SARA) is the 1986 amendment to CERCLA, which allows an "innocent purchaser" (the buyer who did not know about any environmental contamination when the property was purchased) to qualify for CERCLA's third-party legal defense, typically referred to as the *innocent purchaser defense*.

Q: How could I prove I was an "innocent purchaser"?

A: In 2002, Congress enacted the Small Business Liability Relief and Brownfields Revitalization Act. The act amended CERCLA in several significant ways. Among other things, the act required the EPA to issue a rule—known as "all appropriate" inquiry—setting out what a prospective purchaser has to do to qualify as an "innocent purchaser." The EPA's rule (40 CFR Part 312) must also be used by purchasers wishing to qualify for the "bona fide prospective purchaser" and "contiguous property owner" liability defenses that were also created under the 2002 CERCLA amendments.

Q: How does CERCLA benefit me as a property buyer?

A: If you are interested in buying a property but are concerned about possible contamination problems down the road, CERCLA will allow you to enter into an indemnification agreement with the current owner or buy an insurance policy before you buy the property, so that any possible future contamination clean-up costs would be covered.

Q: How would that agreement work?

A: The seller can agree that the buyer will not be responsible for any contamination caused by the seller, or the seller and buyer can agree to share responsibility for different types of contamination.

Q: Why would a property owner want to do that?

A: It is always better to enter into a deal with your eyes open. After the buyers or sellers, or both, conduct an environmental investigation, they can then define the potential problems. Once the problems are defined, they can decide if anything needs to be done about them now, if future study is warranted, or if a "wait-and-see" posture is best. Regardless of what decisions are made, there are potential costs to all contamination, and an agreement between the buyer and seller regarding who's responsible for those costs is important.

Q: If I end up cleaning up contamination left by a prior owner, can I bring a legal action to recover my costs?

A: Yes. In 2007, the U.S. Supreme Court ruled that even owners and operators that were not "innocent" could sue to recover all or a part of their clean-up costs from a prior owner and operator. As a result of the court's decision, such actions—which were formerly severely restricted—are now easier to bring.

–originally prepared by Thomas M. Skove, Esq., and updated by Božana Lazić Lundberg, an associate at the law firm of Walter Haverfield LLP.

You May Need an Environmental Permit for Your Business

Q: When do I need an environmental permit?

A: Depending on the nature of the business operations, one or more environmental permits may be required from various local, state or federal regulatory agencies whose duty is to administer laws protecting human health, safety, and the environment. Generally, permits are required if an activity *will* result in the release of pollutants or contaminants into the air, result in a discharge into soil or groundwater, or result in a discharge into surface waters. For example, it is unlawful to install, operate or modify a source of air contamination within Ohio without first obtaining permits from the Ohio Environmental Protection Agency (Ohio EPA) or its local designee. Permits may be required before a facility can be built if construction will generate stormwater from the construction site, or before commercial and industrial facilities discharge industrial wastewaters into sanitary sewers, or discharge sanitary or industrial wastewaters or storm water directly into the state's waters. Permits may be needed if streams, creeks, rivers or wetlands will be disturbed or altered by any proposed activity. Permits may also be required for various types of solid or hazardous waste storage, treatment or disposal activities.

Q: Are environmental permits difficult to get?

A: The time, effort and cost to obtain environmental permits often depend on the types of permits involved, the complexity of the commercial or industrial operation and the potential impacts on the environment. Depending on the type of business operations and in-house expertise, third-party consultants are often needed to prepare permit applications. Permits might take anywhere from less than a month to a year or more to obtain. The documentation needed to obtain a permit varies from a simple permit application form to an application form that requires the inclusion of detailed engineering plans and drawings, emissions calculations and environmental studies. Often, careful project planning and scheduling are necessary to obtain permits in a timely way. In virtually every case, permits must be obtained prior to any construction, operation or modification of the source of potential discharge, emission, disposal or release. Much of the time needed to obtain the permits is associated with the regulatory agency's review and the public's right to receive notice of the permit application and provide comments on it. Delays in obtaining permits from regulatory agencies often arise from incompletely or inadequately prepared permit applications. It is best to work proactively with the regulatory agency in providing information that will assist its ability to review the application.

Q: How do I know if I need any environmental permits?

A: Legal counsel and technical consultants are readily available to assess the nature of the business operations and to determine whether any permits for those operations would be required. Trade associations can also be helpful in providing guidance about permitting requirements. In addition, you can consult with Ohio EPA's Office of Compliance Assistance and Pollution Prevention at (614)644-3469 or (800)329-7518 or via the Internet at www.epa.ohio.gov/ocapp/complianceAssistanceandPollutionPrevention.aspx.

Q: What is the usual process for obtaining an environmental permit?

A: Environmental permit applications are routinely submitted to the local Ohio EPA district office or local board of health that has jurisdiction over the facility. For an existing business, it may be advisable to consult with legal counsel or a consultant before contacting a regulatory agency about permitting requirements. For the establishment of new business operations, the best place to start is to contact the nearest Ohio EPA district office to find out if any environmental permits are required for the business. Permit applications are available from the Ohio EPA's district offices (or their local designees) or from the Ohio EPA via the Internet. Completed permit applications must be submitted, along with any filing fees, to the Ohio EPA district office, or its local designee, for review and approval. Information about the permitting process and many of the permit applications is available at Ohio EPA's website, which you can find at http://epa.ohio.gov/.

Q: What if I am purchasing a business with existing environmental permits?

A: Generally, the transfer of existing environmental permits to the new owner or operator of the facility is subject to specific regulatory requirements. In most cases, this is a simple process of providing advance written notification of the permit transfer to the respective Ohio EPA district office, or its local designee. In some cases, a permit transfer notification form must be submitted and a small fee paid. In other cases, approval for the permit transfer must be obtained from the regulatory agency. The best sources of information on the transferability of existing permits upon sale of the business are contained in the terms and conditions of the permits, the applicable environmental regulations, and from the regulatory agency that issued the permits. Planning and coordination with the respective governmental agency are necessary to ensure the permit transfer is effective at the time a change in ownership or operations occurs.

Q: Once environmental permits are transferred/obtained, am I done?

A: Permits and the regulations regarding certain environmentally regulated activities often include financial assurance, record-keeping and reporting requirements. Air pollutant emissions, wastewater discharges and waste management activities may be subject to periodic reporting requirements. In most cases, recordkeeping and reporting requirements will be stated in the permit's terms and conditions, but to be prudent, you should review the applicable rules to better understand what requirements may apply. Permits and the facility's ability to comply with the permits need to be regularly reviewed to ensure compliance. It is important that renewal applications be submitted before the permits expire; otherwise, legal authority to continue to operate may not exist.

–by Brian M. Babb, attorney partner in the Cincinnati firm, Keating Muething & Klekamp, PLL; Douglas G. Haynam, a partner in the Toledo firm, Shumaker, Loop & Kendrick, LLP; and Dale T. Vitale, chief of the Environmental Enforcement Section of the Ohio Attorney General's Office.

How to Manage Chemical or Petroleum Spills or Releases

Q: What should be done if a spill occurs?

A: Generally, immediate notification of the Ohio EPA, U.S. EPA, and the local fire department is required when there is an unpermitted release or spill of certain chemicals, petroleum, or other regulated materials or hazardous substances into the environment. The spill hotline number, which is available 24/7, is (800)282-9378. If a facility has a spill contingency plan, it should be implemented. If a facility does *not* have a contingency plan and employees are not trained to deal with the spill, local emergency response personnel should be promptly contacted. Spilled chemicals, petroleum, materials or substances that are regulated and exceed reportable quantity thresholds should be immediately reported to appropriate governmental agencies. In addition, remediation contractors should be promptly employed to clean up the spill to mitigate the potential damage to the environment and the threat to human health and safety, and to minimize cleanup costs. Legal counsel and environmental consultants should be promptly consulted whenever there is a spill or release of chemicals, petroleum, or other regulated materials or hazardous substances into the environment. Failure to act promptly is one of the primary factors considered by regulatory agencies when determining what actions should be taken in response to spills, especially if the delayed action leads to more dramatic impacts to human health or the environment.

Q: Do accidental spills or releases of chemicals, hazardous substances, or petroleum need to be reported?

A: It depends. If the chemicals, petroleum, regulated materials or hazardous substances are accidentally spilled or released into the environment (air, water or soil), then the business owner needs to quickly determine whether the chemicals, petroleum, substances or materials are regulated and whether the substance or material spilled or released exceeds the reportable quantity limits set forth in various environmental laws and regulations. For example, the spill or release of 25 gallons or more of oil into the environment, or a spill which creates a sheen on any surface water, is sufficient to trigger regulatory notification obligations. Such laws often require the person discovering the spill to report the spill immediately to appropriate authorities. In most cases, it is advisable to make a prompt protective notification to the emergency response and regulatory agencies if there is uncertainty whether a reportable substance or material is involved, if the reportable quantity has been exceeded, or if unsafe conditions exist. The penalties for the failure to promptly report a spill can be substantial and may put the public health and safety at risk unnecessarily.

If chemicals, petroleum, regulated materials or hazardous substances have been spilled inside a building and there is no threat of the materials or substances being released into the environment, spill reporting requirements may not be triggered; however, it is advisable to obtain guidance from an environmental attorney and consultant concerning such matters. There may be instances where there is no threat that chemicals, petroleum, materials or substances spilled within a building will be released into the environment, but it may be advisable to notify regulatory authorities and emergency response providers where health and safety concerns exist or to comply with OSHA requirements. Under most laws, written follow-up spill reports must be submitted to the regulatory agencies and the emergency response providers by the owner or operator of the facility or vessel where the spill occurred as soon as practicable. Qualified consultants and attorneys should be immediately consulted to determine whether the spill or release should be reported and how to manage the spill or release properly.

Q: How do I determine if the spilled substance or material is regulated?

A: Detailed information about the substance or material often will be contained on the Material Safety Data Sheet that was provided when the material was purchased, or you can obtain this information from the manufacturer or distributor of the product. You should review federal and state environmental regulations to determine if the spilled substance or material is regulated and exceeds the reportable quantity threshold. You also may directly contact regulatory agencies for guidance and you should seek assistance from legal counsel and environmental consultants.

Q: When and to whom must the release be reported?

A: Spills or releases of reportable quantities of chemicals, petroleum, regulated materials or hazardous substances into the environment must be reported immediately to the National Response Center at (800)424-8802, Ohio EPA at (800)282-9378, and the local emergency planning committee (call the fire department to find out about the local committee) where the facility is located. Additional information about reporting spills and environmental emergencies is available on Ohio EPA's website (www.epa.state.oh.us/derr/ersis/er/er.aspx).

Q: Will I be required to clean up the spill or release?

A: Generally, yes. Some spills or releases of chemicals, petroleum, regulated materials, or hazardous substances can be cleaned up with spill cleanup kits maintained at the facility. In some cases, it will be necessary to promptly hire a private environmental remediation company to clean up the spilled materials. In other instances, governmental entities may respond quickly to the spill notification and contain or clean up the spilled substances or oil to prevent harm to the environment or human health. The costs for governmental cleanups or response actions are generally billed to the owner or operator of the facility that caused or is responsible for the spill or release.

Q: What are the consequences of a failure to report a spill of hazardous substance or oil into the environment?

A: The failure to promptly report a spill or release may endanger the environment or public health and safety, may compound cleanup efforts and expenses, and may result in the imposition of statutory penalties of up to $25,000 or more per day per violation and, depending on the circumstances, could result in criminal prosecution.

Q: What can I do to prevent spills and releases?

A: Closely control material handling practices. Work with facility personnel, environmental consultants, engineers and attorneys to prepare for and prevent spills by identifying and ensuring compliance with applicable statutory and regulatory requirements, including obtaining required permits, preparing and maintaining updated emergency spill plans and procedures, providing employee training, and having arrangements with third-party remediation contractors in place should a spill or release occur.

–by Brian M. Babb, partner in the Cincinnati firm, Keating Muething & Klekamp, PLL; Douglas G. Haynam, a partner in the Toledo firm, Shumaker, Loop & Kendrick, LLP; and Dale T. Vitale, chief of the Environmental Enforcement Section of the Ohio Attorney General's Office.

Ohio Businesses Can Appeal Ohio EPA Decisions

As a small business, you may be adversely affected by a decision of the Ohio EPA. If so**,** you may have the right to appeal the EPA's decision**.**

An official EPA decision might include the following "acts" or "actions":

- adopting or modifying a rule or regulation;
- issuing, modifying or revoking an order;
- issuing, denying, modifying or revoking a license or permit;
- approving or disapproving any plans or designs.

Any decision by the EPA director that determines a controversial right or privilege is an official act or action of the EPA. The director's refusal to decide on a matter or the EPA's sending out of correspondence or notices may not be an official action or act of the EPA.

If you are adversely affected by an official EPA act or action, you may appeal the EPA's decision to the Ohio Environmental Review Appeals Commission (ERAC), a three-member panel appointed by the governor. ERAC is independent of the Ohio EPA and is charged with hearing appeals that spring from EPA decisions. Your appeal must be filed with ERAC no later than 30 days from the time the EPA issues its official decision, and during the appeal you must demonstrate that the EPA's decision was unlawful and unreasonable. ERAC may accept any evidence deemed relevant, though it is not authorized to rule on constitutional questions. Your appeal to ERAC does not automatically stop or delay whatever act or action is adversely affecting your business.

The ERAC will issue a written order stating either that the Ohio EPA's action is lawful and reasonable or that it is unlawful and unreasonable. If the latter happens, the ERAC may modify the act or action or set aside the EPA's decision and send the matter back to the EPA. You may appeal ERAC's decision to the Franklin County Court of Appeals. ERAC's decision will be reversed if it is found to be unlawful and unsupported by reliable, probative and substantial evidence.

Because the Ohio EPA is concerned with the impact its decisions and regulations have on small businesses in Ohio, a Small Business Compliance Assistance Office has been created. The Small Business Compliance Assistance Office provides newsletters and other notices to small businesses, as well as training and assistance in understanding and complying with Ohio EPA's laws and regulations. Ohio EPA's Small Business Compliance Assistance Office can be reached at (614)644-3469 or (800)329-7518.

If your business is either directly involved with Ohio EPA or adversely impacted by an EPA decision, you have a right to be heard. However, if you do not exercise your rights, you may not be able to make objections in the future. You can obtain advice about the Ohio EPA's laws and regulations from your legal counsel or from a member of the Ohio State Bar Association Environmental Law Committee.

–by Charles R. Dyas Jr., Esq., of the Columbus office of Kegler Brown Hill & Ritter.

Mold: A Small Business Concern

Mold-related property damage and personal injury claims remain a concern for landlords, contractors and other small businesses across the country. Your business may feel the impact in the way of litigation costs associated with handling mold-related damage or injury claims. Furthermore, insurance coverage for such claims is frequently unavailable or cost-prohibitive.

Why have mold claims continued to be a risk management concern? After all, mold has been in existence for ages and is ubiquitous in our environment. At least part of the answer is the heightened public awareness created by media coverage devoted to the mold crisis of the late 1990s and early 2000s, as well as the enduring public perception of any mold as a serious health concern.

The spike in mold-related property damage and personal injury claims has sent insurers scurrying for ways to reduce their exposure. Many carriers simply decline to offer property coverage. In fact, most carriers amended their policies to include mold or fungus exclusions. Thus, while the number of mold-related claims has decreased since the early 2000s, it remains a concern to your business because any mold-related property damage or personal injury claims can expose your business to costly litigation expenses and uninsured losses. Accordingly, the most effective way to manage that risk is to take steps to reduce the number and severity of any claims. To be pro-active about mold requires an awareness of what causes mold growth, the potential consequences of mold contamination and how best to prevent mold-related claims.

So, why does mold grow in buildings? Chronic moisture is the cause. Within as little as 48 hours of exposure to moisture, molds, including the infamous “black mold,” can grow on cellulose-containing building materials. Cellulose is contained in drywall, wood, ceiling tile, carpet or insulation, and other commonly used building materials. Water intrusion can result from a variety of sources, including leaking plumbing, windows or doors, roof or cladding failures, subsurface drainage failures or even poor ventilation. Damp, humid, poorly ventilated wall cavities and interior areas provide a perfect environment for mold growth.

