The Advocate

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by the Business & Corporate Law Section

The Advocate

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Feature Articles

Columns

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On the Cover

A pelican claims his territory on a moored dingy as his cohorts circle and dive for fish in the Sea of Cortez. Photo taken by Jacobi Graziano while on a cruise near Le Paz, Mexico. Mr. Graziano is a freelance photographer in the Boise area.

Section Sponsor

This issue of *The Advocate* is sponsored by the Business and Corporate Law Section.

Editors

Special thanks to the September *The Advocate* editorial team: Brian Kane, Scott Randolph and Brent Wilson.

Want to Write?

The Advocate welcomes ideas for general interest articles. Aside from feature articles by sections, *The Advocate* seeks lively writing about legal ethics, business management and technology, among other issues. Please contact Managing Editor Dan Black at dblack@isb.idaho.gov or call (208) 955-8866 to query before writing.

The Advocate

Official Publication of the Idaho State Bar

ISB IDAHO STATE BAR

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Idaho Law Foundation Fall 2009 CLE Schedule

September 25
Idaho Evidence Law Update
8:30 - 10:30 a.m. at the Law Center Boise
Live Webcast Statewide
2.0 Credit RAC*

October 2
Idaho Practical Skills
8:30 a.m. - 4:00 p.m.
Boise Centre
6.0 Credits of which 2.0 are Ethics Credit
RAC*

November 13
The Complete Legal Negotiator
8:30 a.m. - 3:30 p.m.
The Grove Hotel, Boise
6.0 Credits

November 20
Headline News—Year in Review
8:30 a.m. - 4:00 p.m.
University Inn, Moscow
6.0 CLE credits of which 1.0 is Ethics Credit RAC*

December 4
Headline News—Year in Review
8:30 a.m. - 4:00 p.m.
Red Lion Hotel, Pocatello
6.0 CLE credits of which 1.0 is Ethics Credit RAC*

December 11
Headline News—Year in Review
8:30 a.m. - 4:00 p.m.
Oxford Suites, Boise
6.0 CLE credits of which 1.0 is Ethics Credit RAC*

December 18
Ethical Trial Advocacy
8:30 - 10:30 a.m.
Oxford Suites, Boise
2.0 Ethics CLE Credit RAC*

*RAC—These programs are approved for Reciprocal Admission Credit pursuant to Idaho Bar Commissions Rule 204A(e).

President's Message

In 1969, Idaho had Fewer Lawyers, but Faced Similar Issues

Man had just walked on the moon. Upstate New York had survived the Woodstock invasion. There were no computers, cell phones, Facebook or Twitter—most telephones still had a cord and a rotary dial. Albums were vinyl, eight-track tapes were new, cassettes and CDs were well in the future. Bob Dylan released Nashville Skyline and then appeared on Johnny Cash's first television show. And the last episode of the original Star Trek aired. Midnight Cowboy was the first widely released X-rated movie. Muhammad Ali was convicted of draft evasion and stripped of his title after refusing to enlist in the Army as a conscientious objector (a conviction reversed two years later by the Supreme Court). President Nixon appointed Warren Berger as the new Chief Justice, ending the Warren Court era; Chief Justice Berger would vote with the majority in *Roe v. Wade* four years later. Walter Cronkite was reporting nightly on the war in Viet Nam, even as the first drawdown of troops began as the president had pledged in his election campaign. Charles Manson shocked the world. But the Miracle Mets provided a needed respite and bright spot as the summer turned to fall in 1969.

B. Newal Squyres

Closer to home, there were 720 members of the Idaho Bar in 1969, spread across the state by local bar association as follows: First District—64; Clearwater Bar (Second District)—75; Third District—63; Boise Bar (Fourth District)—237; Fifth District—96; Sixth District—75; Seventh District—83; and 24 out-of-state. Only a third of Idaho's lawyers were practicing in "the Boise Bar" while today, excluding reciprocal admittees, a little over 50 percent practice in the Fourth District. Idaho's five largest firms—four in Boise (Eberle Berlin, Elam Burke, Hawley Troxell and Moffatt Thomas) and the Parry Robertson firm in Twin Falls—had a total of 49 lawyers but only one had over 10. The four big firms in Coeur d'Alene each had two attorneys, and Lewiston's largest firm had four. In Eastern Idaho, there were seven attorneys in Idaho Falls' largest firm. And two Pocatello firms had five lawyers each. The overwhelming majority of Idaho's lawyers were in solo practice or in firms of one to four lawyers.

