

### 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, etc.

*—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 preworkouts.

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

*—by Thomas C. Washbush, an attorney with the Columbus office of Benesch Friedlander Coplan & Aronoff.*

## 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. The lender seeks a court order to sell the borrower's real estate to raise money to pay off the debt owed to the lender. There is usually a promissory note signed by the borrower that defines the debt, and a mortgage signed by anyone with a title interest in the land. The borrower is known as the *mortgagor*, and the lender as the *mortgagee*.

**Q: Who can initiate a foreclosure?**

**A:** A foreclosure in Ohio is initiated by the filing of a complaint 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. Due to the complexities of modern mortgage lending practices, 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 Web sites so you can communicate with them. This information will appear on most letters sent to you from either the lender or servicer.

**Q: Can a foreclosure be prevented before it is filed?**

**A:** Yes! If you fall behind in your mortgage payments, 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. These people will talk to you to see if there is a solution other than foreclosure.

**Q: What types of alternatives are there prior to foreclosure?**

**A:** The most frequent alternative is 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*. A modification can lower your principal balance or interest rate, or even extend the final due date of your loan to make current payments lower. A modification is like a new contract amending the prior contract.

***Q: I have other loans with my lender besides my mortgage; will these be affected?***

**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: While I do not have other loans with my mortgage lender, I do have different loans with other lenders. Will these loans be affected by the 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 lender grounds to call its loan due even though you have continued to pay that other lender according to the terms of that loan. In addition, credit cards often have *universal default* provisions under which they 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 prior to filing the foreclosure complaint?***

**A:** Generally, no. Most loan agreements 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 receive notice after the judgment is 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: forbearance agreements or loan modifications. In addition, you can bring your account up to date by a process known as a *reinstatement*. You often will have to pay your lender’s attorney fees and costs if you reinstate your loan. Or you can pay the loan in full by refinancing your loan with a new lender. In that case, under Ohio law you will not have to pay the lender’s attorney fees. Last, you might be able to complete a *short sale* in which the lender agrees to accept less than a full payoff through a private sale.

***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 for a business owner who seeks to continue doing business in the location its 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.

***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 to 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 upon 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 make a request to the court to order the sale of the property to pay the debt. This is usually 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 in 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.

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

### **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, have an important impact on 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 which 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 not 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.*

### **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 the new law.

—by Justin D. Flamm, a partner in the Cincinnati office of Taft, Stettinius & Hollister LLP.

## 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 recently 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.” 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 e-mail, fax transmissions, cellular phones, cordless phones, text messaging, video conferencing, and

other electronic means. Generally, lawyers may communicate with clients by e-mail 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 a business entity's constituents, acting in their organizational capacity, communicate with their organization's lawyers, they cannot expect the entity's lawyers to keep these communications secret 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.

***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 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, one of the two general rules requiring disclosure of information still may require lawyers to disclose information outside the organization.

*—by Lance Tibbles, a professor of law at Capital University Law School in Columbus.*

### Contact the Law Office of Michael J. Davis

To talk to Michael J. Davis about your legal concerns, please contact us by calling 513-604-8391 or emailing us at [davislaw01@gmail.com](mailto:davislaw01@gmail.com)

Michael J. Davis is located in Mason, Ohio, and serves clients throughout Ohio, including Lebanon, Maineville, Mason, Morrow, Springboro, South Lebanon, West Chester, Warren County, Butler County, Hamilton County, Clermont County and Clinton County, Ohio.