Awareness of moisture sources and prevention of chronic moisture and water leaks are the keys to avoiding mold claims. Installation of kitchen and bathroom exhaust fans; properly operating HVAC systems; routine plumbing inspections; maintenance and inspections of roofs, windows, and the building envelope; and maintenance of drainage systems all can work to prevent the moisture problems that cause mold growth.

Upon discovery of a water leak, first shut off all sources of moisture. If it is an acute water loss with fungal growth not yet visible, promptly remove water-damaged building materials and use dehumidifiers and fans to quickly dry out the area. If mold is visible or if there is an earthy or musty odor present, assume that a fungal problem exists. According to the U.S. Environmental Protection Agency’s Mold Remediation in Schools and Commercial Buildings, if there is less than 10 square feet of visible fungal growth present, the mold should be cleaned up and any damaged building materials removed. If more extensive growth is identified, additional steps must be taken. For mold removal guidelines, visit the Environmental Protection Agency’s website at www.epa.gov.

In short, be proactive. Train employees or tenants to recognize signs of water intrusion or mold and instruct them to report or respond to the problem immediately. Awareness and prevention are the small business owner’s best allies in avoiding mold-related claims and containing insurance costs.

–by Ronald B. Lee and Ryan P. Kennedy, attorneys in Roetzel & Andress’s Akron office who practice primarily in the areas of toxic tort and product liability litigation.

Know Ohio's Open Burning Regulations

Q: What does the Ohio Environmental Protection Agency (Ohio EPA) consider "open burning"?

A: The burning of any material(s) where air contaminants resulting from combustion are emitted directly into the air without passing through a stack or chimney.

Q: Why do Ohio's laws prohibit so many kinds of open burning now?

A: Open burning can be harmful to health and property. Depending upon the material being burned, open fires can release many kinds of particles and toxic fumes, which can irritate allergies or cause difficulty breathing. The pollutants released by open burning also make it more difficult to attain or maintain health-based air quality standards, especially in or near major metropolitan areas. Gases released by open burning can harm neighboring buildings by corroding metal siding and damaging paint.

Q: Are there certain materials that can <u>never</u> be burned at any time, anywhere in the state?

A: Yes. They include:

1) items containing rubber, grease, plastic and plastic-coated wire, asphalt, or items that are made from petroleum, including tires, cars and auto parts;
2) garbage or any wastes created in the process of handling, preparing, cooking or consuming food; and
3) dead animals.

Q: Where is open burning illegal?

A: With the exceptions below, open burning in restricted areas is not permitted. Restricted areas are those within:

1) the boundaries of any municipal corporation;
2) corporation limits and a 1,000-foot zone outside any municipal corporation having a population of 1,000 to 10,000; and
3) corporation limits and a one-mile zone outside any municipal corporation with a population of more than 10,000.

In addition, open burning is prohibited when air pollution warnings, alerts or emergencies are in effect.

Q: When is it legal to open burn in a restricted area?

A: Items/reasons for burning that are permitted within restricted areas without any notice or permission from EPA include:

1) heating tar;
2) welding and acetylene torches;
3) smudge pots and similar occupational burning needs;
4) ensuring the warmth of outdoor workers and strikers;
5) bonfires, campfires, and outdoor fireplace equipment used for cooking for human consumption, pleasure, religious, ceremonial, warmth, recreational or similar purposes if: they are fueled with clean, seasonal firewood, natural gas or the equivalent; they are not used for waste disposal; and they have a total fuel area of three feet or less in diameter and two feet or less in height.

Landowners can also burn the following materials within restricted areas so long as Ohio EPA receives written notice to burn 10 days prior to the activity:

1) Prevention or control of disease or pests, with written or oral verification to the Ohio EPA from the Ohio Department of Health or local health department, centers for disease control and prevention, cooperative extension services, the Ohio Department of Agriculture, or the United States Department of Agriculture that open burning is the only appropriate disposal method.
2) Bonfires or campfires for ceremonial purposes that do not meet the above requirements, so long as they are no greater than five feet in diameter by five feet in height, burn no longer than three hours, and are not for waste disposal purposes.
3) Disposal of agricultural waste, including material generated by crop, horticultural or livestock production practices (including fence posts and untreated scrap lumber, but not buildings including dismantled or fallen barns, land clearing waste, garbage or dead animals). No materials can be burned that contain rubber, grease, asphalt, liquid petroleum products, plastic or building materials. Burning of agricultural waste must be at least 1,000 feet from any inhabited structure not located on the property, and no off-premises waste may be burned.

Rules do apply to all of these exceptions. For example, fires must be kept to a minimum size for the intended purpose. Also, fires cannot cause visibility hazards on roadways, railroad tracks or air fields.

There are certain other exceptions that must be *approved in advance* by written permission of Ohio EPA. These may include: fires set to train firefighters; fires set to dispose of certain explosive materials; recognized horticultural or wildlife management practices that involve burning; fires or other pyrotechnics not for waste disposal set as part of commercial film-making or video production activities for motion pictures or television; and in other emergency or extraordinary circumstances as determined necessary by the director of Ohio EPA. Allow at least two weeks to obtain written permission from Ohio EPA.

Q: What types of open burning are allowed <u>outside</u> restricted areas?

A: All of the exceptions to open burning in restricted areas apply to unrestricted areas as well. However, outside a restricted area, different limitations apply and other types of waste generated on the premises can be burned:

1) Agricultural waste: material generated by crop, horticultural, or livestock production practices. This includes fence posts and untreated scrap lumber, but not buildings (including dismantled or fallen barns), land clearing waste, garbage, or dead animals. No materials containing rubber, grease, asphalt, liquid petroleum products, plastics or building materials may be burned. Ohio EPA must receive written notice of intent to open burn agricultural waste at least 10 days prior to the burn if the size of the waste pile exceeds 20 feet in diameter by 10 feet in height (or 4,000 cubic feet).
2) Land-clearing waste: plant matter that is removed when land is cleared for residential, commercial or industrial development, including plant waste cleared for new agricultural development. This material may be burned only under certain circumstances and *with prior written permission from Ohio EPA.*
3) Residential waste: any plant matter, such as tree trimmings, stumps, brush, weeds, leaves, grass, shrubbery and crop residue, and any wastes such as wood or paper products that are generated on a one-, two-, or three-family residence as a

result of residential activities. Garbage may not be burned outdoors. Ohio EPA must receive written notice of intent to open burn residential waste at least 10 days prior to the burn if the size of the waste pile exceeds 10 feet in diameter by 10 feet in height (or 1,000 cubic feet).

No open burning can take place within 1,000 feet of an inhabited building located off the property where the fire is set, nor can the fire obscure visibility for roadways, railroad tracks, or air fields. Wastes should also be dried and stacked to provide the best practicable condition for efficient burning.

No waste generated off the premises may be burned. For example, a tree-trimming contractor may not haul branches and limbs to another site and burn them there.

Q: Do I ever need written permission from the Ohio EPA to open burn in an unrestricted area?

A: Yes—when burning land-clearing waste, utilizing burning to dispose of ignitable or explosive materials, burning for firefighter training, or when burning for recognized horticultural or wildlife management practices. When burning land-clearing waste, certain conditions must be met in order to receive Ohio EPA permission. To learn more about those conditions, contact your local Ohio EPA district office.

Q: How do I give appropriate notice to EPA or go about obtaining permission for open burning?

A: When notification is required, it must be submitted 10 working days in advance of the proposed burn. This does not include Saturdays, Sundays or legal holidays. Notification must include: a) purpose of the proposed burning; b) nature and quantities of materials to be burned; c) the date or dates when such burning will take place; and d) location of burn site. If EPA determines the open burning is not allowed, the applicant will be notified.

When permission is required, the applicant must allow at least 10 working days for EPA to review the permit, not including Saturdays, Sundays or legal holidays. Applications must contain: a) purpose of the burning; b) quantity or acreage and nature of materials to be burned; c) date when proposed burning will take place; d) location of burning site, including a map showing distances to residences, populated areas, roadways, air fields and other pertinent landmarks; and e) the methods or actions that will be taken to reduce emissions of air contaminants. Permission must be obtained for each specific burning project.

Notification or permission can be sent to the Ohio EPA district office for your county. The Ohio EPA webpage has a list of open burning contacts available.

Q: Does Ohio EPA ever allow exceptions to the rules?

A: Yes, under certain circumstances. However, if a material or type of fire is prohibited for your area, you must contact EPA before burning.

Q: Can a community enact a local ordinance to allow open burning?

A: Local ordinances cannot be less strict than the state law described in this article. They may, however, be more strict. It is always a good idea to check with your local community and fire department to prevent issues before open burning.

Q: What will happen to me if I'm caught doing illegal open burning?

A: Ohio EPA has the legal authority to enforce the open burning laws. Violations can result in substantial penalties. If you have questions or wish to report an open burning incident, contact your Ohio EPA district office or your local air pollution control agency.

Q: Are there other restrictions on burning I should know about?

A: The Ohio Department of Natural Resources (ODNR) prohibits any open burning in unincorporated areas between the hours of 6 a.m. and 6 p.m. during the months of March, April, May, October and November unless the burn is conducted in a plowed field or garden and is at least 200 feet from any woodland, brush land or field of dry grass. Prescribed fires, those used to meet resource management objectives, are allowed during these months so long as a Prescribed Fire Manager is on site. Contact ODNR Division of Forestry for more information (http://ohiodnr.com).

–by Leah Curtis, Director of Legal Education, Ohio Farm Bureau Federation, located in Columbus; updated January 2013.

What Business Owners Should Know about Mold and Indoor Air Quality Issues

Mold infestation may lead to a variety of legal claims against businesses. Such claims can include regulatory enforcement actions under OSHA's "general duty" clause, Ohio's statutory landlord tenant laws and municipal housing codes. They can include bodily injury claims under general tort principles and workers' compensation laws. And even if no bodily injury is alleged, there can be claims for property damage under laws governing real estate transactions, Ohio's Consumer Sales Practices Act and general contract law. Claims can arise against virtually any business involved in the life of a building, from construction contractors, real estate brokers and landlords, to employers whose workers simply occupy the building.

To help control those potential liabilities, the business owner can follow some basic steps:

1) Mold only becomes a problem in the presence of oxygen, heat, organic material and moisture. Avoid mold problems by controlling moisture and humidity in your building and by keeping organic materials such as drywall, wood and carpet dry. Clean up any water intrusion within the first 24 hours.

2) Where there is no visible mold problem but there is an alleged indoor air quality problem, hire a qualified testing contractor to recommend and conduct appropriate tests to determine the nature and location of the problem. The contractor's project supervisor should hold the title of Certified Industrial Hygienist from the American Industrial Hygiene Association. The testing contractor should be completely separate from the remediation contractor to avoid conflicts of interest.

3) When a mold problem is visible, spend your money on remediation, not testing. Follow remediation recommendations published by EPA or by the Institute of Inspection, Cleaning and Restoration Certification. If hiring a remediation contractor, require the project manager to be certified by IICRC or the American Indoor Air Quality Council, and obtain references.

4) Thoroughly investigate and document any allegations of health effects by individuals potentially exposed to mold.

5) Notify your insurer of any known mold-related problems or claims. Mold damage may or may not be covered under your policy, but either way, your insurer may be able to point you in the direction of appropriate contractors and other resources to help mitigate the damage.

6) Carefully consider what legal duties you may have to disclose a mold issue, and consult with your legal counsel if you are in doubt. There may be specific legal disclosure requirements regarding mold.

While each mold infestation scenario is different and potentially complex, taking these basic first steps can prevent serious problems.

–by Brent C. Taggart is a partner in the Columbus office of Vorys, Sater, Seymour and Pease LLP.

How Are Environmental Liabilities Handled by the Bankruptcy Code?

Q: My company is facing bankruptcy and wishes to reorganize under Chapter 11 of the Bankruptcy Code. How does Chapter 11 address environmental obligations, such as my company's contaminated property?

A: All claims, including environmental obligations, are generally handled the same way as other claims are handled in bankruptcy, but because environmental claims are brought by a governmental entity (such as a state or the EPA), they are sometimes afforded special treatment. Environmental claims are typically claims for cleanup costs, payment of civil or administrative penalties for past violations of environmental law, or claims for the current cost of complying with the law if the debtor is reorganizing under Chapter 11.

Q: I've heard that environmental claims are exempted from the automatic stay. Is this true?

A: Generally, yes. Once a debtor files a petition in bankruptcy court, the "automatic stay" prevents creditors from taking any further action against the debtor to collect on their claims. For example, a person who has a breach of contract claim against the debtor cannot even file suit against the debtor. Instead, the creditor must file a *claim* for *breach of contract* with the bankruptcy court and wait to see how the claim is handled by the court.

Governmental entities, however, cannot only file environmental claims against a debtor; they can simultaneously file suit against the debtor and attempt to convert their claim into a *judgment* if they prove their case. However, even though the government may convert their environmental claim into a judgment, they cannot collect on the judgment unless the bankruptcy court authorizes it.

Q: Must I continue to comply with all laws, including environmental laws, if my company is reorganizing under Chapter 11?

A: Yes. Federal law provides that a debtor in possession, *i.e*., a debtor undergoing a reorganization under Chapter 11, must continue to comply with all applicable state and federal laws, including environmental laws, while the reorganization is pending.

Q: My company has contaminated property as part of its assets. Can it just abandon the property or sell it to someone else?

A: No. Contaminated property cannot be abandoned to avoid a governmental obligation. However, you may be able to sell the contaminated property if notice is given to other creditors, the government's environmental claim is addressed, and the bankruptcy court authorizes the sale. The new buyer would then be obligated to comply with environmental laws and clean up the property.

Q: When my company submits its plan for reorganization to the bankruptcy court for approval, can the governmental entity (for example, the Ohio EPA) object to my plan?

A: Yes, and under the Bankruptcy Code, the governmental entity's claim will likely be the largest single claim asserted, as cleanup costs usually run into the millions of dollars. Creditors and claims that are similar are lumped together for purposes of objecting to reorganization plans, and thus governmental entities with large environmental claims may have more votes when it comes to approving or rejecting the reorganization plan.

Therefore, it is important to discuss with those governmental entities what they would need to satisfy their claims before submitting a reorganization plan to the bankruptcy court.

The law changes frequently, and it is important to consult with an attorney regarding any environmental liability concerns you may have.

–by David G. Cox, The Law Office of David G. Cox.

EPA's Lead Renovation, Repair and Painting Rules Impact Home Repairs

For businesses related to home repair and remodeling, spring is usually a busy season. It's the time when many homeowners want to improve their homes. However, since 2010, when the Environmental Protection Agency's (EPA) Lead Based Paint Renovation, Repair and Painting Rules (Rules) took effect, the cost of these repairs has gone up significantly. The Rules require that a certified individual or firm perform all renovation activities (above a certain threshold) at single family homes, multi-family dwellings and child-occupied facilities (such as childcare centers and kindergartens) built before 1978. See www.epa.gov/getleadsafe.

The Rules apply to **anyone who receives compensation** for renovation work resulting in the disturbance of painted surfaces that might contain lead contaminants. The Rules primarily affect specialty trade contractors such as painters and carpenters, but they also apply to owners of rental property and government or non-profit organizations that perform their own rehabilitation work. Small maintenance projects (under six square feet indoors and under 20 square feet outdoors) are exempt from these requirements, unless they involve window removal, demolition, or the use of prohibited practices such as open-flame paint strippers and power tools without HEPA filters. Under the Rules, all individuals performing the renovation must be either certified or have been trained by a certified renovator, and a certified renovator must supervise the project. The certified renovator must ensure that the renovation is performed in accordance with the work practice standards of the Rules. Before starting a renovation project, unless it is an emergency repair, the certified renovator must give the homeowner an EPA lead safety pamphlet or, if a multi-family building is being renovated, post signs in common areas to alert the tenants.

The Rules mandate that lead dust and debris must be contained, and that the work area must be cleaned up daily while the project is underway and inspected once the project is completed. These requirements can add hundreds, if not thousands, of dollars of additional costs to a typical home renovation project.