Although the size of our Bar has grown exponentially in the last 40 years, as has the size of law firms all over the state, the majority of Idaho's lawyers continue to practice solo or in firms of one to four. For example, there are 26 private firms ranging in size from 10 to 48 attorneys where 508 of us practice; 17 of these firms have 10 to 20 lawyers. The Attorney General has the largest law office in the state with 123 lawyers, followed by the 60 attorneys practicing in the Ada County Prosecutor's Office. In the over-10 category, another 314 attorneys practice in corporate legal departments and other governmental entities, including public defenders' offices, the courts and the U.S. Attorney's Office. A total of 312 attorneys are in private practice in 49 firms of between 5 and 9 lawyers, and another 181 practice in public and corporate offices of between 5 and 9. This means 1,498 of Idaho's 3,260 in-state attorneys practice in firms of 5 or more.

So, why all this interest in 1969? I entered law school that year, and on behalf of the Idaho Bar, and shortly after writing this, I will continue the tradition of making a short speech welcoming the University of Idaho Law School Class of 2009 to the study of law and their quest to join our noble calling three years hence. Thus the reason for my retrospection. There will be about 114 students in the U of I's Centennial Class. There were 55 in the Class of 1969.

As I was gathering the material for this column, Diane suggested I read the transcribed proceedings of the 43rd Annual Meeting of the Idaho State Bar held in Sun Valley on July 9, 1969. I could have written a whole column about this meeting, but cannot end this one without sharing a few nuggets from it. Presiding was President Hal Ryan, State Senator, practicing lawyer in Weiser, and later Chief Judge of the U.S. District Court. Judge Ryan began the proceedings (transcribed by court reporter Francis Wander of Weiser) thusly: "Good morning, I am glad to see so many of you full of breakfast at this point and up here, and those of you not full of breakfast [I] can understand why you can't stand the thoughts of it."

The meeting then turned to the reports of various committees, including the Court Modernization Committee, headed by Jim Lynch, who reported on the creation, after the Governor's veto of similar legislation two years earlier, of the one magistrate's division of the district court, replacing the justice, probate and city magistrate courts. This will be among Mr. Lynch's most significant legacies.

There were eight resolutions before the Annual Meeting that year, all of them noteworthy, but Resolution No. 3 is particularly so; it began as follows:

"WHEREAS, the desirability and feasibility of physically relocating the University of Idaho's College of Law at Boise or some other place has been often discussed and debated by members of the Idaho State Bar, law students and professors from time to time over the past years;"

The Resolution sought only to have the issue studied by a committee appointed by the Bar Commissioners but was defeated by a vote of "everything" to 237 (the only votes in favor being from the "Boise Bar").

I will not regale the new students with all of these numbers.I will say that no matter how much things have changed, the foundation of the law is constant, as is the process of solving problems based on the law. "The law is the calling of thinkers." [1] Generations of lawyers have begun to learn to think like a lawyer by studying contracts, property, torts, civil procedure and criminal law and procedure. These courses provide the foundation for the study of more specialized subjects, such as environmental law (and the National Environmental Policy Act of 1969).

Our clients come to us because, in the end, they have nowhere else to turn (or because they have learned by experience there is nowhere else they should turn). Although our advice may sometimes have little to do with the law or even the legal ramifications of a decision, statute or regulation, the ability to think analytically, (like a lawyer, if you will), provides the basis from which we act. And most often, what we are doing is applying the law to the facts, as we first learned to do in law school. As one writer put it almost 90 years ago:

"Law is simply a more or less complete system of rules created by society as a substitute for violence; and, theoretically at least, is but an application of common sense, justice, and the customs of the times to business and other relations between human beings.[2]"

B. Newal Squyres *is a senior litigation partner of Holland & Hart LLP. He is serving a sixth-month term as President of the Idaho State Bar Board of Commissioners. He represents the Fourth District. Newal received his undergraduate and law degrees from Texas Tech University.*

Endnotes

[1] Fred R. Shapiro, The Oxford Dictionary of American Legal Quotations 257 (1993) (quoting Oliver Wendell Holmes, Jr., "The Profession of the Law" (lecture to Harvard undergraduates February 17, 1866)).

[2] Frank Hall Childs, How to Find the Law 71 (1923).

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2009 RESOLUTION SCHEDULE

District Bar Association Resolution Meetings –meeting dates and times

1st District, Coeur d'Alene	*Noon*	*November 13*
2nd District, Lewiston	*Evening*	*November 12*
3rd District, Nampa	*Evening*	*November 17*
4th District, Boise	*Noon*	*November 18*
5th District, Twin Falls	*Evening*	*November 18*
6th District, Pocatello	*Noon*	*November 19*
7th District, Idaho Falls	*Noon*	*November 20*

DISCIPLINE

RAMI AMARO
(Withheld Suspension/Public Reprimand/Probation)

On July 20, 2009, the Idaho Supreme Court issued a Disciplinary Order suspending Rami Amaro from the practice of law for a period of ninety (90) days, with the entire ninety (90) day suspension withheld, placing her on Bar Counsel probation and imposing a public reprimand based on violations of Idaho Rules of Professional Conduct 1.6 [Confidential Information] and 1.9 [Duties to Former Clients].