A firm can become certified under the Rules by submitting an application to the EPA. A certified firm must, in turn, provide training to its employees. An individual worker can become a certified renovator by successfully completing an eight-hour initial renovator training course offered by an accredited training provider. The certified individual must then complete an accredited four-hour refresher course every five years.

Renovators should take all steps necessary to ensure they are in compliance with the Rules, because violations may carry substantial penalties of up to **$37,500 per day**.

The Rules do not apply to homeowners' do-it-yourself renovations. However, if children under six live in the home or will be visiting, homeowners should follow the work practice standards spelled out in the Rules to protect these children from the potential harms associated with exposure to lead.

–by Joseph M. Reidy, an environmental attorney in the Columbus, Ohio office of Ice Miller, LLP.

Ohio's Regulation of Demolition or Renovation of Buildings Containing Asbestos

The presence of asbestos in construction materials is now well-recognized as a potential health hazard. In Ohio, demolition or renovation of buildings containing asbestos is regulated by the Ohio Department of Health (ODH) under state law and the Ohio Environmental Protection Agency (OEPA) under the federal Clean Air Act. The regulatory programs of these two agencies overlap, so it is important to understand which agency you must work with when conducting certain aspects of asbestos abatement or removal.

OEPA regulations apply to the demolition and renovation of buildings, except for single family homes or buildings with four or fewer dwelling units. In contrast, ODH regulations are based on the amount of asbestos present in a building, regardless of its use. In early 2012, OEPA expanded its definition of "asbestos containing material." So, even if you were familiar with previous regulations, be sure to read them again.

Prior to beginning any demolition or renovation, the owner or operator of a building must have the building inspected/sampled for the presence of asbestos. Notification and permitting requirements are then triggered, depending on the amount of asbestos that is found. For demolition, OEPA requires notification regardless of the amount of asbestos; for renovation, notification is only required if the amount of asbestos exceeds 260 linear feet on pipes, 160 square feet on other building components, or 35 cubic feet off building components. Notification to ODH must be made if more than 50 linear feet or 50 square feet of asbestos is to be removed. Even if notification is not required, all asbestos must be properly disposed.

Any individual responsible for removal or abatement of greater than 50 linear feet or 50 square feet of asbestos must be certified by the ODH, including those responsible for supervising, monitoring, identifying and planning asbestos abatement or removal, and the work is also subject to federal Occupational Health and Safety Administration (OSHA) requirements. Prior to the start of any project, the building owner must enter into a written contract with the asbestos removal or abatement contractor. That contract must contain a listing of all individuals working on the project and a statement that they are licensed and certified, a detailed description of all project activities and a requirement that all activities will be carried out in accordance with applicable regulations.

Violations of ODH and OEPA requirements carry stiff civil and criminal penalties. For violations of ODH regulations, civil penalties can reach $5,000 per day, and criminal penalties include incarceration of at least a year and at least $10,000 for the first offense, with escalating penalties for second or subsequent offenses. Civil and criminal penalties for violations of OEPA regulations can reach up to $25,000 per day and can also include incarceration. Enforcement for violations by one agency will not necessarily prevent enforcement by the other agency.

–by Joseph Reidy and Nicole Woods, attorneys in the Columbus office of Ice Miller, LLP.

Online Law

Chapter 12

The Rules of Doing Business Online

Mike and Kathy own a small retail business. They wanted to expand their business by selling online, so they hired a company to procure a domain name and design their website, complete with an online catalog and a shopping cart.

The site worked fine and their sales, while not as significant as they had hoped, did expand. They were getting orders from customers throughout the United States and several foreign countries.

Then the surprises started. When the domain name was up for renewal, they received a substantial invoice from the website design company. "Hey, I already paid you," Kathy told them. "Yes, you did," they replied. "But we own the copyright to your website, so if you want to continue using it, you'll need to pay us the annual license fee." Kathy was not impressed. "Well, we'll just take our business elsewhere," she said. "Go ahead," they replied. "But we own your domain name, so you can't move that, and you can't move any of our design from your existing site to some other site. If you do, that would be copyright infringement and we would sue you." Rather than start again from zero, Mike and Kathy ended up paying this company again for the work they thought they had already paid for. The next year, the website design company went out of business, and Mike and Kathy were lucky—they were able to gain control over their domain name, and the company told them they could go ahead and continue using the website without further payment of license fees.

But just when they thought they were home free, they received a letter from a stock photo service notifying them that two of the images on their website—images that had been put there by the design company—infringed the photo service's copyrights, and demanding $10,000 in damages and license fees. They ended up settling for a few thousand dollars.

The next surprise was when they started receiving return shipments of expensive electronic equipment they had sold to some customers in Europe several months previously. All the equipment was heavily used and not in good condition. They emailed the buyers, stating that their company policy was "no returns after 30 days." They received a response from an attorney who said, "Your policy is not enforceable; European law applies and, because you did not provide the required legal notices, my clients have an absolute right to a refund." The credit card company had already charged back the amounts, and after checking with their lawyer, Mike and Kathy realized there was nothing they could do.

The final surprise was that, when they typed the name of their company into various search engines, the first thing that kept popping up was the name of a competitor. They soon discovered that the competitor was far more successful at selling online, using Mike and Kathy's company name. No wonder their online sales were sluggish!

Such stories are not hypothetical situations; they happen repeatedly.

Doing business in cyberspace means being subject to a somewhat different legal environment from doing business at a physical location. Some examples:

- **Web-related service contracts.** It is important to pay attention to copyright and ownership rights. Unless there is a written agreement to the contrary, whoever designs your company's website owns the copyright to it. Also, make sure the designer verifies the

source of all images you didn't supply, and verifies that you have the right to use those images on your website.
- **Contracts without signatures.** A written signature is no longer required to form a contract; a click on an on-screen button that says "agree" is enough. It is important that every online transaction be treated as a real contract, with adequate terms and conditions, limitations on liability, etc.
- **Online terms.** If you are selling goods or services online, you need to have a full set of terms-of-use that you understand and comply with. Never just copy terms-of-use from other sites. There are restrictions on how much you may limit your liability, and you may not be able to specify that the law of your own state applies. Even for companies that sell commercial goods the old-fashioned way through a sales staff, it is becoming increasingly popular to remove the terms and conditions of sale from the "fine print" on the back of the order form, and instead simply include a reference to the company's online terms and conditions.
- **Privacy law.** Both as a legal and as a practical matter, it is important to implement and post a privacy policy that complies with the law in the buyer's jurisdiction, and then comply with your own privacy policy. The Federal Trade Commission as well as state consumer protection agencies often levy penalties against companies that fail to comply with their own privacy policies.
- **Online marketing.** The federal CAN-SPAM Act governs commercial solicitations via email. It is easy to comply with, but compliance is mandatory and the penalties for noncompliance can be substantial. Resist the temptation to pay people to write positive online reviews of your business as though they were neutral observers; it can be considered a deceptive trade practice.
- **Minors.** Contrary to popular belief, minors can enter into contracts online, but there are strict limits regarding correspondence with, and collecting information about, anyone who is or is likely to be under age 13. Any online seller of goods or services targeted at minors needs to be aware of the numerous laws protecting minors in an online environment.
- **Export regulations.** Most goods can be shipped overseas without special licensing or permits, but certain software and high-technology goods are restricted.
- **Trademark law.** Putting the name of your business and products online exposes them to the world. You need to be sure your marks do not infringe anyone else's marks, and you need to protect them from infringement by others.

Search engine optimization. While not solely a legal issue, optimization involves using specific words and phrases in a website, often as *tags* to enable the search engines to find your website. Such tags, often called *keywords* or *adwords*, can be purchased from search engine companies so that, when a user types in that particular word, the search results will include a link to the website of the company that bought the word. Company names, trademark names, and the names of a particular type of product are often used as keywords, etc. There have been lots of lawsuits involving companies that purchase competitors' names as keywords, thus diverting traffic perhaps intended for a competitor's site.

These are just some of the issues that need to be considered. There is certainly no reason to shy away from doing business online, but prevention of problems is always better than having to solve them.

–by Robert L. Ellis, a partner at Hennis, White & Ellis in Columbus and former chair of the OSBA Digital Technology Law Committee.

Be Careful When Using Internet Services

Many business owners and entrepreneurs learn the hard way that the Internet is a mixed bag of unpredictable services: some sources of information are reliable, and some are not.

I recently was informed about a couple of new business owners who decided to start a company. They turned to the Internet for help incorporating their business. They found a company—let's call it ABC Incorporations.com—that promised to set up their corporation for less than an attorney would cost. ABC Inc.com did not help them decide if they should be incorporated or discuss with them relative benefits of establishing an LLC versus a corporation or other business entity. The new entrepreneurs did not know to ask these questions. They simply filled in the online form and sent in their application.

A few weeks later they received their certificate of incorporation from the state of Ohio and a host of other materials regarding the company set up by ABC Inc.com. The company had made its representative the owner of the business and a local individual at a mailbox store the statutory agent. The business owners who had paid the Internet company to set up their corporation basically had transferred the ownership of their business to the Internet company.

I do not know whether the Internet company intentionally made itself the owner or simply made an error, but I doubt the new entrepreneurs had intended to transfer their business to an out-of-state party.

What this example points out is the significant risk you take when dealing with nameless, faceless Internet providers. When you use the Internet for business, keep these tips in mind:

1) Know whom you are contacting and whether or not they have a physical address. It can be very difficult to get problems resolved if you cannot even find the people who run the website.
2) Make sure the company has the experience and credentials to do the job. Remember, almost anyone can create a professional-looking website.
3) Google them. One of the best ways to learn about a web-based company is to use an Internet search engine to see if there are any articles or information available from third parties about the site.
4) Take a test drive. Give an Internet company a small project and see how your account is serviced before committing to a significant amount of business or service.
5) Send them an email. Many websites publish email addresses, but never respond to emails. Email a website provider seeking more information before working with a site. If a company cannot respond to you before you buy, how likely is it that you will get a response after you have given your money and there is a problem?
6) Think about what you send out. Do not send proprietary, financial, or other sensitive information to a website you do not know or trust. It is not enough to be notified that the web page is secure. If you must send particularly sensitive information, ask for a mailing address and send it by certified mail so you can limit the accessibility of the information and will have a physical address should something go wrong.

The Internet can be and is used successfully for business and legal work. By using the above tips and strategies you will be better able to avoid Internet problems and the pitfalls associated with web businesses.

–by Jeffrey J. Fanger, the managing member of the Cleveland law firm of Fanger & Adelman LLC.

Electronic Signatures: Can Your Computer Sign a Contract without Your Knowledge?

It is common knowledge that people can enter into a contract online by clicking an "I accept" button, but electronic signature laws at the state and federal level are much broader. The federal version is the Electronic Signatures In Global and National Commerce Act (E-SIGN). E-SIGN is significant because it means that electronic signatures are valid for commercial transactions throughout the United States and for all international commercial transactions based on United States law. E-SIGN invalidates state laws requiring paper signatures (with a few exceptions discussed below), as well as state-level electronic signature laws and court decisions that have conflicting provisions. It permits businesses to require electronic signatures of their customers as a condition of doing business. Also, many laws that used to require retention of paper originals have been pre-empted, and it is now permissible to retain copies of many types of documents in electronic rather than paper form.

Q: What is an "electronic signature"?

A: E-SIGN defines it broadly: "an electronic sound, symbol or process, attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record." This definition means that a simple email response of "okay" can be the equivalent of your signature. The concept of a signature as being limited to a physical mark on a piece of paper has been abandoned, and in its place is the concept of "indication of assent." Contracts can now be entered into by pressing "1" on a phone, by entering a pin number, by clicking a box on a web page, by sending a text message or instant message response to an offer, or—if the privacy aspects can be ironed out—even by means of a biometric identifier (a biometric identifier might read, "Please sign the rental agreement by placing your thumb on the ID pad"). Although a verbal statement or a recording of a verbal statement is specifically excluded from the definition of "electronic signature," E-SIGN does not prohibit verbal statements from being used as signatures; there just has to be some other law that allows them to be used in that way.

Q: What about contracts that must be notarized?

A: E-SIGN also permits electronic notarization. Although only one state, Virginia, has enacted a law regarding remote, electronic notarization of documents, the issue raises some intriguing possibilities: Since people conduct major transactions online at home after hours (not only at real estate offices and banks during working hours), will notaries in some states still have to personally witness the person signing the contract—even if both the person signing and the notary use electronic signatures? Will a videoconference suffice for the notary to "witness" the person signing?

Q: What about electronic forgery risks?

A: Encryption and detailed technical standards were developed in the past to make electronic signatures forgery-proof, but practical considerations discouraged their use. Instead, businesses simply exchanged emails. While the risk of electronic forgery has not been eliminated, it has thus far proven to be no greater than paper forgery. After all, an exchange of emails leaves an extensive electronic record of times, IP addresses, servers used and other parameters not available with paper documents.

Q: Is it possible for computers to make contracts without involving people?

A: Yes, and it makes sense in a business context. The law allows contracts to be formed by "electronic agents." *Electronic agent* is defined as "a computer program or an electronic or other automated means used independently to initiate an action or respond to electronic records or performances in whole or in part without review or action by an individual at the time of the action or response." Thus, binding contracts can be formed by machines without the direct participation of any human being. This sounds revolutionary, and it is, but to date electronic agents are active mostly between companies that have agreed—via real people—to conduct certain transactions automatically. Nonetheless, right now it is perfectly legal to program a computer to search for various items on the Internet and purchase them at the lowest price it can find, using a credit or debit card, without any human being involved once the program has started running.

Q: Is there any type of contract that cannot be signed electronically?

A: Yes. E-SIGN does have some limits. It applies only to commercial transactions. It does not apply to wills and trusts; family law matters such as marriages, adoptions or divorces; court documents; or notices of termination of various sorts such as evictions, utility cutoffs, product recalls and insurance cancellations. Although it applies to the *Uniform Commercial Code* provisions for contracts and sales, and for written waivers, it does not apply to commercial paper, bank deposits and collections, letters of credit, warehouse receipts, investment securities or transactions involving a security interest.

The law prohibits the states from imposing any particular standards of their own for electronic signatures. Congress wanted to allow the private sector to come up with workable standards that could evolve over time.

E-SIGN makes it much easier to conduct business and enter into agreements online. Nonetheless, these days, when you're on the phone or online, you need to pay special attention to what buttons you push.

–by Robert L. Ellis, a partner at Hennis, White & Ellis in Columbus.

The Federal CAN-SPAM Act and the TCPA: Rules for Marketing by Email and Text Messaging

If you promote your products or services by email, make sure that your email marketing complies with the federal "CAN-SPAM Act" or you could face potential stiff penalties. The CAN-SPAM Act, which is the short title for the "Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003," took effect on January 1, 2004, in an effort by Congress to curb the growing problem with "spam" emails. The act gives Internet users the right to demand that a party stop sending them commercial emails. The act empowers federal agencies (primarily the Federal Trade Commission or "FTC"), state agencies, and Internet service providers to enforce its provisions. Such enforcement includes the right to seek money damages (for example, the FTC can seek fines of up to $16,000 per violation) or criminal prosecution against those who falsify headers, those who falsely create email accounts or Internet addresses in order to send spam, and those who retransmit commercial emails to conceal the origins of spam emails.

CAN-SPAM applies to commercial email

The Act applies to all "commercial email," that is, emails that have the primary purpose of advertising or promoting products or services. The act applies against anyone who sends commercial email, initiates or procures the sending of the email, or who retransmits such email. It means that you are, or your business is, responsible for the commercial emails sent on your behalf by a third party you had employed to assist you with email marketing.

The restrictions in the CAN-SPAM Act do not apply to *transactional* or *relational messages*, which are emails sent to facilitate, complete, or confirm a transaction, or provide warranty or safety information for a product or service used or purchased by the recipient.