The Idaho Supreme Court's Disciplinary Order followed a stipulated resolution of an Idaho State Bar disciplinary proceeding in which Ms. Amaro admitted that she had violated I.R.P.C. 1.6 and 1.9. The basis for the admitted violations was Ms. Amaro's unauthorized disclosure of information about her former client's intention to declare bankruptcy and Ms. Amaro's concerns about those circumstances to her former client's employer. The disclosure of the information was also the basis of a civil claim by the former client against Ms. Amaro.

The Disciplinary Order provides that the ninety (90) day suspension will be withheld and Ms. Amaro will serve a one (1) year probation, subject to the conditions of probation specified in the Order. Those conditions include that Ms. Amaro will serve the entire ninety (90) day suspension if she admits or is found to have violated any of the Idaho Rules of Professional Conduct for which a public sanction is imposed for any conduct during Ms. Amaro's period of probation. Further, during her one (1) year period of probation, Ms. Amaro must provide reports to Bar Counsel.

The withheld suspension and this public reprimand do not limit Ms. Amaro's eligibility to practice law.

Inquiries about this matter may be directed to: Bar Counsel, Idaho State Bar, P.O. Box 895, Boise, Idaho 83701, (208) 334-4500.

KENT E. WHITTINGTON
(Public Reprimand)

The Professional Conduct Board of the Idaho State Bar has issued a Public Reprimand to Idaho Falls lawyer, Kent E. Whittington, based on professional misconduct.

The Professional Conduct Board Order followed a stipulated resolution of an Idaho State Bar disciplinary proceeding, in which Mr. Whittington admitted that he violated Idaho Rules of Professional Conduct 8.4(b) [Commission of a criminal act] and 4.4(a)(1) [Respect for the Rights of Third Persons].

The Complaint related to Mr. Whittington's conviction of misdemeanor battery. The circumstances of that conviction were that while waiting for a hearing in court, Mr. Whittington touched a witness's long hair. The circumstances of the touching were disputed and Mr. Whittington denied any intent to harass a witness. The Magistrate Judge sentenced Mr. Whittington to 180 days jail, 174 days suspended and he was ordered to pay a fine and court costs. Mr. Whittington was also ordered to complete counseling classes on personal boundaries, ethics and sexual harassment and write a letter of apology to the witness. Mr. Whittington was placed on supervised probation for six months and unsupervised probation for six months. He has complied with all terms of his sentence.

The public reprimand does not limit Mr. Whittington's eligibility to practice law.

Inquiries about this matter may be directed to: Bar Counsel, Idaho State Bar, P.O. Box 895, Boise, Idaho 83701, (208) 334-4500.

NOTICE TO MARK T. MCHUGH OF CLIENT ASSISTANCE FUND CLAIM

Pursuant to *Idaho Bar Commission Rule* 614(a), the Idaho State Bar hereby gives notice to Mark T. McHugh that a Client Assistance Fund claim has been filed against him by former client Louis B. Haws, in the amount of $400. Please be advised that service of this claim is deemed complete fourteen (14) days after the publication of this issue of *The Advocate*.

NOTICE TO MARK T. MCHUGH OF CLIENT ASSISTANCE FUND CLAIM

Pursuant to *Idaho Bar Commission Rule* 614(a), the Idaho State Bar hereby gives notice to Mark T. McHugh that a Client Assistance Fund claim has been filed against him by former client Kimberly Owens, in the amount of $1,908.75. Please be advised that service of this claim is deemed complete fourteen (14) days after the publication of this issue of *The Advocate*.

OF INTEREST

Givens Pursley earns Alfred P. Sloan Award

Givens Pursley LLP, one of Idaho's oldest law firms, was again selected winner of the 2009 Alfred P. Sloan Award for Business Excellence in Workplace Flexibility. Givens Pursley was the only law firm in Idaho to win the award. It recognizes employers that successfully use flexibility to meet both business and employee goals.

Harris named Trial Lawyer of the Year

Jim C. Harris, Boise was named Idaho's 2009 Trial Lawyer of the Year and presented the James J. May Award. Harris was recognized for his successful efforts to limit liability insurance company abuse and represent common people in their struggles for corporate accountability, the Idaho Trial Lawyers Association said. Harris is a former Ada County prosecuting attorney and a personal injury lawyer. He is a certified civil trial specialist and is with Filicetti Law Office in Boise.

Idaho State Bar awards scholarships

Ben McGreevy and **Dylan Hedden-Nicely** from the University of Idaho College of Law are the first recipients of the Idaho State Bar Real Property Section's student scholarship. Students receiving the highest grade in their first year Property Law class receive $1,000 each at the beginning of their second year of law school as part of their financial aid award. The Real Property Section created this scholarship in 2008.

AARP seeks legal advocates in Capitol

AARP hopes a few long-term volunteers will help the nonprofit agency advance its legislative goals. The Capitol City Task Force is meant to implement the AARP's strategic plan, which includes monitoring legislative developments.

Volunteers for the task force are asked to show expertise in the legislative process and a commitment to the goals of AARP. A task force member would serve a two-year term and receive training.

Volunteers will track bills, provide testimony and work with legislators. Those interested are encouraged to call Dede at (208) 855-4005.

IOLTA Income Declines, Affecting Several Programs

Diane K. Minnich

Most of you are familiar with IOLTA, interest on lawyer trust accounts. IOLTA is an innovative program allowing attorneys to place client funds traditionally held in non-interest bearing accounts into interest-bearing accounts. Interest earned on these accounts is remitted directly by participating banks to the Idaho Law Foundation. These funds are then distributed through a grant process to programs serving the public. Idaho's IOLTA program has distributed over $5.5 million in grants during its 25-year history. In accordance with Idaho Rule of Professional Conduct 1.15, IOLTA funds are used to provide funding for the following purposes:


Diane K. Minnich

- To provide legal aid to the poor;
- To provide law-related education programs for the public;
- To provide scholarships and student loans; and
- To improve the administration of justice

Recent grant recipients of Idaho IOLTA funds include Idaho Legal Aid Services, the Idaho Volunteer Lawyers Program, Catholic Charities of Idaho, Idaho Legal Resource Line, Law Related Education Program, UI College of Law Scholarships, YMCA Youth Government program, and 4H Know your Government program.

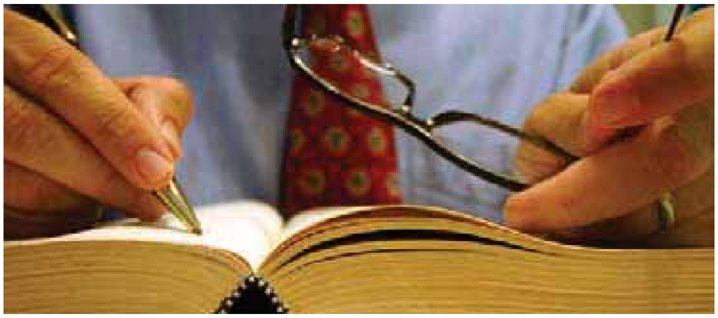
Because interest rates have dipped to their lowest level in half a century, we have seen a significant decrease in IOLTA funds available to support critical Idaho law related services. In 2008 the Idaho Law Foundation was able to grant $450,000 to law related organizations. In 2009 that amount decreased to $360,000. For the 2010 grant cycle, the Idaho Law Foundation Board of Directors was only able to designate approximately $190,000 as the amount available for grants, a decrease of nearly 50%. This decrease comes at a time when the need for services to families and individuals is increasing.

Although interest rates have decreased considerably, the banks listed below have continued to offer favorable interest rates for IOLTA accounts.

- Bank of the Cascades
- Idaho Central Credit Union
- Idaho Independent Bank
- Idaho Trust Bank
- Syringa Bank
- Wells Fargo Bank
- Zions Bank

We appreciate the continued support of these banks. We encourage you to work with your bank to offer as high an interest as possible during these difficult economic times.

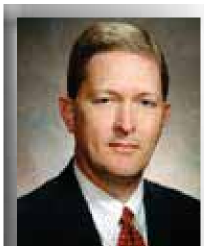
Even with this much needed support from banks that have stepped up to support IOLTA, programs that provide critical law related services to Idaho citizens will see a significant decrease in 2010. Your support of organizations such as Idaho Volunteer Lawyers Program, Law Related Education, and Idaho Legal Aid Services, is more vital than ever this year. It's crucial that we continue to offer our generosity to these important programs to ensure they are able to offer vital legal services and education to Idaho citizens.



Welcome from the Business and Corporate Law Section

David Scott Jensen
Moffatt, Thomas, Barrett, Rock & Fields, Chtd.

In the last few years, limited liability companies and the Idaho Uniform Limited Liability Company Act have played a large role in the life of the Business and Corporate Law Section. A committee of the Section spent many hours reviewing the Revised Uniform Limited Liability Company Act with Idaho's Uniform Law Commissioners. LLCs have been extensively featured in each of the Section's annual seminars for the last few years. The articles in this edition of the Advocate sponsored by the Section reflect this importance of LLCs with three of the seven articles relating to LLCs.