General rules on how to comply with the CAN-SPAM Act:

- Commercial emails must clearly identify that the message is an advertisement if you do not have prior *affirmative consent* from an Internet user to send such emails. Affirmative consent means that the email recipient expressly agrees to receive a message either in response to a clear and conspicuous request for such consent or at the recipient's own initiative.
- The commercial email must allow the recipient to send a reply message or other "Internet-based communication" to opt out of future emails from the sender. The "opt-out" information must include the sender's valid, physical postal address.
- The email sender can offer a list or menu that allows the recipient to choose which types of commercial emails would not be welcome, *provided* that this menu also includes a general opt-out of all commercial emails.
- The opt-out request must be honored with 10 days.
- The email message must have correct header information.
- The message must have an accurate subject line. Avoid using clever turns of phrases in the subject line if such wording might confuse or mislead recipients regarding the content of the message.

Text messaging

In addition to the CAN-SPAM Act, the Telephone Consumer Protection Act (TCPA) and Federal Communications Commission (FCC) rules ban text messages sent to a mobile phone using an autodialer unless 1) the user previously gave consent to receive the message or 2) the message is sent for emergency purposes. You also must give the user the ability to revoke consent for future mobile text messages, such as by dialing a short code. A user must give consent orally or in writing, which may include an agreement obtained electronically under the federal E-SIGN Act (the Electronic Signatures in Global and National Commerce Act).

Practical tips

The CAN-SPAM Act supersedes all existing state spam laws, except for state laws that prohibit falsity or deception in any portion of a commercial email. For example, Ohio has enacted a statute that imposes criminal penalties against spammers who use fraud and deceit to send bulk commercial email in Ohio (ORC §2913.421). Therefore, a violation of the CAN-SPAM Act may violate Ohio law as well.

Your business should develop a reliable database system to collect, maintain and store customer information so that "unsubscribe" requests can be processed quickly, including all opt-out requests communicated directly to your business and to any third party engaged to assist with an email campaign. For text messaging, users must "opt-in" and agree orally or in writing to receive promotions. It also means that your business must ensure that all opt-out requests provided to any third party are transmitted promptly to your business and to any other party managing your advertising email database. Finally, this is not a comprehensive article on the CAN-SPAM Act; you should seek advice of your counsel on how you or your business should manage an email marketing program.

–by A. Brian Dengler, a technology and intellectual property attorney in New Albany, Ohio, and media law, business and ethics instructor at Kent State University.

An FTC Violation in One Hundred Forty Characters (or Less)

There are approximately one billion people on Facebook. Twitter has more than 500 million account holders. Add in all of the bloggers and it becomes crystal clear that social media is more than just a fad. Social media is being used worldwide to connect old acquaintances, make business referrals, and market and advertise products and services. Chances are a vast majority of your employees, customers, potential customers and competitors access a social media site on a daily basis. Social media is quickly becoming a preferred way for businesses to tout products and services.

The Federal Trade Commission regulates the use of endorsements and testimonials in advertising through its published "Guides Concerning the Use of Endorsements and Testimonials in Advertising." These endorsement guides, which have been in effect for more than 20 years but were most recently updated in 2009, address endorsements by consumers, experts, organizations and celebrities. Make no mistake, these endorsement guides apply with the same force and effect to social media.

So when your company's receptionist writes on his or her personal Facebook page a glowing review of the new product your company launched, do you have anything to worry about? The short answer is "yes."

Under the guides, an endorsement is "any advertising message (including verbal statements, demonstrations, or depictions of the name, signature, likeness or other identifying personal characteristics of an individual or the name or seal of an organization) that consumers are likely to believe reflects the opinions, beliefs, findings or experiences of a party other than the sponsoring advertiser, even if the views expressed by that party are identical to those of the sponsoring advertiser." The overriding principle when it comes to endorsements is that they must reflect the honest opinions, findings, beliefs or experiences of the endorser.

The issue with your receptionist posting a review on his or her Facebook page is that there is a connection between the endorser (your receptionist) and the seller of the product (your company) that might materially affect the weight or credibility of the endorsement. When such a connection exists, it must be disclosed. Your receptionist's employment would likely affect the weight or credibility of the endorsement. Unless your receptionist's employment is clearly and conspicuously disclosed on his or her page, the post violates the FTC's endorsement guides.

While the advantages of being able to so easily communicate a message about your product or service to such a wide demographic are huge, it is important to keep the endorsement guides in mind when using endorsements and testimonials for your products or services. An easy way to educate your employees on how to properly use social media for business purposes is to adopt a clear, well-written social media policy. By educating your employees on what they can and cannot say and do, you should be able to avoid violations of FTC regulations.

Go to the FTC's business legal resources page at http://business.ftc.gov/legal-resources/5/33 for more information. Besides the endorsement guides, you will find other information that will help you keep your business on good terms with the FTC.

–by Alan Hartman, a Cincinnati attorney practicing at Dressman Benzinger LaVelle psc.

Screening Job Applicants' Social Media Sites?

Be Aware of Pitfalls

While social networking sites have become a popular resource for job applicant screening, employers should be aware of the legal issues that exist and take steps to avoid any unintended consequences.

Sites such as Facebook, Twitter and LinkedIn often are accessed by hiring managers because they are easy-to-use and cost-free, contain millions of active users, and provide information about potential job applicants that otherwise might go unrevealed.

By using social networking sites, however, employers unintentionally may be exposed to liability springing from protected class factors and other legally protected personal information such as family health histories, race, age, gender or disabilities that should not influence the hiring decision. Employers might find themselves in hot water, legally, if they are ill-prepared to support the decisions made during the hiring process. In order to be confident in their defense against refusal-to-hire claims, a number of guidelines should be followed:

- Given developing privacy laws, employers should refrain from asking, and especially from requiring, applicants to provide their personal social media passwords or log-ins.
- It is best if a non-decision maker screens the candidate via social media sites so that only relevant qualifications are relayed to the hiring manager. While reviewing the content on social media sites, only job-related criteria should be considered.
- Documentation is critical. The evaluation process and rationale supporting an employer's decision-making should be recorded. This demonstrates consistency in the hiring process, which is key to defending against applicant discrimination claims. To avoid being accused of unjust hiring practices, recruiters should not selectively choose candidates to be researched online.
- The reliability of the information located online should be considered, as well as any generational differences that may exist between hiring managers and potential job candidates. Employers should not render conclusions that might result in the elimination of qualified candidates based on unverified or misunderstood information.

While using social networking sites for applicant screening has become popular, it is important for employers to avoid the pitfalls that exist when incorporating such background checks into the hiring process.

–by John W. McKenzie, Esq., a shareholder with the Akron labor and employment law firm Kastner Westman & Wilkins, LLC, which represents management exclusively.

National Labor Relations Board Addresses Employee Social Media Activity

Society's ever-increasing use of social media platforms has created new problems for employers. Concerns include whether an employer can regulate the content an employee posts online if the posting is made while the employee is off-duty, whether the employer should implement a social media policy and what this policy should say.

Reports published by the National Labor Relations Board focus on employer-employee social media issues. They detail NLRB decisions involving employee social media activity. They also address whether employer policies limiting employee social media use are overly broad and could reasonably be interpreted as restricting employee communications protected under the National Labor Relations Act (NLRA).

Under the NLRA, employees may engage in protected, concerted activity. Such activity exists when two or more employees act together regarding the terms and conditions of their employment. Employers may not interfere with this kind of activity.

NLRB Social Media Cases
Most of the cases discussed in the NLRB reports involve situations where one or more employees used a social media site, such as Facebook or Twitter, to post comments about some aspect of their employment, and the employer subsequently took an adverse action. In some of the cases, other employees responded with comments of their own. Whether this type of online activity amounts to protected, concerted activity depends on the specific facts of each case.

If employees' online posts also involve comments from other co-workers and focus on job performance or working conditions, they may be protected activity. This is true even if the posts are made while an employee is off-duty. If, however, an employee's posts are more along the lines of gripes or harassment, and if no other employees respond, this activity may not be protected. In situations involving social media, employers should use care in gathering facts and consult an attorney before taking action against an employee.

NLRB Rulings on Social Media Policies
In devising a social media policy, employers should avoid using overly broad language and should clearly define key terms so that the policy is not construed as restricting lawful employee activity. In its decisions on the lawfulness of social media policies, the NLRB has focused on whether there are examples or contextual qualifiers that could be understood as placing limits on how the policy is applied.

In their social media policies, employers cannot:
- prohibit employees from making comments about the employer online;
- prohibit employees from identifying themselves as employed by the company; or
- prohibit employees from making defamatory comments about the employer online.

Employers are permitted, however, to impose a policy that:

- prohibits the disclosure of confidential information;
- prohibits use of the company's trademarks; and
- prohibits vulgar, obscene, threatening or harassing online comments that relate to race, religion, color, age, sex, ancestry, national origin, disability or any other characteristic protected by applicable federal, state and local law.

Overall, an employer's social media policy must provide the necessary context to clarify that only harassing or discriminatory communications are prohibited. Overbroad statements will be found unlawful if examined by the NLRB.

–by Kelly Schoening, Esq. and Katie Cassidy, Esq., associated with the firm of Dressman Benzinger Lavelle psc.

As Mobile Apps Grow, So Do Potential Problems

"Mobile apps" are becoming as ubiquitous as mobile phones. Today, mobile apps provide increasingly numerous functions for mobile phones to interact with you as well as with other devices. All of those interactions have significant business, technology and legal implications.

For instance, mobile app issues can include copyright, trademark, patent, trade secret, contract, tort, privacy, Children's Online Privacy Protection Act, CAN-SPAM, Federal Communications Commission, Federal Trade Commission, licensing, open source and class-action legal issues, to name a few. These issues concern not only manufactures of mobile phone devices but app developers as well.

Patents

In a recent patent infringement case involving Apple and Samsung (*Apple Inc. v. Samsung Electronics Co.*, [USDC, ND, CA, Aug. 24, 2012]), a jury awarded Apple $1.05 billion in damages after finding that Samsung infringed on several of Apple's patents. The lesson for mobile app developers (and manufacturers) is to be aware of the patent pool in which your technology is designed to play, and protect your intellectual property rights promptly if you become aware of possible infringing activity.

Promissory fraud

In *Haught v. Motorola Mobility, Inc.* (8/23/2012), the U.S. District Court for the Northern District of Illinois denied a motion to dismiss a class-action lawsuit in a case example of tort law interacting with mobile apps. The case involves the manufacturer of a mobile phone announcing a future upgrade of the operating system of its mobile device. A consumer purchased the mobile device allegedly in reliance on that representation only to find (after the return policy expired) that the manufacturer was not going to provide the upgrade. Although the outcome of this lawsuit has not yet been determined, the case provides one example of how promissory fraud (tort) issues may arise with mobile devices.

Privacy

On May 25, 2012, the FCC announced an inquiry into privacy and security of information stored on mobile communication devices. The public notice solicited comments regarding the privacy and data-security practices of mobile wireless service providers with respect to customer information stored on their users' mobile devices and the application of existing privacy and security requirements to that information. The FCC's questions include:

- How have those practices evolved since the FCC collected information on this issue in 2007?
- Are consumers given meaningful notice and choice with respect to service providers' collection of usage-related information on their devices?
- Do current practices serve the needs of service providers and consumers, and in what ways?
- Do current practices raise concerns with respect to privacy and data security?

The FTC and other regulators are also looking into privacy issues concerning mobile apps. As wireless service providers and mobile app developers become stewards of sensitive customer and business data, including personal identifying information, how will the law and regulations evolve? Will wireless service providers and mobile app developers be viewed differently or the same as Internet service providers?

What these developments mean for mobile app developers and the businesses hiring mobile app developers is that they, and their legal advisers, must be mindful of the evolving legal issues. When the subpoena is served with the complaint alleging violations of these and other legal rights, this is not the time to ask, “Is there an app for that?” to wish away the pending legal liabilities.

Death and the Digital Age

With an increasing number of business assets residing in digital form and accessible only through electronic means, you and your business associates need to be mindful of what will happen to those digital assets when an owner, officer or key employee of the business dies.

Digital assets include financial information about the business (*e.g.*, bank and credit card accounts), documents, email, social media websites, photographs, trade secrets and other items not meant, nor appropriate, for public disclosure. These digital assets may also include some very personal and private items such as employee medical and financial information.

What if the business owner or employee who managed these digital assets dies? Access to the digital assets most likely will require, at a minimum, knowledge of the user name and password (or, in some cases, possession of a working security token used in conjunction with the user name and password). If the digital assets are encrypted, then knowledge of the encryption key will be necessary to unlock the encryption in order to be able to see and read the digital assets.

For small- to medium-size businesses where there is one individual in control of the business and that individual dies, the digital assets of that individual, and his or her business, may be at risk of not being readily known or, if known, readily accessible. Those who may have an interest in the existence of the business' digital assets (*e.g.*, family members, employees, shareholders, business partners, creditors, and claimants to intellectual property rights owned or used by the business) may not even be aware of the existence and location(s) of all of the digital assets. A business could fail if timely access to the digital assets of the business is not obtained.

Some states have passed statutes or are considering legislation to provide executors of a deceased person's assets a right to take control of certain digital assets. However, these state statutes are not uniform in their language and scope, and as of June 2013, no federal law adequately addressed these issues. The Uniform Law Commission (www.uniformlaws.org) proposed in January 2012 that a study committee be formed to consider drafting uniform legislation concerning access to digital information by a fiduciary administering a decedent's estate. As of June 2013, their work product, the "Fiduciary Access to Digital Assets Act" was still under consideration. It may be some time, however, before a uniform statute, if any, is produced by the National Conference of Commissioners on Uniform State Laws and adopted by the states.

Current, albeit limited, statutory resources available in this area fall short in their approach to the contracts, licenses, intellectual property rights, privacy rights and the technologies that sit at the threshold to accessing many digital assets. In fact, several state and federal laws limit access to certain digital assets except to the original account owner(s) and/or authorized designees.

What steps can your business take to protect itself and its digital assets? Assuming that those who may have a legitimate need or desire to know about the digital assets of the business are even aware of the existence of the digital assets, how will they deal with the access and control of these assets?

Consider taking some proactive steps to develop a plan for handling your company's digital assets including:

- Consult with an attorney who has experience in estate planning and digital assets, or an estate planning attorney who consults with an attorney knowledgeable about the laws affecting digital assets.
- Digital assets estate planning services offering a technological solution to handling digital assets can be contacted through the Internet, but their terms of use are not uniform and may open your company to legal risks. Before entrusting the keys to your company's digital life to a digital estate planning service, consult with a knowledgeable attorney to review and discuss the terms of use with you.
- Be aware of the terms of use governing websites that may contain your business's digital assets. Control over the digital assets may be stymied by the terms of use of these websites. For instance, the social media website of a key employee may not allow his or her heirs to continue the decedent's social media presence as a memorial to the decedent. In some instances, the family or heirs may have valid reasons for wanting the decedent's social media presence to be promptly removed, but will have to work through the terms and conditions of the social media website provider. Consider what might happen if the marketing manager or website developer who registered your business's domain in his or her own name dies. Getting access to make changes to your business's website could be very difficult, and if a renewal payment to maintain ownership of the domain (URL) is missed, the website domain could be lost.
- If your company's digital assets include a collection of e-books in which the copyright rights are owned by a third party, it may be an infringement of copyright rights if multiple copies of an e-book are created and distributed to multiple heirs or shareholders.

Like most things in life and in business, a little planning may go a long way in preserving and protecting one's digital legacy.

–by Alan S. Wernick, Esq., ITIP Institute. ©2013 & 2012 ALAN S. WERNICK. WWW.WERNICK.COM.

Handling Legal Matters

Chapter 13

When a Handshake Isn't Enough

The Web site designer offered to create an Internet identity for the radio station. He and the station manager reviewed similar websites, outlined key information for the new site, decided to launch the site as soon as possible, and shook hands.

Final agreement, right?

Not exactly. Their discussion overlooked important issues such as what exactly is the business owner paying for? Design? Input of artwork? Audio and video links? And what does "as soon as possible" really mean? It is an old-fashioned concept: a business deal sealed with a handshake. But handshakes do not always hold up well in court.

Here are a few sound, but simple steps to protect yourself in negotiating a contract.