David Scott Jensen

The first featured article is Rex Blackburn and Dale Higer's explanation of the significant provisions of the new Idaho Uniform Limited Liability Company Act. The second article, by Nicole Trammel, examines fiduciary duties in LLCs and identifies several fiduciary duty issues that should be addressed in operating agreements. Winston Beard provides the last article on LLCs and presents what he believes are serious weaknesses of the new act. I hope these articles on LLCs will generate a vigorous dialogue among Idaho practitioners about Idaho's new LLC act.

Our fourth article remains within the context of business entities and considers the fiduciary duties upon a director of a company in the "zone of insolvency." Melanie Rubocki explains that under such circumstances, directors and officers owe the corporation's creditors the same fiduciary duties they owe to the corporation and its shareholders.

The fifth article addresses another issue that arises more frequently during these trying economic conditions. Nicole Snyder and Scott Randolph explain the requirements of the Worker Adjustment and Retraining Notification Act of 1988 when an employer is engaged in a mass layoff or plant closure.

The topic of the sixth article arises in all phases of the business cycle, but is certainly more exciting during the good times. This article by Richard Teichner and Erik Bolinder provides a guide through the terminology and methodologies of business valuations.

The last article looks beyond the borders of Idaho and compares the Idaho UCC to the United Nations Convention on Contracts for the International Sale of Goods. As Christine Nicholas explains in her article, an international trade contract will likely be subject to the Convention unless a clear choice of law provision provides otherwise. With more and more Idaho businesses engaging in international trade, it is imperative that the lawyers advising these businesses understand the advantages and disadvantages of the Convention.

The Business and Corporate Law Section is a thriving, active section that will soon be more active for its members. The Section's past monthly meetings were just business meetings primarily for the Governing Council. Beginning with the September 2009 meeting, the monthly meetings will be 30 minutes of business followed by a free 30 minute CLE. Section members may participate by telephone conference if they cannot attend the meeting.

The Section is also blessed with a very healthy bank balance. During the coming year, the Governing Council will be exploring ways in which to put the Section's funds to use for its members. Anyone with a suggestion for how the funds may be used should contact me or any member of the Governing Council.

The members of the Governing Council for the next year are Michael Bixby, Erik Bolinder, Kari Campos, Matt Christensen, Michael Dingle, David Hammerquist (Secretary), Stephen Hardesty, Bart Harwood, Randolph Hill, David Jensen (Chair), Jeffery Moss, Tobi Mott, Molly O'Leary (Treasurer), Kris Ormseth, Melanie Rubocki, Paul Street, and Brent Williams.

BUSINESS AND CORPORATE LAW SECTION

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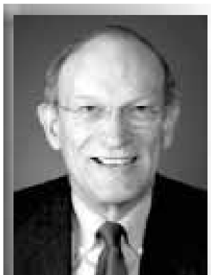
The New LLC Act Preserves Idaho's Traditions

Rex Blackburn, *Idaho Power Company*
Dale G. Higer, *Investors Financial Corporation*

Introduction

In 2008, Idaho became the first state to adopt the Revised Uniform Limited Liability Company Act ("RULLCA"), which was adopted by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") in 2006. The Legislative Committee of the Business Section of the Idaho State Bar ("Business Section Legislative Committee"), initially chaired by Winston Beard and later by David Jensen, reviewed RULLCA and the LLC statutes of four other states before settling on RULLCA. The Business Section Legislative Committee made a few minor modifications to RULLCA and the Idaho Uniform Law Commission sponsored RULLCA before the Idaho Legislature.[1]


Rex Blackburn


Dale G. Higer

Background

Since Wyoming adopted the first limited liability company act in 1977, much has happened in the development of the law in this area. The IRS ruled that limited liability companies ("LLC") could be taxed as partnerships even though an LLC shields its members from liability like a corporation. All states and the District of Columbia have adopted LLC statutes. LLC filings are significant in every U.S. jurisdiction, including Idaho. In many states new LLC filings approach or even outnumber new corporate filings on an annual basis. In 1997, the tax classification changed when IRS "check-the-box" regulations became effective. As a result, single-member LLCs are now popular as sole proprietorships and as corporate subsidiaries.

In 1994, NCCUSL adopted the Uniform Limited Liability Company Act ("ULLCA") and revised it in 1996 in anticipation of the "check-the-box" regulations. Seeing it as an opportune moment to identify the best elements of the myriad "first generation" LLC statutes and to infuse those elements into a new, "second generation" uniform act, NCCUSL appointed a drafting committee in 2003 to undertake a complete revision of ULLCA.

The RULLCA drafting committee met formally, at least twice a year, from the spring of 2003 until the summer of 2006. The drafting committee was comprised of nine Uniform Law Commissioners (including the authors of this article), two reporters, 13 advisors from the American Bar Association ("ABA") at large and at least four representatives of the ABA's various Sections. Collectively, the drafting committee had participants from at least 15 states (including heavily commercial states such as California, Colorado, Delaware, Indiana, Illinois, Massachusetts, Minnesota, Pennsylvania and Texas). Many of the drafting committee members devote their professional practice to LLC law. The drafting committee reviewed LLC statutes from all states and the District of Columbia. Over the course of three years, at three NCCUSL annual meetings, the drafting committee submitted its work for line by line review and debate of the commissioners appointed in each of the 50 states, the District of Columbia, the U.S. Virgin Islands and Puerto Rico. The American Bar Association has endorsed RULLCA.

Beginning in February 2007 and continuing through December 2007, the Business Section Legislative Committee reviewed RULLCA and the LLC acts of California,[2] Delaware, Minnesota and Washington before deciding by a near unanimous vote that RULLCA was the best choice for Idaho. This Committee made a few changes to RULLCA, including deleting the pre-filing provisions and adding the Professional Limited Liability Company provisions of the then-existing Idaho LLC act. Committee members included David Jensen, Bart Harwood, John Runft, Richard Riley, Nicole Snyder, Bill Batt and Chuck Goodenough (Idaho Deputy Secretary of State), all of whom have extensive experience with LLC law.

RULLCA's Consistency With Existing Idaho Law

Idaho's version of RULLCA represents the most complete and thorough statutory treatment of LLC law in existence. It consists of 11 thoughtfully organized parts, containing 90 separate sections. RULLCA provides comprehensive treatment of, among other subjects: entity formation and filings, relations of members and managers to persons dealing with the LLC, relations of members to each other and to the LLC, transferable interests and rights of transferees and creditors, member disassociation, dissolution and winding up, foreign LLCs, actions by members, and finally, merger, conversion and domestication. RULLCA clarifies a number of issues not resolved under existing Idaho (or other) LLC law. RULLCA's extensive commentary to each section provides interpretative guidance to lawyers and courts. Moreover, as RULLCA is adopted in other jurisdictions, Idaho lawyers and courts will, as has been the case with the UCC and other uniform laws, benefit from judicial decisions interpreting identical statutory language. These advantages of uniformity lead to predictability and consistency of law, and reduce business transaction costs.

RULLCA's key default provisions permitting non-written operating agreements, establishing per capita voting and distribution rights, and establishing member/manager governance structures are consistent with Idaho's first generation LLC statute, which was enacted in 1994, and other Idaho unincorporated entity acts going back for over a century. Although other states have adopted a patchwork of LLC statutes that reflect non-uniform default rules relating to governance and membership rights, the "normal" LLC is relatively standard from state to state. It is a closely-held business consisting, on average, of three members. The members conduct business pursuant to an often informal, and at times incomplete, "agreement". Because of statutory provisions limiting member liability, the LLC has overwhelmingly become the entity of choice for closely-held businesses. For these reasons, RULLCA has adopted default rules that are based on a traditional, but relatively simple, "partnership" model, rather than a more complex "corporate" model.

Subject to a few limited exceptions, members of an LLC may generally agree to governance and membership rights that differ from RULLCA's default rules.[3] If the members of an Idaho LLC want to follow a corporate model in their operating agreement, they are free to do so. RULLCA affords members the broadest permissible freedom of contract. The default rules follow a partnership model and apply only when members do not agree to other terms.

Default rules should serve the normal expectations of most persons who, for reasons of lack of sophistication, expertise, or sound legal counsel have not considered or expressly agreed upon terms governing the rights and relations of the members. RULLCA's default provisions best serve this objective. As Goodenough observed,

> As it happens, the bulk of the filings in this Office (Secretary of State) appear to be small, start-up businesses whose members see themselves dividing up any income from the

business equally. If someone is investing a sizable sum into a business with the idea that another person will provide the labor and expertise, then it would appear easy for the two members to divide distributions along any pattern they can agree upon—in the operating agreement.

The Drafters, the Uniform Law Commissioners, the Bar committee, and this Office all agreed that it would be best to make the default provisions in the statute match the expectations of the small start-up businesses such as the contractors, painters, landscapers, et al., who contemplate a partnership split. This is another matter that is not a departure from the old statute. Under old Idaho Code sec 53-629, where it provides that if the operation agreement does not provide otherwise, each member shares equally. [4]

In particular:

1. RULLCA's Definition of "Operating Agreement" (Section 30-6-102 (15)): Like the overwhelming majority of current LLC statutes, including Idaho's 1994 LLC statute (I.C. § 53-601(11)), RULLCA permits the members to adopt an operating agreement orally, in writing, or through course of conduct. This default rule is entirely consistent with the reality that a significant number of closely held LLCs will not be governed by a written operating agreement. While more sophisticated entities may deviate from the default rule and require a written agreement, imposing the requirement of a written operating agreement by statute on all LLCs is not realistic or prudent. If the LLC conducts business without a written operating agreement and its members later find themselves in dispute, a court will either fashion an equitable resolution based upon the conduct and discussions of the parties, or simply ignore the actual expectations and conduct of the members. RULLCA (and Idaho's previous act) allow a court to enforce the actual expectations of the parties – even if not reduced to writing – without resorting to legal fiction or adherence to a strict rule that imposes inequitable results. This result is consistent with reported court decisions. In addition, RULLCA does not state any rule as to whether the statute of frauds applies to an oral operating agreement. This is left to other law.