- First, prepare an outline of all items to be covered in the agreement. Discuss each item with someone else in the organization; two heads are better than one.
- Avoid "do-it-yourself" contracts. Instead, talk with a lawyer—before you enter into the agreement, not afterwards.
- Get signatures. No agreement is final until both people agree to the terms and conditions and confirm it with their signatures. A court is more likely to dismiss claims that a verbal estimate or quote is a contract. Sometimes it is not. Only a piece of paper that has signatures, a date, and specific details of the arrangement can be considered a reliable contract.
- Be specific. What do I have to do? What do I get in return? How much will I be paid and when? Are the deadlines realistic? If the contract doesn't spell out these details, a court will decide later what the contract "says," and this may not be what is intended.
- Clearly state the business terms. Clarify the definitions and put them in writing. This will avoid confusion and/or misunderstanding.
- Seek the advice of others as needed. For example, your insurance agent can guide you through liability/exposure issues, your accountant can calculate tax implications, and most importantly, fellow employees can ensure that you deliver on your promises—on time and on budget.
- A signed contract is a binding agreement. Keep an original, fully signed copy for your files. And shake hands—after the ink dries.

–by Neil W. Gurney, a partner in the business group of Ulmer & Berne, LLP, Cleveland.

When The Emperor Has No Clothes…

Remember the fairy tale where the emperor was hoodwinked by some con artists saying his new fabulous suit was spun with gold thread so fine that only the smartest subjects could see it? Remember how the emperor commented on how beautiful the suit was because he wanted to appear intelligent? Remember that everyone around the emperor told him how great it looked because they did not want to lose his favor? Remember how the emperor walked *completely* naked among his subjects until a young child yelled, "But the emperor has no clothes on!"

Unfortunately, family businesses sometimes resemble small kingdoms where the family members may be afraid to tell the founders the truth about a delicate subject for fear of being fired—or worse—cut out of the will!

As the family business's legal advisor and counselor, the lawyer often will be in the position of telling the founder information he or she NEEDS to know, but may well not WANT to know. In fact, the attorney may be the *only* person objective or brave enough to tell the truth—such as, "Your son has a drug problem and may not be the proper choice for your successor," or, "The amount you believe is right for the valuation of your family business is way too high."

When advising a client, the law charges a lawyer with informing the client about what the law says, helping with decisions about future conduct and relationships, and being truthful.

Few attorneys enjoy being the bearer of bad news and few business owners enjoy discussing disagreeable matters. However, a business should depend on its attorney to be a counselor, a trusted adviser—the person who will always speak the truth—even if the information is unwanted or unpopular.

–Beatrice E. Wolper, president of the Columbus firm, Emens & Wolper Law, LPA.

Mediation Can Resolve Business Disputes

Q: What is mediation?

A: Mediation is any process in which a neutral third party, the mediator, facilitates communication and negotiation between parties to assist them in reaching a voluntary agreement regarding their dispute. Through the mediation process, a mediator facilitates a discussion with parties and/or their attorneys in an effort to resolve disputes by mutual agreement in an expeditious manner.

Q: What is a mediator?

A: A mediator is an individual who conducts mediation. Mediators are neutral third parties who facilitate communications between parties involved in a dispute to reach a mutually acceptable agreement. Mediators assist parties with issue identification and problem solving. The mediator usually will meet separately with each side for private, more candid discussions. A mediator may be a court employee, a volunteer helping a court, or a lawyer or other professional in private practice. Although many mediators are also lawyers, that credential is not required.

Q: What kinds of cases or disputes can go to mediation?

A: Just about any type of case can be mediated successfully. Courts often utilize mediation for cases involving business contracts, intellectual property, real estate and land use disputes, employment matters, and collecting on accounts, just to name a few. Mediation is also utilized outside of court for cases involving consumer complaints, land use and environmental issues, as well as neighborhood disputes.

Q: Will the mediator issue a decision in my case?

A: No. The mediator has no decision-making authority. The mediator assists parties and/or their attorneys to look at the case more objectively, discuss various options, review strong and weak points of each side's position, and listen to each side so the parties can find a mutually acceptable solution to their dispute.

Q: What does the mediator tell the judge?

A: Very little. The mediator may tell the judge whether the mediation occurred or has been terminated, whether a settlement was reached and what parties attended.

Q: Should I bring witnesses and exhibits to the mediation?

A: No. Mediation is not like a trial or arbitration. While the attorneys, parties and the mediator will discuss the evidence, there are no witnesses, no testimony, no exhibits, no objections, no cross examination and no arguments. You may, however, bring relevant documents that may help to further explain, clarify or update the factual situation from your perspective.

Q: Will I be expected to testify?

A: No. Mediation is not like a trial. Rather, through the mediation, parties participate directly in the discussions and make decisions about how to proceed and whether or not to settle.

Q: Can the mediator tell me what my case is worth?

A: No. The mediator is not there as a judge, jury or arbitrator of the case and will not make an assessment or recommendation about your case. You and your attorney should evaluate your case and weigh the benefits of settling. The mediator, the attorneys and the parties may, however, discuss the costs of going forward with litigation as compared to the benefits of settlement.

Q: Will the other side be there?

A: Generally, yes. In a business case, the other party(ies) or company representative(s) should be present to offer their view of the issues and to make decisions about resolving the dispute. If your case involves insurance, the insurance adjustor will be there representing the carrier. It is often important for all parties present to listen to and learn about each other's point of view on the way to a resolution.

Q: I want my day in court. Why should I settle?

A: You have every right as a citizen to seek a fair trial in court. A trial is not, however, the only legal choice available. More than 95 percent of all U.S. cases filed never go to trial. Some cases need a trial because of an unusual legal question, a factual dispute, or a serious disagreement about a fair settlement value. Before going to trial, first consider factors such as time, expense, distraction from your business, disclosure of private business information like customer lists or trade secrets, court delays, possible appeal, the risk of a bad result, the facts of the case becoming part of a public record and stress associated with a lengthy court process.

Q: What happens if we can't settle?

A: If parties do not believe they are able to reach a mutually acceptable resolution through mediation, the case could ultimately go to trial. Sometimes, attorneys and their parties agree to engage in further negotiations, often at a later time once certain legal questions are resolved by the judge or after formal discovery, for example. There is no penalty or extra cost for using mediation, beyond the mediator's fee, if applicable. One of the strengths of mediation is that parties do not lose any rights or access to other means of dispute resolution if they try mediation first.

–originally prepared by Harold D. Paddock, Esq. Updated by Marcie Patzak-Vendetti, magistrate and director of Court Mediation Services for the Mahoning County Court of Common Pleas, Juvenile Division.

Uniform Mediation Act Affects Business Dispute Resolution

Q: What is the Uniform Mediation Act?

A: The Uniform Mediation Act (UMA), adopted by Ohio and effective as of 2005, significantly impacts mediation. It is designed to provide for a uniform set of legal rules regarding mediation practices from state to state. The UMA can be found in chapter 2710 of the *Ohio Revised Code*, sections 2701.01 to 2710.10.

Q: Why should I be concerned about the UMA?

A: Mediation is being utilized more and more, both in and out of Ohio's courts, to resolve business disputes, and it is likely that even more disputes and cases will be mediated in the future. Knowing how the UMA impacts mediation will be increasingly important for those who participate in mediation.

Q: What types of mediation are covered by the UMA?

A: The UMA broadly defines mediation as any process in which a mediator facilitates communication and negotiation between parties to assist them in reaching a voluntary agreement regarding their dispute. What is *not* covered by the UMA, however, are collective bargaining in the labor field, peer mediations at primary or secondary schools, labor dispute mediations, court settlement conferences conducted by a judicial officer (judge or magistrate) who might make a ruling in the case, and mediations in a correctional institution for youths if all parties are residents of that institution.

Q: Who can be a mediator under the UMA?

A: The UMA defines a mediator as an individual who conducts a mediation. A mediator does not have to have special credentials or a license, but a mediator must be impartial. Some courts may require specific training for their mediators and, in certain situations, the parties to a business dispute can pick a mediator with a special background, like accounting, technology or finance.

Q: In essence, what does the UMA do?

A: The primary purpose of the UMA is to protect the private and confidential nature of communications before, during and after a mediation. This is important because, when people do not talk openly with the mediator and each other, the chances of a successful settlement drop. The UMA protects the privacy of the mediation communications, and thus helps everyone reach a mutually beneficial resolution.

Q: How does the UMA protect the privacy of talks in a mediation?

A: The UMA creates a legal privilege for *mediation communication* (any statement, whether oral in a record, verbal or nonverbal, made before, during or after a mediation). A *privilege* is the legal ability of one person to block another person's testimony from being introduced in a later court proceeding. The mediator, all parties, and any other people present at the mediation (such as attorneys) have a privilege in varying degrees under the UMA to stop other people from revealing what was said at a mediation.

Q: Can a person give up the protection of the UMA?

A: Yes. A mediator, a mediation party and a non-party participant may waive or give up his or her mediation privilege. It is important to remember, however, that all parties to a mediation are protected by the UMA. Even if all but one party involved in the mediation have given up the privilege, that one party still may choose to use the privilege to block certain testimony.

Q: Is everything said in a mediation protected by the legal privilege in the UMA?

A: No. Under the UMA, certain communications or types of statements are legally excluded. For example, discussion regarding abuse or neglect of children or the elderly, crimes or threats of violence, materials subject to public records laws, and signed settlement agreements are not protected from disclosure by the legal privilege provided under the UMA.

Also, the UMA does not stop or limit communications outside of court to third parties. If someone is concerned about protecting proprietary business information or trade secrets, for instance, the parties may enter into a signed confidentiality agreement prior to the start of a mediation.

Q: What can a mediator tell a judge if the case is in court?

A: A mediator is limited by the UMA in what can be communicated to the judge. The mediator may tell the judge whether the mediation occurred or has been terminated, whether a settlement was reached and what parties attended. A mediator cannot report, analyze, evaluate or make findings or recommendations to a court or judge.

Q: Does a mediator have any obligations under the UMA?

A: Yes. A mediator must make an inquiry to reveal any potential conflicts of interest that might affect his or her impartiality. Additionally, if asked, a mediator must disclose his or her qualifications to mediate a dispute.

Q: Where can I learn more about the UMA?

A: The Internet has many resources on the UMA in Ohio. You can read the full text of the UMA at http://codes.ohio.gov/orc/2710. The Supreme Court of Ohio has information on the UMA at www.supremecourt.ohio.gov/JCS/disputeResolution/resources/uma/default.asp.

–originally provided by Harold D. Paddock, Esq., and updated by Marcie Patzak-Vendetti, magistrate and director of Court Mediation Services for the Mahoning County Court of Common Pleas, Juvenile Division.

Can Foreclosure Mediation Help Me?

Q: What is foreclosure mediation?

A: Mediation is any process in which a neutral third party, the mediator, facilitates communication and negotiation between parties to assist them in reaching a voluntary agreement regarding their dispute. When the mediation process is applied to foreclosure issues, a mediator works with the parties to a mortgage, with or without attorneys, to resolve the mortgage problem by mutual agreement before it reaches court, default judgment or foreclosure sale. The mediator has no authority to decide the case.

Q: We bought a building for our business, but are now having trouble making payments. Why should our business mediate its mortgage problem?

A: Mediation allows you to make decisions directly and determine what solution is best for your business. Many mortgage problems, whether caused by a sudden change in the terms of the mortgage, like a rate adjustment or a change in your financial situation, can be resolved through good communication. An experienced mediator can help you create solutions. Right now, lenders are generally willing to discuss reasonable solutions, and mediation provides a more controlled, diplomatic environment in which to have discussions that, without a mediator, might be tense or difficult.

Q: How does using foreclosure mediation differ from using a "debt relief" service?

A: While some mediators volunteer their time and others charge limited fees for hours actually worked, there are no hidden or ongoing fees or costs associated with mediation and, in most cases, it only takes a few hours of time. "Debt relief" services, however, may charge excessive fees for modest results, and some are actual scams.

Q: What is pre-suit mediation?

A: Pre-suit mediation is a conference that is held before a lawsuit is filed. Once a suit is filed, it becomes a public record and anyone can get information about the parties. Credit reporting services monitor court records and note the filing of a foreclosure as a black mark on a person's or corporation's credit rating. Pre-suit mediation avoids a public record, saves expenses and solves problems (such as non-payment) before they become worse.

Q: Will the mediator make a recommendation to the court about our case?

A: No. A mediator makes no decisions, assessments or recommendations to the court. In fact, the mediator can only tell the court (assuming the case is already pending) whether the mediation occurred or has been terminated, whether a settlement was reached, and which parties attended the mediation. Mediation communications in Ohio are privileged and cannot be used at trial.

Q: Should we bring witnesses and exhibits to the mediation?

A: No. Mediation is not a trial. There are no witnesses, no exhibits, no objections, no cross examination and no arguments. You may, however, bring relevant documents to help you further explain, clarify or update the factual information related to your mortgage and financial circumstances.

Q: Will the business owners be asked to testify?

A: No. In mediation all parties come together and are there to listen, participate, negotiate and decide whether or not to settle.

Q: Can the mediator help us with our case?

A: No. The mediator may assist parties to identify certain problems for each side, and to discuss the drawbacks of foreclosure versus the benefits of settlement. However, the mediator is *not* there as a judge, jury, or arbitrator of the case, nor as an advocate or advisor for either side. The mediator (even a mediator who is also an attorney) cannot give legal or financial advice. You must evaluate your finances, cash flow, and the benefits of possible new mortgage terms.

Q: Will the other side be there?

A: Generally, yes. A lender representative with authority to settle and the current property owner(s) should be present and prepared to negotiate. The mediator usually will meet separately with each side for private, more candid discussions.

Q: Can we bring our attorney?

A: Yes. Under Ohio law, a party can bring an attorney or another support person to the mediation.

Q: What if we decide to give up our building and walk away?

A: If, after careful consideration, you decide to give up your place of business, you can return your mortgaged property to the lender through a *deed in lieu of foreclosure*. You can still mediate such issues as the date of turnover, when to move out and any other obligations you may have.

Q: Can't we go to trial rather than settle?

A: You have the right to a fair court hearing, but foreclosure cases hardly ever go to trial. The judge usually decides foreclosures based on motions the lender files with the court. Each side should thoroughly discuss every factor before choosing to settle with new terms or go forward with foreclosure. Mediation allows you to explore settlement without risk, and with a trained mediator's help.

Q: What happens if we can't settle?

A: If parties do not believe they will be able to reach a mutually acceptable resolution through mediation, everyone may agree to negotiate further at a later time or the case could ultimately go forward in court. There is no penalty or extra cost for using mediation, beyond the mediator's fee, if applicable. One of the strengths of mediation is that parties do not lose any rights or access to other means of dispute resolution if they try mediation first.

Q: What are Ohio courts doing about foreclosure mediation?

A: The Supreme Court of Ohio, under the leadership of former Chief Justice Thomas Moyer, created a model program to help local courts start their own foreclosure mediation programs. Information about this model is available at www.supremecourt.ohio.gov/JCS/disputeResolution/foreclosure/default.asp. To see if the common pleas court in your county has adopted such a program, contact the court administrator, the local bar association or the clerk of courts. Remember that asking for mediation of a foreclosure case pending against you does not automatically prevent a default judgment.

You should contact an attorney to make sure you file an answer to the foreclosure complaint.

–originally prepared by Harold D. Paddock, Esq. Updated by Marcie Patzak-Vendetti, magistrate and director of Court Mediation Services for the Mahoning County Court of Common Pleas, Juvenile Division.

Three Keys to Dealing with Litigation

As a small business attorney, I often have clients who face litigation for the first time. Sometimes they choose to go to court, and sometimes it is an unpleasant surprise. Either way, it is often a frustrating and tense time for a business owner unfamiliar with the process. Armed with a little information, however, a lot of stress can be eliminated.

The law may aspire to be fair and just, but it doesn't even try to be fast.
Recognizing the limits of the litigation process will go a long way to alleviating stress and preventing misunderstandings. Filing a complaint, obtaining service of process (delivery of your complaint to the other party, a.k.a., the *defendant*) and receiving an answer from the defendant may take two months and much more if problems with service of process arise.

Once service is obtained, the other side has 28 days to respond to the complaint you filed. Do not get your hopes up. Extensions to this deadline are frequently requested and provided. You can reasonably expect to wait two or three months from the complaint-filing date to obtain service and receive the defendant's answer. Do not fret; there is more waiting ahead, and you will get used to it.

The answer is anything but…
You should understand that an answer is a very specific type of legal document. It generally contains denials of virtually every paragraph in your complaint and a laundry list of defenses that must be asserted so they will not be waived. This is just how answers are prepared; it is nothing personal. When you answer a complaint, you will do it the same way. If you know that an answer will be a flat-out denial of what you know is true, it may be easier to accept.

CMC, discovery, pre-trials, hearings, oh my!
Shortly after the answer is filed, the court generally holds a case management conference (CMC). This is a quick meeting (sometimes by phone) to select dates for the rest of the case. Your attorney will likely provide you with some or all of those dates, which will include dates for trial and discovery cut-off.

You should know that these are "best-case scenario" dates that likely will change depending on circumstances. For example, if the trial is scheduled for ten months from now, you can expect that it will be held a *minimum* of ten months from now and maybe significantly later. While you should calendar these dates, always contact your attorney before going to court to confirm that nothing has changed.

The *discovery* process (during which both sides learn information about the case) can take anywhere from a few months to years depending on the complexity of the case. Discovery, however, is the heart of the case and you, as a business owner, must give prompt attention to discovery requests from your attorney and from the opposing side. Cases are often won or lost based on discovery.

It is essential to provide your attorney with blemishes as well as trophies. Clients often believe that keeping a negative item from their attorney will benefit their case. Often, however, what you view as bad may not be that harmful to the case (and sometimes is not even relevant) and can easily be addressed if your attorney knows about it in advance.

Relatively small problems, however, can derail the entire case if your attorney is unaware of them and builds the case on a foundation that is not firm. If the opposing party learns about the issue, it inevitably gets exposed at the most inopportune moment. Knowing about problems ahead of time, your attorney can present the strongest possible arguments and prepare for the other side's counter-arguments. Additionally, a business owner who lies during testimony or becomes evasive about a small, simply embarrassing matter can damage the business's credibility and change the outcome of the case in a way that is disproportionate to the embarrassing item's actual importance.

Be patient, be responsive, be upfront.
When approaching litigation, remember to: *be patient*, because the legal system moves at its own pace; *be responsive*, because dragging your feet on discovery requests and inquiries from your attorney needlessly delays your case and can work against you; and *be upfront* in your communications with your attorney about both the strengths and the weaknesses in your case. By understanding these principles and cooperating with your attorney, you will greatly reduce the stress and frustration that can come from litigation.

–by Jeffrey J. Fanger, the managing member of the Cleveland law firm of Fanger & Adelman LLC.

Divorce Victim: Family Business?

Divorce is the end of a marriage. But the divorce process and the divorce itself has fallout, including the family's business, the enterprise that provides the family's financial support.

Often the family's business is one of the largest marital assets. Generally, most of the family's wealth, net worth and support is tied to the family's business. At least one and often both of the partners in a marriage are owners, employees or participants in the family business.

When both spouses are working in the family's business, the personal and financial effect of divorce can be more severe than if only one spouse participates. If both partners are active in the family's business and working together, the divorce process itself can lead to many destructive forces invading the business from personal recriminations to financial feuding. Moreover, family businesses are not easily divided, so it is difficult for divorcing spouses to take a piece and "go their separate ways." Generally one partner gets to keep the business and pays the other for his or her share. Perhaps divorcing spouses' need for money and liquidity explains why, according to an October 31, 2005, *Business Week* article ("Good Divorce, Good Business" by Michelle Conlin), 10 percent of divorced spouses continue working together after the divorce.

Is it ever possible to prevent divorce from harming the family business? Perhaps not, but divorcing spouses can take certain steps to protect the business as much as possible so that it can continue to generate income for the newly separated family.

Prenuptial agreements can also protect a family's business in some instances. Children who are in line to receive stock in the family's business should be urged to have a prenuptial agreement before they marry. While enforceability may be challenged and the judge may compensate divorcing spouses in other ways, setting a valuation procedure and dealing with later acquired stock and appreciation in stock owned at the time of marriage, can help to minimize disruption of the business if a divorce occurs.

Even with a prenuptial agreement, a necessary objective is to find ways to divide the business's wealth without actually dividing the business. For example, when adult children are working in the business and are the designated successors, this division sometimes can be achieved by giving part or all of the family's business to the next generation. In this way, both spouses find some assurance that the family's business wealth (or at least much of it) will not end up benefiting a new spouse. Moreover, assuming there are enough other assets, the divorcing spouses feel they have split the business by giving it to their children while leaving the business intact.

Agreements among business owners can provide for mandatory buyback of ownership in the event of a divorce using a discounted valuation and/or extended payment terms in order to preserve the business and protect its assets. While a buyout may not work with a majority shareholder involved in a divorce because it would shift control, it can be effective to protect the business when minority shareholders are involved in the divorce and can protect against having to sell assets or borrow heavily to pay off one of the divorcing spouses.

–by Charles R. Schaefer, an attorney with the Cleveland firm of Walter Haverfield LLP.

Attorney Fees: What You Should Know

Q: I'm thinking about hiring an attorney to do some legal work for me, but I'm worried about the expense. Can I find out ahead of time how much it will cost?

A: Yes. You should ask your attorney about fees before asking him or her to represent you. In most instances, a written fee agreement spelling out information about payment of fees and expenses as well as billing procedures should be signed by both you and your attorney. This is especially important where the matter is complex or the representation is for an ongoing matter. Such an agreement should set forth the specific legal services to be provided by the attorney and the amount of legal fees to be paid by you, the client, for those services. The fee agreement should also set forth how expenses, such as court filing fees, photocopying, telephone calls, investigators, etc., are to be paid. Before signing a fee agreement, you should read it carefully and ask questions about any provision you do not understand. If you think the agreement is unclear, you may ask the attorney to revise it to make it clear to you before you sign it. You also should ask for an estimate of the total charges that will be billed, and ask for monthly billing statements and written receipts for all amounts paid to the attorney.

Q: How do attorneys charge for their services?

A: Attorneys may charge for their services in one of several ways. Most legal work is billed at an hourly rate. If attorneys bill hourly, they should keep daily billing logs to record the time they spend working on behalf of their clients.

Sometimes, attorneys may charge a *flat fee* for a particular service. This method of billing is generally chosen for short-term legal matters such as a real estate closing or a matter involving a specific service, such as preparation of a will or trust.

In certain types of cases, a lawyer may work on a *contingent* fee. In this type of arrangement, the lawyer gets paid for his or her time only if the client is successful in recovering money from a lawsuit. The payment, in this case, would be a percentage of the recovery. Your attorney must tell you ahead of time what that percentage will be.

Contingent fee arrangements are made most often in cases where the client brings suit to recover for damages, such as personal injury caused by a negligent driver in a traffic accident. If the client is not successful in recovering any money, then the lawyer agrees not to take a fee for his or her services. The client may still be responsible for costs and expenses associated with prosecuting a case regardless of whether or not any money is recovered, but the attorneys' ethics rules *do* allow payment of costs and expenses to be made payable contingent on the recovery of money from the suit. The question of expenses is a matter that should be clearly set forth in the fee agreement, and the fee agreement should clearly state whether the contingent fee is calculated before or after payment of expenses.

Q: I called an attorney, who said she was unable to tell me exactly what it would cost for her services. Why couldn't she?

A: Often, lawyers are able to estimate how much time a particular legal matter will take to complete and, thus, are able to provide relatively accurate fee estimates. However, because each person's legal situation is unique, what appears on the surface to be a simple legal matter may prove more complex and time-consuming once the work has begun. Therefore, often it may be difficult for an attorney who charges an hourly rate to tell you exactly how much the work will cost.

–by the staff of the Ohio State Bar Association.

How To Get the Most from an Attorney-Client Relationship

Q: How is an attorney-client relationship created?

A: Generally, persons may consult with and be represented by an attorney whenever they choose. The client is usually responsible for the fees associated with the service. When a person hires or retains a particular attorney, and the attorney agrees to represent that individual, an attorney-client relationship is created.

Q: How do I go about hiring an attorney?

A: If you need an attorney and you do not know one you would like to hire, ask for a recommendation from friends, neighbors, or others whose opinions you respect. You may also contact one of the lawyer referral services operated by county and city bar associations across the state. To locate a list of lawyer referral services in Ohio, visit www.supremecourt.ohio.gov/attysvcs/lawyerreferral/default.asp. In selecting an attorney, you should take the same careful steps you would take when selecting another professional, such as a doctor or dentist.

Q: How can I check an attorney's qualifications?

A: Before hiring an attorney, you have the right to know that person's training and experience in dealing with cases similar to yours. Be sure to ask the attorney questions about his or her education, experience and qualifications. You may also ask for references from other clients and lawyers.

Q: How can I be sure that the attorney I plan to hire is legally licensed to practice law in Ohio, and has not had any client complaints?

A: You can find out if an attorney is licensed to practice law in Ohio by contacting the Supreme Court of Ohio's Attorney Registration Office at 65 South Front St., 5th Floor, Columbus, Ohio 43215-3431; phone: (614)387-9320; or by visiting the court's website at www.supremecourt.ohio.gov (select "Attorney Information" and then "Attorney Directory"). You can also find out if the attorney has been disciplined. To find out if there are any pending disciplinary cases against an attorney, you will need to contact that office. You cannot, however, find out if there are any *pending* complaints against the attorney *unless* there has been a *probable cause* finding by the Board of Commissioners on Grievances and Discipline. Only the Supreme Court of Ohio has the authority to restrict or end an attorney's right to practice law in Ohio.

Q: What is a "consultation"?

A: The first meeting with an attorney is frequently called a *consultation*. The attorney uses this meeting to evaluate the client's case, to assess whether the attorney is qualified to handle the particular case, and to determine whether the attorney can represent the client or whether some factor exists (such as a conflict of interest) that would prevent the attorney from taking the client's case. The client should use the initial consultation as an opportunity to get acquainted with the attorney; to discuss the attorney's background and training, how the attorney is to be paid, what expenses may be involved in the case, how and when the client can communicate with the attorney (*e.g.*, personally in the office, by phone, by email or in writing); and to find out the names of all those persons who will be working on the case (*e.g.*, paralegals, associates, etc.).

Q: What is a fee agreement?

A: A fee agreement is basically the payment contract between the attorney and the client. Fee agreements should always be requested, and should always be in writing and signed by the client and the lawyer at the time the lawyer is hired. Such an agreement should, at a minimum, set forth the specific legal services to be provided by the attorney, the amount of legal fees to be paid by the client for those services, and when payment is due. The fee agreement should also set forth how other expenses, such as court filing fees, photocopying, telephone calls, investigators, etc., are to be paid. Before signing a fee agreement, the client should read it carefully and ask questions about any provision the client doesn't understand. The client also should ask for an estimate of the total charges that will be billed, and ask for monthly billing statements and written receipts for all amounts paid to the attorney.

Q: What are the attorney's responsibilities in an attorney-client relationship?

A: The attorney's primary task is to protect the client's legal rights. Attorneys must use their best efforts on behalf of their clients, but they cannot guarantee particular results in cases. Attorneys also must observe the ethical standards set forth in Ohio's Rules of Professional Conduct.

The attorney should keep his or her client informed of the status of the client's legal problem and should provide copies of all correspondence and documents prepared on the client's behalf or received from another party. An attorney may not settle the client's case without the prior approval of the client.

Q: What are the client's responsibilities in an attorney-client relationship?

A: For the attorney-client relationship to work effectively, the client must be truthful in all discussions with his or her attorney. The client must give the attorney both the favorable and unfavorable facts pertaining to the legal matter, and must provide copies of all relevant information and documents to the attorney. The attorney must be informed of any changes in the client's situation. Clients must pay in a timely manner all legal fees earned by the attorney, and any other expenses or items agreed to in the retainer or fee agreement.

Q: How is the attorney-client relationship terminated?

A: In most cases, the attorney-client relationship is ended when the legal matter is concluded. However, with certain limitations, either the client or the attorney may terminate the attorney-client relationship at any time. This should be done in writing, and in accordance with any provisions contained in the retainer or fee agreement and, for the attorney, with the Rules of Professional Conduct. The attorney is entitled to be paid for the work completed before termination. The client is entitled to a refund of any unused or unearned fees paid in advance.

–by Janet L. Green Marbley, administrator of the Clients' Security Fund of Ohio.

Payback Time:
Supreme Court of Ohio Agency Reimburses Clients of Dishonest Lawyers

The person trusted with business secrets and personal information is your legal advisor. But every profession has its bad apples and, as with clergy, police, doctors, and teachers, there are a few unethical and dishonest lawyers.

That's no consolation to their victims, however, so the Supreme Court of Ohio has established a fund to compensate clients who have lost money or property as a result of the dishonest conduct of a licensed Ohio attorney. The Clients' Security Fund receives all of its funding from attorney registration fees.

Q: What types of losses are covered?

A: The Clients' Security Fund compensates losses resulting from the "dishonest conduct" of a licensed Ohio attorney. Dishonest conduct includes theft, misappropriation, or embezzlement of client funds or property. It does not include negligence or malpractice by an attorney or loans made to an attorney.

Q: Can I receive reimbursement of legal fees paid to my attorney?

A: Legal fees will be reimbursed only when the attorney fails to provide the services for which he or she was paid. Legal fees are not reimbursable simply because the client is dissatisfied with the services provided or with the results obtained.

Q: Who can apply for compensation from the Clients' Security Fund?

A: Almost any law client who has lost money or property as a result of a theft, embezzlement or misappropriation by his or her attorney may file an application for reimbursement with the fund. An attorney-client relationship must exist between the applicant and the attorney. A guardian or other representative of a claimant may file a claim on behalf of the client.

Q: How much can I receive as compensation from the Clients' Security Fund?

A: The fund can reimburse the full amount of the loss up to the maximum of $75,000.

Q: How can I file an application for reimbursement with the Clients' Security Fund?

A: Application forms may be obtained by calling the following toll-free number: (800)231-1680 (in Ohio only). Applications may also be obtained online at www.supremecourt.ohio.gov/boards/clientsecurity/default.asp. The application must be filed within one year of the occurrence or the discovery of the attorney's dishonest act.

–by Janet L. Green Marbley, the administrator of the Clients' Security Fund of the Supreme Court of Ohio.

Lawyers Keep Clients' Confidences

Q: Are lawyers required to keep secret the information learned during the attorney-client relationship?

A: Generally, yes. The Supreme Court of Ohio has stated: "A fundamental principle in the attorney-client relationship is that the attorney shall maintain the confidentiality of any information learned during the attorney-client relationship. A client must have the utmost confidence in his or her attorney if the client is to feel free to divulge all matters related to the case to his or her attorney." Three separate, but overlapping, rules protect information that clients give to their lawyers within the lawyer-client relationship.

1) *Confidentiality* – Under the rules of legal ethics, lawyers generally cannot *voluntarily* reveal information relating to the representation of their clients without their clients' express or implied consent.

2) *Attorney-client privilege* – Under the rules governing the introduction of evidence in court, lawyers generally cannot be *compelled* to reveal communications with their clients. However, the attorney-client-privilege applies *only* when clients communicate confidentially with their lawyers in order to obtain legal service.

3) *Work product* – Under the rules of civil and criminal procedure, lawyers generally cannot be *compelled* to reveal written material that was created while working on their clients' behalf to prepare a case for trial. When lawyers do legal research, take notes of witness interviews, or meet with other lawyers to develop strategies, the written material is called *work-product* and it is protected from disclosure by rules of both criminal and civil procedure.

The rules of legal ethics prevent lawyers from volunteering what they know, the rules on introducing evidence in court prevent lawyers from being compelled to tell what was discussed with their clients, and the rules of court procedure prevent lawyers from being compelled to reveal written information created for litigation.

Q: Why are lawyers required to keep secret information relating to the representation of their clients?

A: The primary reason is to encourage clients to provide their lawyers with all possible pertinent information—including possibly embarrassing or damaging information—that may be relevant to their legal problem. Full communication allows lawyers to determine what is or is not relevant to their clients' case. The confidentiality rule protects clients from being penalized for consulting with lawyers and telling their lawyers as much as possible about the matter.