2. RULLCA's Per Capita Voting and Distribution Rules (Parts 4 & 7): Like Idaho's previous LLC statute, RULLCA provides per capita default rules for voting, sharing of profits, and distributions. While members of more sophisticated or highly capitalized LLC's may agree to vote, share profits or make distributions on the basis of capital contributions, a per capital default rule does not meet the normal expectations of those most likely to be subject to default rules. Most closely held LLCs are not "capital intensive" (and those that are highly capitalized are much more likely to seek legal counsel when forming an LLC). A per capital default rule is a "trap for the unwary" member of a small, lightly capitalized business. For example, if two painters form an LLC, but only one member contributes even a modest amount of capital (e.g. painting equipment with limited value), under a per capital default rule only the member contributing capital of even nominal value is entitled to all accumulated earnings of the LLC. This is the result even if both members otherwise contributed equal value to the success of the business through their labor, expertise or business relationships. To suggest that a per capital default rule is necessary to protect a person investing a million dollars in an LLC with another person who is contributing only his labor is an extreme example that will likely never happen. The more likely scenario involving a person investing that amount of money will be that the person seeks qualified legal counsel to protect that person's interests, which will likely result in an operating agreement that provides for a per capital default rule (if that is indeed what the members want). RULLCA does not preclude this result. The members only have to adopt an operating agreement reaching this result.

3. RULLCA's Member/Manager Governance Structure (Part 4): Like Idaho's first generation LLC statute, RULLCA provides for alternative "member managed" or "manager managed" governance structures. This is consistent with the vast majority of existing LLC statutes. A complicated corporate based "board of managers/ governing manager/treasurer" default statutory governance structure has been adopted in only two states (North Dakota and Minnesota). While more sophisticated LLCs are free under RULLCA to adopt such a structure, that structure is ill suited for most closely held businesses. In fact, the failure of members to adhere to complex governance formalities increases the risk that the shield protecting members from individual liability will be "pierced".

4. RULLCA's Standards of Conduct for Members and Managers (Section 30-6-409): RULLCA's default rules relating to the duties of loyalty and care for members and managers are consistent with the formulations of corresponding duties found in other unincorporated association law, and improve on those formulations by expressly recognizing the "business judgment rule" in the context of the duty of care. Recognition of the business judgment rule, and assessment of member/manager conduct by comparison to other similarly situated persons is necessary to accommodate actions of members and managers that span a broad spectrum from ministerial to discretionary conduct. Importantly, RULLCA's formulation of these default rules affords members broad power to modify, by agreement, standards of conduct applicable to the members/managers of an LLC.

Importantly, RULLCA's formulation of these default rules affords members broad power to modify, by agreement, standards of conduct applicable to the members/ managers of an LLC.

Other Significant Provisions of the New Idaho Act

The Operating Agreement

Like the partnership agreement in a general or limited partnership, an LLC's operating agreement serves as the foundational contract among the entity's owners. RULLCA centralizes all statutory provisions pertaining to the foundational contract, and contains a number of substantive innovations concerning the operating agreement. These include: better delineating the extent to which the operating agreement may define, alter, or even eliminate aspects of fiduciary duty; expressly authorizing the operating agreement to relieve members and managers from liability for money damages arising from breach of duty, subject to specific limitations; and stating specific rules for applying the statutory phrase "manifestly unreasonable" thereby providing clear guidance for courts considering whether to invalidate operating agreement provisions that address fiduciary duty and other sensitive matters.[5]

The Power of a Member or Manager to Bind the Limited Liability Company

The original Uniform Partnership Act adopted in 1914 codified a particular type of apparent authority by position, providing that "[t]he act of every partner ... for apparently carrying on in the usual way the business of the partnership binds the partnership . . . ". This concept makes good sense for general and limited partnerships. A third party dealing with either type of partnership can know by the formal name of the entity and by a person's status as general or limited partner whether the person has the power to bind the entity.

This concept does not make sense for modern LLC law because: (i) an LLC's status as member-managed or manager-managed is not apparent from the LLC's name (creating traps for unwary third parties); and (ii) although most LLC statutes provide templates for member-management and manager-management, variability of management structure is a key strength of the LLC as a form of business organization.