Q: Is information transmitted by electronic means protected by these secrecy rules?

A: Yes. Lawyers and clients may exchange confidential information by email, fax transmissions, cellular phones, cordless phones, text messaging, video conferencing, and other electronic means. Generally, lawyers may communicate with clients by email without encryption or other safety measures, but enhanced security measures may be required for any form of electronic communication transmitting exceptionally sensitive information.

Q: ***Can a business organization, as well as a natural person, be a client?***

A: Yes. The rules requiring lawyers to maintain confidentiality of their clients' information apply to both natural persons and to entity clients such as corporations, partnerships, and unincorporated associations.

Q: ***When lawyers represent business organizations, do the organizations' constituents—the owners, officers, directors, trustees and employees—also become the lawyers' clients?***

A: No. Organizational clients are legal entities, but they can act only through their constituents. Lawyers, who are employed or retained by organizations, represent the organizations acting through their constituents. Lawyers employed or retained by an organization owe allegiance to the organization, rather than to any constituent or other person connected with the organization. Constituents of business organizations do not automatically become clients of the organizations' lawyers. When the organization's constituents who are acting in their organizational capacity communicate with their organization's lawyers, they cannot expect the lawyers to withhold the information from their client, the business entity. However, lawyers must keep those communications confidential within the business entity, subject to the permitted and required disclosures of confidential information set out below. In addition, when an organization is the client, the attorney-client privilege belongs to the organization and cannot be invoked or waived by employees acting outside of their employment capacity.

Q: ***Who holds the attorney-client privilege when business organizations that are represented by lawyers are dissolved?***

A: When a business organization is a client entitled to invoke the attorney-client privilege and the organization has been dissolved, the attorney-client privilege extends to the last board of directors or their successors in interest, or to the trustees or their successors in interest.

Q: ***Can clients keep facts secret by telling these facts to their lawyers and then relying on the attorney-client privilege to prevent discovery of the facts?***

A: No. The attorney-client privilege protects only *communications*, not facts. Clients cannot hide facts by telling them to their lawyers. What is privileged is the content of the communications between the clients and their lawyers. What clients say or write to their lawyers is privileged. The facts about what clients knew, did, or failed to do are *not* privileged.

Q: ***Are there exceptions to the three "secrecy rules"?***

A: Yes, and the exceptions are detailed and complex. Here is a summary of some of the most important exceptions.

- **Confidentiality**
  Ohio lawyers **may** *volunteer* information relating to the representation of their clients when the clients give "informed" consent or when it is implied that the disclosure is authorized in order to carry out the representation. In addition, lawyers **may** *volunteer* information relating to the representation of their clients if the lawyers reasonably believe it necessary to: 1) prevent reasonably certain death or substantial bodily harm; 2) prevent their clients or others from committing a crime; 3) mitigate substantial injury to financial or property interests resulting from their clients' commission of illegal or fraudulent acts for which their clients have used their lawyers' services; 4) obtain legal advice about their own compliance with the lawyer disciplinary rules; 5) claim or defend in controversies between lawyers and their clients, defend against criminal or civil

claims based on conduct in which their clients were involved, or respond to allegations in proceedings concerning the lawyers' representation of their clients; and 6) comply with other law or court orders.

- **Attorney-client privilege**
  In Ohio, there are three basic *exceptions* to the attorney-client privilege that *permit* lawyers to disclose information when it is compelled by judicial process. 1) The *crime-fraud exception* applies when clients have used their lawyers' services to commit a crime or fraud. 2) The *testamentary exception* applies in Ohio when competing claimants are asserting claims through a deceased client and the dispute addresses their deceased client's competency, or whether their deceased client was the victim of fraud, undue influence or duress. 3) In Ohio, lawyers may testify by the *express consent* of their clients, or, if the client is deceased, by the expressed consent of the surviving spouse or the executor or administrator of the deceased client's estate. There is no requirement that the surviving spouse, executor or administrator must make the same decision about the waiver that the decedent would have made.

  Under the common law there are four major ways in which clients may be deemed to waive the attorney-client privilege: 1) *waiver by disclosure* – revealing privileged documents or privileged communications; 2) *waiver by failure to object* – when a lawyer fails to object to a question that calls for privileged information; 3) *waiver by attacking their lawyer's work* – clients who sue their lawyers or former lawyers for malpractice waive the attorney-client privilege for communications relevant to the malpractice action; 4) *waiver by putting the advice of counsel in issue* – lawyers may reveal their communications with their clients when their clients' defense against criminal charges is that they relied on their lawyers' advice that the conduct was lawful.

- **Work product**
  Sometimes the opposing party may obtain parts of a lawyer's work-product if that party has *substantial need* of the materials and is unable to obtain the information in any other way.

Q: Are there instances when lawyers are required to reveal their clients' secrets?

A: Yes. In Ohio, there are two general rules and one rule specifically related to representing business organizations that *require* lawyers to disclose information relating to the representation of their clients.

1) Lawyers have duties of candor to the courts. If the lawyer, the client or a witness for the client has offered false evidence and the lawyer later learns of its falsity, the lawyer must take "reasonable measures" to remedy the situation, including, if necessary, disclosure to the court. In addition, lawyers in adjudicative proceedings must take reasonable measures to remedy the situation, including, if necessary, disclosure to the court, when they know that their clients or other persons intend to engage, are engaging, or have engaged in criminal or fraudulent conduct relating to the proceeding.

2) Lawyers must be truthful in statements to others. When representing clients, lawyers must disclose material facts when disclosure is necessary for lawyers to avoid assisting their clients' illegal or fraudulent acts.

3) A recent Ohio rule provides that lawyers for organizations are to proceed as is necessary in the best interests of their client organizations when the lawyer knows or reasonably should know that an owner, officer, director, trustee, or employee of the organization is acting, intends to act, or refuses to act in a manner that is 1) a violation of a legal obligation to the organization, or 2) a violation of law that reasonably might be imputed to the organization and is likely to result in substantial injury to the organization. More specifically, if it is necessary to enable organizational clients to address the matter in a timely and appropriate manner, lawyers *must* refer the matter to higher authority within the organization, including the highest authority that can act on behalf of the organization.

   This rule only requires lawyers to report within the organization, *i.e.*, *report up the ladder*. It does not require or permit lawyers to report outside the organization, *i.e.*, *report out*. Nevertheless, the two general rules requiring lawyers to 1) speak with candor to the courts and 2) avoid assisting their clients' illegal or fraudulent acts still may require the organization's lawyers to disclose information outside the organization.

–by Lance Tibbles, a professor of law at Capital University Law School in Columbus.

Paralegals Aid Attorneys and Clients

Q: What is a paralegal?

A: A paralegal is an individual who works under the supervision of an attorney, performing legal work that an attorney would ordinarily perform for a client. Paralegals work in law offices, in corporations and for government agencies. The number of paralegals in the United States has been increasing over the past 30 years, and is expected to continue to rise.

Q: What is the difference between a paralegal and a legal assistant?

A: There is no difference. The title is a matter of personal preference.

Q: What types of legal work can paralegals perform?

A: Paralegals can interview clients and witnesses; research facts and the law; and draft wills, trust agreements, contracts, pleadings and other legal documents. Paralegals are most extensively used in the litigation area where they take an active role in drafting motions, briefs and interrogatories. Paralegals also assist lawyers in the courtroom by organizing and tracking exhibits and preparing witnesses to testify during the trial.

Q: Can a paralegal perform legal work directly for clients?

A: Paralegals cannot engage in the practice of law. Paralegals may not give legal advice to clients or represent clients in most courts. Because paralegals are not licensed to practice law, performing legal work directly for clients would constitute the unauthorized practice of law in violation of state statute.

Q: Are communications with a paralegal covered by the attorney-client privilege?

A: Yes. As agents of the lawyer, paralegals are required to maintain client confidences. Information provided by a client to a paralegal during the course of representation by the attorney may not be shared with others.

Q: Can a paralegal appear in court on behalf of someone other than himself or herself?

A: A legal assistant cannot represent clients in contested matters in the courtroom. There are some administrative agencies that will allow paralegals to represent individuals at the administrative hearing stage. If the final order of the agency is appealed to a court, however, the individual would need to obtain a lawyer for representation.

Q: How can a person become a paralegal?

A: At the present time, no state licenses paralegals. The Ohio State Bar Association (OSBA) offers a voluntary credentialing program for paralegals. An individual who meets the eligibility requirements and passes a written examination will be designated as an "OSBA Certified Paralegal." The two national paralegal associations, the National Association of Legal Assistants and the National Federation of Paralegal Associations, also have a voluntary certification process for paralegals. Although there are no formal educational requirements for paralegals, numerous colleges, universities and proprietary schools throughout Ohio and the nation provide paralegal education programs leading to a paralegal degree or certificate. The American Bar Association (ABA) has an approval process for paralegal education programs whereby a program can gain the ABA's approval if it meets a strict set of quality standards.

Q: What do paralegals do to enhance the legal profession?

A: Attorneys enhance the legal profession's ability to provide legal services to clients at affordable rates when they use paralegals. By delegating work which would have been done by the attorney (whose cost to the client would have been billed at a higher rate), lawyers have made paralegals a vital part of the legal profession.

–by Laura C. Barnard, an attorney and Director of Paralegal Studies at Lakeland Community College in Kirtland.

Top Five Legal Mistakes Small Businesses Make

Business gurus often advise entrepreneurs that they should not be afraid to make mistakes. But, when it comes to the legal aspects of your business, not being afraid of making mistakes can lead to disastrous consequences. What are the common legal mistakes business owners make? Here are my top five.

1) ***Delaying seeking legal advice***. Knowing the legal pitfalls is key to avoiding them. When starting a business, many entrepreneurs put off retaining competent legal counsel either because they are too busy or because they think a lawyer will cost too much. The cost of prevention is much less than the cost of correction. Clients have paid thousands of dollars to fix mistakes that could have been avoided if they had spent a few hundred dollars in legal fees earlier. And in some cases, the mistakes can't be fixed.
2) ***Improper company formation and maintenance***. Having the appropriate legal structure is important for both personal liability and tax liability. Proper formation also includes documenting the owners' rights. Nothing dooms a business faster than an unresolved misunderstanding among the owners that could have been avoided by a written agreement made before the dispute arose. Once the appropriate structure is in place, a business must comply with the formalities of maintaining that structure, such as keeping corporate meeting minutes and other records. Failure to properly maintain the business structure could result in the loss of liability protection.
3) ***Not protecting intellectual property***. Intellectual property includes patents, copyrights, trademarks, trade secrets, and other confidential or proprietary information. Many businesses fail to put adequate procedures in place to protect their inventions, works, and brands and to restrict disclosure of confidential information. Without such procedures and the use of appropriate agreements, a business may lose its valuable intellectual property assets.
4) ***Not having contractor agreements***. A business often needs workers, but either it is not ready to hire employees, as is typically the case with a new business, or the task is better handled by an outside contractor for work such as website development. Many businesses make the mistake of not having a written agreement with the outside contractor that specifies the scope of the project, ownership of work product and related intellectual property, noncompetition, nonsolicitation of customers, nonsolicitation of employees, and independent contractor status. A business is often surprised to learn that it does not own the rights to the work product it just paid to have developed because there is nothing in writing to secure those rights or the written document is inadequate.
5) ***Not having employment agreements***. A mistake closely related to mistake #4 is not having a written employment agreement with each employee. Many businesses assume that, since the employee is an employee-at-will, there is no need for a written agreement. If noncompetition, nonsolicitation of customers and employees, and ownership and protection of intellectual property are important to the business, it needs written employment agreements.

Making legal mistakes costs businesses money, lots of money, and sometimes results in failure. Don't let legal mistakes ruin your business.

–by Alan J. Hartman, a partner in the Cincinnati firm of Dressman Benzinger LaVelle psc.

Exit Strategies

Chapter 14

Exit Strategies for Small Business Owners

Developing an effective exit strategy is one of the most important issues faced by small business owners. It requires careful planning well ahead of the desired exit. Often, however, many owners do not begin planning for an exit soon enough. Two of the more common exit strategies are the succession of the business to a relative and the sale of the business.

Planning for succession
Aside from management issues, the most important aspects of a succession include tax and estate planning issues. Owners many times transfer their company to relatives at a reduced price or for no charge. This can result in estate and gift tax consequences and, therefore, needs to be addressed carefully. In a succession, ownership is often either given away ("gifted") or sold to the relative.

Ownership can be gifted all at once or over time. Currently, individuals can gift assets valued up to $14,000 per donee each year with no gift tax consequences. Over a lifetime, individuals can also gift an additional $5.25 million without gift tax (as of 2013, this amount will be indexed for inflation in future years). These tax exclusions may be doubled if the donor's spouse also gifts assets. For example, Joe Smith, a business owner, along with his wife, could give $28,000 worth of stock to each of their two children each year. Above that amount, Mr. and Mrs. Smith could, over the course of their lifetimes, give as much $10.5 million of stock in total to their children and pay no gift tax. Mr. and Mrs. Smith would need to file gift tax returns and should have their stock appraised by a professional appraiser, especially if the valuation includes discounts. A professional appraiser often can discount the value of the stock (and thus perhaps reduce the taxable gift) because the stock is not traded on a public exchange or because the donee does not control the company.

It is advantageous to make gifts early. If the assets are held at death, they may be subject to death taxes. The federal tax is currently 40 percent (as of July 2013). By gifting early in life, the assets' appreciation (increased value) does not count against the estate for tax purposes. For example, more shares can be gifted without gift tax when the share value is $100 instead of $1,000.

Instead of gifting ownership, family members may choose to sell it, but at a reduced rate. If the sale is financed by a note, interest should be charged at or above the applicable federal rate (published monthly by the IRS). If not, the IRS will expect the seller to pay tax on interest income even though no interest was paid.

Another option is a self-canceling installment note. Generally, such a note automatically cancels the buyer's obligation to pay if the seller dies during the note term. This has the advantage of giving annual income to the seller during life, but not requiring the buyers to make payments when the seller no longer needs them. The remaining balance would not be subject to estate tax if the self-canceling installment note is properly drafted.

Sale of the business
A business owner may not be able to transfer a business to a relative. If so, the most desirable exit will likely be to sell the business. A sale of the business requires careful advance planning.

The most advantageous time to sell a business is when it is profitable and growing, and when the owner is not forced to sell. Before offering a business for sale, it is a good idea to put the "house in order," so to speak. Review financial performance and operations to determine whether there are any problems that might be exposed through a potential buyer's close inspection. Also, it is often a good idea to have a professional valuation performed to get a general idea of what the business may be worth. Remember that, because there are many different ways to evaluate a business's worth, one professional valuation may differ significantly from another.

Usually, the most daunting task is locating a buyer. Potential buyers include insiders such as management, strategic buyers such as competitors or businesses looking to expand or diversify and financial buyers such as venture capital and investment firms. A business broker can be hired to help identify prospective buyers.

A number of different factors will affect whether the sale is structured as a sale of the company's stock or its assets or as a merger. These include tax issues, the nature and extent of the seller's existing and potential liabilities and the terms of the contracts to which the seller is a party.

After the seller and the buyer agree on a sale structure, typically:

- the parties draft a letter of intent to outline the general terms and conditions of the transaction;
- the buyer investigates the seller's business;
- the parties draft the transaction documents and negotiate with the buyer about price and sale details; and
- the parties satisfy any conditions spelled out in the transaction documents, such as a requirement of shareholder approval or the consent of creditors and other third parties.

After these steps are taken, the transaction can be closed and the sale consummated.

–by D. David Carroll and Harlan S. Louis of the Columbus law firm of Bailey Cavalieri, LLC. Updated by Adam J. Biehl of the same firm.

Planning To Sell Your Business?

If you, as a business owner, are thinking about selling your company, consider the following:

- **Shore up your management team.** While some business buyers only want to acquire business assets or a particular product, most look to current management to help build the business with them. Review key personnel and hire appropriate people to fill any existing gaps. The additional salary cost may yield a higher selling price.
- **Modify your business plan.** Seek professional assistance to hone your business plan and ensure it reflects your current operation and any growth plans.
- **Review your financials.** If you have failed to consistently meet projections, revise them to more realistically reflect the realities of your business and true growth opportunities. Hire competent tax professionals to insure that the financials reflect standard accounting principles.
- **Follow corporate formalities.** Make sure your business has annual meetings; record the minutes of all board meetings. Engage a board of directors/advisors to give you input on key decisions. Update employee handbooks and other corporate policies.
- **Make peace.** Whether it is with the IRS, a former customer or an employee, try to resolve all outstanding disputes and legal challenges.
- **Maintain financial discipline.** Take charge-offs now for bad debt and other problems. Repay any shareholder loans, take non-working family members off the payroll and finance only true business expenses.
- **Make appropriate capital expenditures.** Sellers often delay capital expenditures when selling the business is within sight. This merely causes a disproportionate reduction in the purchase price. Make the expenditure now and remove that burden from the new owner.
- **Maintain all personal and real property in working order.** Allowing equipment to fall into disrepair sends a strong negative signal to potential buyers.
- **Meet with your business advisors.** Let your accountant and attorney know of your plans to sell so that they can begin to advise you about maximizing your purchase price, minimizing any potential taxes and optimal deal structures.
- **Keep your eye on the ball.** Positioning your company for a sale takes a great deal of time and effort, but do not forget to tend to the day to day running of the business so there is something of value to sell.

–by Thomas C. Washbush, an attorney with the Columbus firm of Benesch Friedlander Coplan & Aronoff.

Life Insurance Figures in Business Succession Planning

Q: I own a business with two other equal owners. We believe that the business is worth more than $750,000 if we were to sell it. The business owns a total of three policies of term life insurance, $250,000 on each of us, payable to the business. If one of us dies, will that owner's family receive the money?

A: No. The business receives the money as the designated beneficiary of the life insurance policy.

Q: Does the deceased owner's family inherit the share of the business?

A: Maybe. It depends on several factors. Transfer of a share in the business may be restricted by written documents commonly known as *buy-sell* agreements. Otherwise, the deceased owner's share is left to the person(s) designated in his or her will.

Q: What are buy-sell agreements?

A: They are written agreements between: a) a business and an owner; b) the owners; or c) a combination of (a) and (b). There are two major types. The first is a *redemption agreement* in which the *business* agrees to buy the owner's interest upon a "triggering event" (such as that owner's death). The second is a *cross-purchase agreement* in which the *owners* agree to buy the share of another owner upon a triggering event. The buy-sell agreement may stand alone or may be incorporated into other, more comprehensive agreements, such as partnership agreements or close corporation agreements. The agreements usually will address conditions that trigger a buy-out, as well as the price and terms of payment.

Q: If there is a buy-sell agreement, must the business buy the deceased owner's share of the business from the deceased owner's family, and must the family agree to the sale?

A: Yes, if the agreement requires a sale.

Q: If the family members of a deceased owner receive a business share through inheritance, may they sell it if they wish to?

A: Yes, assuming there are no restrictions on the sale. The family can sell to anyone, including the other owners. The sale price and the terms are all subject to negotiation.

Q: Is the business required to use the life insurance money to "buy out" the deceased owner?

A: No, not unless the business and the owner have agreed to this in writing.

Q: What are the advantages of life insurance and a buy-sell agreement?

A: Life insurance in combination with a buy-sell agreement provides liquidity (available cash), assures all the owners of a market for the sale of their share in the event of death, and provides protection for their families. It further ensures that the business and surviving owners will not have to borrow money, reduce working capital or divert future earnings to buy the share. The surviving owners also avoid potential meddling and disputes caused by those who may have inherited or bought the deceased owner's share.

The family of the deceased owner does not have to worry about finding a buyer and is assured of receiving cash shortly following the death in order to pay bills, estate taxes, etc. They also do not have to worry about overseeing and protecting their share of the business.

Q: What is the best way to require the business to buy the deceased owner's share?

A: Prior to someone's death, the business owners sign an agreement which obligates the business to buy an owner's share should one of them die. The deceased owner's estate is likewise required to sell the share to the business. Of course, the availability of life insurance to fund the buyout is dependent upon health and cost.

Q: What determines the price of the deceased owner's share?

A: The price is usually defined in the written agreement and may be based on many factors. For example, the business may operate in an industry which uses traditional measures of value, such as "book" value, one year's gross revenues, one year's earnings, etc. A price may be set periodically, or it may be based on a qualified appraisal or on a formula.

Q: If life insurance proceeds are less than the defined price of the business share, what happens?

A: Usually, the written agreement will anticipate that possibility and provide an alternative way to fund the purchase price. For example, the business may either borrow the difference or pay it over time in installments.

–by Paul S. Klug, an attorney with the Cleveland firm, Ziegler Metzger.

Make Your Succession Plan a Plan To Succeed

When siblings Mike and Amy started a cleaning service business as equal owners 30 years ago, they started out small—cleaning a local office or two. Over the years they added employees and commercial clients, including Mike's two sons and Amy's three daughters.

Mike died unexpectedly, and the business floundered. Did Mike's widow, who had no interest in running the business, inherit his share? Who was in charge? Where did their children fit in?

Every entrepreneur who starts a business should write a plan to succeed. They often overlook the need for a well-thought out succession plan. Who will carry on their dream when they cannot?

Two compelling forces often pull on business founders. Their business creation—their baby—can pull them one way. Their children's desires and abilities as successors may pull them another way. These forces ignite strong emotions.

A succession plan considers the future. It sets a plan for how to carry on the business with minimal acrimony and transfer value to a second generation (if that is the objective) at the least possible tax cost. The plan recognizes that poor choices could lead to financially devastating results.

To begin, all owners forge an agreement on business objectives. They should address the "what-ifs" such as incompatibility, disability, retirement, or death. Then they put those objectives in writing in a *buy-sell* agreement: an agreement either between a business and an owner, or the owners—or both.

Consider two types of buy-sell agreements:

- A redemption agreement. The business agrees to buy the owner's interest upon a "triggering event" such as that owner's death.
- A cross-purchase agreement. The owners agree to buy the share of another owner upon a triggering event.

Both agreements usually address conditions which trigger a buy-out, as well as the price and payment terms.

Next, all the owners should review the feasibility of funding the agreement with life insurance if the death is the triggering event—to pay off the deceased owner's shares. In case of other triggering events, such as retirement, does the business (or do other owners) borrow money? Are they able to internally finance the purchase? Make sure all of the owners' personal objectives and their wills and trusts are coordinated accordingly.

Advice to owners: Do not tackle it yourself. This is an emotionally and legally complex area of law; seek counsel from a qualified estate or business planning attorney. If a business is to survive into a second and third generation of leadership, it needs a succession plan to succeed.

–by Paul S. Klug, an attorney with the Cleveland firm, Ziegler Metzger.

Business Succession: The No-Tax Solution

You have worked very hard building your business. Now you are considering retiring or reducing your role while the business continues. How can you make sure your business will continue to flourish? Is there a buyer you trust who will continue the good work you have started? Is there a buyer at all? Can you limit your exposure to taxes in the process? Under certain circumstances, you can establish a buyer, substantially reduce or eliminate any capital gains taxes related to the stock sold and increase the cash flow of the business by obtaining an “exemption” from U.S. and Ohio income taxes.

How do you do it? Well, the *Internal Revenue Code* permits certain closely-held U.S. corporations and their owners to obtain the following benefits:

- Owners of C-corporations who sell their stock to a qualified employee stock ownership plan (ESOP) can defer gains taxes to the extent the proceeds are re-invested in the securities of U.S. operating companies. Under certain circumstances, the capital gains taxes may never have to be paid. Selling shareholders may be able to borrow against the investment portfolio in order to diversify their holdings.

- In the tax year after the stock sale to the ESOP, the shareholders (*i.e*., the trustee of the ESOP and other qualifying shareholders, if any) can elect to be taxed as an S-corporation. Thereafter, the profits of the corporation will be exempt from income taxes to the extent of ESOP ownership.

- An ESOP, in combination with certain wealth preservation trusts, can reduce or eliminate federal estate taxes that would otherwise be payable based on the value of closely-held company stock.

In brief, by selling your stock to an ESOP trust, you are able to establish a buyer and elect to have the proceeds you receive invested in “qualified replacement property,” thereby deferring any tax on that sale (and then, through an S-Corp election, reducing the tax burden on the company going forward). Notwithstanding these great benefits, this succession plan also addresses company management succession. An ESOP may help attract a quality successor management team by giving team members a stake in the company res as plan participants. It may also inspire greater dedication and productivity by the employees, who, as plan participants, will own the company.

Business succession planning must also address the family and legacy concerns of business owners. For example, you may reduce or eliminate estate taxes by creating a charitable remainder trust (CRT) and an irrevocable life insurance trust (ILIT). Subject to certain conditions, you can contribute your stock to a CRT. The trustee of the CRT, in turn, can sell the stock to the ESOP at fair market value. You, who contributed the stock to the CRT, receive a current income tax deduction in addition to a stream of income for life from the CRT. Upon your death, the remaining funds are transferred to the charity named in the CRT. While living, you can use that stream of income from the CRT to fund the ILIT premium payments, which will eventually benefit your children or other beneficiaries. If the ILIT is properly structured, the death benefits from the insurance policies in the ILIT, which are payable upon your death, will not be subject to estate taxes.

Thus, all of these business succession tools, when properly and expertly applied, can provide you, as an owner of a closely-held corporation, with a solid business succession plan that addresses family and legacy concerns, potentially improves the financial standing of the company, and attracts and retains high quality successor management at a significantly reduced tax cost.

–by Timothy C. Jochim, Chair of the Business Succession/ESOP Group at the Columbus office of Kegler Brown Hill & Ritter, former adjunct professor of corporate finance at the Capital University School of Law, and a member of the legal advisory committee of the ESOP Association, Washington, D.C. Updated by Peter E. Jones, Of Counsel with the Columbus office of Kegler Brown Hill & Ritter.

Business Bankruptcy: What, When, and How

Q: What types of bankruptcy are available?

A: Corporations, partnerships, limited liability companies and individuals who operate businesses are eligible to file for bankruptcy under Chapter 7 or Chapter 11 of the Bankruptcy Code. Individuals who own businesses may also qualify for Chapter 13 bankruptcy if they are below the debt limits imposed by Chapter 13.

Chapter 7 bankruptcy is known as *straight liquidation*. In a Chapter 7 case, a trustee (assigned by the U.S. Trustee's Office or chosen by the debtor's creditors) may liquidate, or sell, the debtor's non-exempt assets to satisfy all or a portion of the creditors' claims. Any portion of debts not paid by the trustee (with certain exceptions for individuals) is discharged if the debtor is an individual, and the creditors cannot force the debtor to pay the remaining amount. If the debtor is some form of business entity (corporation or LLC), then its remaining debts are not discharged, and if it continues business after the bankruptcy, its creditors may collect their debts against the debtor.

Chapter 11 *reorganization* is typically used by corporations or businesses that want to stay in business as an alternative to Chapter 7 liquidation. A Chapter 11 reorganization is available to individuals, but it is typically an expensive process that is not frequently used by individuals. In a Chapter 11 reorganization, the debtor may keep its property, and agree to pay creditors with future earnings according to a plan of reorganization.

Chapter 13 is a *reorganization* case similar to Chapter 11 but is limited to individuals who have less than $1,081,400 in secured debts and $360,475.00 in unsecured debts. It is more simple and inexpensive than Chapter 11, but a good alternative for a small business owner's reorganization.

Q: When is it appropriate to file for bankruptcy?

A: The decision to file bankruptcy varies according to each unique situation. Anyone considering bankruptcy should consult with an experienced bankruptcy lawyer who can determine whether such an option would be appropriate and when it would be most beneficial to file.

Given that each case must be independently evaluated, it may be appropriate to file for bankruptcy when: 1) a significant event occurs that would subject the business assets to a creditor's claim, such as a large judgment lien or tax lien; 2) the business is unable to pay its debts and regular operating expenses as they come due; or 3) it has property that it wishes to keep from the reach of creditors' collection activities.

Q: What process would I go through in order to file bankruptcy?

A: You would file a petition for bankruptcy at the bankruptcy court and provide the bankruptcy court with a schedule of assets and liabilities and a Statement of Financial Affairs. These documents would include a list of everything the business or an individual owns and everything the business or individual owes to creditors, as well as historical financial information concerning recent years' revenues, and transfers of money made within one year or more before filing for bankruptcy. In addition, in a Chapter 7 bankruptcy you would pay a $306.00 fee to file these documents, $281.00 in a Chapter 13, and in a Chapter 11 bankruptcy you would pay $1,213. In addition to the filing fee, there is a quarterly fee to be paid to the United States Trustee in Chapter 11 cases. After these documents are filed, in a Chapter 11 case you would have a meeting with an analyst from the United States trustee's office for the district and a meeting with an assigned trustee. The meeting with the assigned trustee may be attended by your creditors, and the documents you filed would be checked for accuracy. Also, you would be asked additional questions about your own or the business's finances.

Additionally, if you want to continue operating your business in Chapter 11, there are a number of orders you must obtain. Most importantly, if a lender has a security interest in your accounts receivable and cash, you must obtain court approval to use that lender's cash to pay the business's bills. If you do not obtain the necessary court orders, the business must cease operating.

Q: Can a discharge of debts in bankruptcy be denied?

A: Yes. The filing of a bankruptcy petition does not guarantee the discharge of debts for individuals.

General discharge of debts in bankruptcy may be denied to an individual if a person commits certain acts of misconduct before or after the bankruptcy petition, such as destroying, concealing or removing assets that might otherwise be used to pay creditors in the bankruptcy case. Also, a discharge of debts may be denied if the person has destroyed or concealed records that show what assets are available to pay creditors. Finally, a person may be denied a general discharge if he or she has lied under oath during the bankruptcy case or refuses to answer questions without a good reason.

Aside from acts of misconduct, a person will not be granted a general discharge if he or she has obtained a discharge in a Chapter 7 case within eight years of the date that a second bankruptcy is filed. Business entities do not receive a discharge in a Chapter 7 case.

Additionally, a Chapter 11 business debtor's discharge may not occur if: 1) the plan provides for liquidation of substantially all of the debtor's property; 2) the debtor does not engage in business after the plan is consummated; and 3) the debtor is not an individual. Consequently, corporations and partnerships that either sell their assets through a Chapter 11 case or cease doing business after a Chapter 11 case is completed do not receive a discharge of their indebtedness.

Q: If a general discharge of debts in bankruptcy is granted, are there still any debts that would have to be paid?

A: Yes. Even if a general discharge is granted, some debts cannot be discharged in bankruptcy for individuals. These include: 1) taxes that the debtor has incurred in the three years prior to the date of bankruptcy filing or taxes assessed within 240 days of the bankruptcy filing; 2) certain "trust fund" taxes such as sales tax and wage withholding taxes; 3) certain student loan debts; 4) child or spousal support and any other debts arising from or assumed under a domestic court order; 5) criminal fines, certain restitution orders, and debts arising from a DUI; and 6) any debt incurred because the debtor has committed fraud, breached a fiduciary duty as a trustee, or committed a "willful" act causing injury to a creditor.

The debts listed above typically do not appear in bankruptcy cases for businesses with the exception of tax liabilities. Nevertheless, if an individual files a bankruptcy case as a sole proprietorship, his or her personal debts are also included in the filing. Therefore, a sole proprietor's bankruptcy filing would address all of the business debts and personal debts, such as child support, student loan debts or others, and would be treated as discussed above.

Q: How would a bankruptcy discharge affect my company's credit record?

A: It depends upon the facts and circumstances of each case. Of course, the bankruptcy will be noted on the company's credit record, but the effect of this notation depends upon the outcome of the case (the case is dismissed or a reorganizing plan is confirmed). Also, individual creditors have differing policies regarding those who have filed for bankruptcy protection. What is certain is that a bankruptcy filing will appear on credit records for up to ten years, and will most likely cause difficulty in obtaining loans and trade terms, either because the loan or terms will be denied, because a higher rate of interest will have to be paid, or because additional collateral or guarantors will be required by the lender.

–by Anthony J. DeGirolamo, a Canton attorney.

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