RULLCA recognizes that "statutory apparent authority" is an attribute of partnership formality that does not belong in an LLC statute. Section 30-6- 301(1) provides that "a member is not an agent of the limited liability company solely by reason of being a member." Other law – most especially the law of agency – will handle power-to-bind questions. Although conceptually innovative, this approach will not significantly alter the commercial reality that currently exists between limited liability companies and third parties.

Default Rules on Management Structure

RULLCA retains the manager-managed and member-managed constructs as options for members to use in configuring their inter se relationship, and the operating agreement is the vehicle by which the members make and state their choice of management structure. Given the elimination of statutory apparent authority, it is unnecessary and may be confusing to require the articles of organization to state the members' determination on this point.

Charging Orders

The interests of creditors are restricted to a member's distributional interest and provide a judgment creditor with a "charging order" as the only method of executing against that interest. Further, a creditor's interest may be foreclosed and sold in a judicial foreclosure sale only if the court finds that payment may not be made within a reasonable time. The purchase in a foreclosure sale, however, does not make the purchaser a member.

A Remedy for Oppressive Conduct

Reflecting case law developments around the country, RULLCA permits a member (but not a transferee) to seek a court order "dissolving the company on the grounds that the managers or those members in control of the company … have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the [member]."[6] This provision is necessary given the perpetual duration of an LLC formed under RULLCA[7] and RULLCA's elimination of the "put right" originally provided by ULLCA, § 701.[8]

Derivative Claims and Special Litigation Committees

RULLCA provides members with the right to file a derivative action on behalf of a company alleging certain kinds of misfeasance on the part of the LLC by its management.[9] The company may form a "litigation committee" to investigate claims asserted in the derivative action. This stays the litigation while the committee does its investigation. The objective of the investigation is to determine if the litigation is for the good of the company. The litigation committee ultimately reports to the court with a recommendation to continue with the plaintiff or the committee as plaintiff, or to settle or to dismiss.

Organic Transactions – Mergers, Conversions, and Domestications

Since Idaho adopted the Model Entity Transactions Act in 2007, the Business Section Legislative Committee incorporated into Idaho's version of RULLCA comprehensive provisions authorizing LLCs to merge or convert into another type of entity, authorizing other types of entities to merge and convert into an LLC, authorizing an LLC to domesticate in another state and authorizing a foreign LLC to domesticate in the enacting state.[10]

Existing LLCs

Idaho's RULLCA applies to all LLCs formed on or after July 1, 2008, and applies to all LLCs on July 1, 2010.[11] LLCs formed before July 1, 2008, will, in most cases, not need to make any major changes in their structure before July 1, 2010, when RULLCA applies to them. The July 1, 2010, applicability date, however, provides a legitimate reason for attorneys to contact pre-July 2008 formed LLCs to review operating agreements and practices, and to recommend appropriate changes.

Conclusion

Idaho's version of RULLCA represents the most complete and thorough statutory treatment of LLC law today. It was thoughtfully reviewed by experienced Idaho practitioners prior to its adoption. Importantly, RULLCA clarifies a number of issues not resolved under existing Idaho law and provides the many advantages of uniformity, including predictability and consistency of law. RULLCA also carries forth many important governance structures consistent with Idaho's first generation LLC act and a century of Idaho law previous to the legislature's recognition of the LLC as a business entity form. Equally important, RULLCA default rules reflect the typical business structure and expectations of an overwhelming majority of the businesses formed in Idaho while allowing significant flexibility to more sophisticated businesses to agree to differing structural and governance models via an operating agreement. As a result, Idaho's RULLCA gives individuals and Idaho businesses an important tool to further and protect their interests.

About the Authors

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Dale G. Higer *is general counsel for Investors Financial Corporation, a privately held company investing in "seller originated" real estate contracts and mortgage notes collateralized by first position liens on real estate. Prior to that, Mr. Higer was a capital partner with Stoel Rives LLP practicing in the areas of banking, creditor's rights, bankruptcy, real estate, estate planning, probate and state and local taxation. He was a charter member of the American College of Real Estate Lawyers and is a Commissioner of the Idaho Commission on Uniform State Laws. In addition to serving on the RULLCA drafting committee, he has served on several uniform law drafting committees, including the Business Organizations Act, the Unincorporated Nonprofit Association Act and the drafting committee to revise UCC Article 9, and is a member of the Joint Editorial Board on Uniform Unincorporated Organizations Acts.*

Endnotes

1 RULLCA was not endorsed by the Idaho State Bar.

2 California and Washington bar committees are currently reviewing RULLCA for introduction in their legislatures. Iowa was the second state to adopt RULLCA and New Jersey and the District of Columbia are expected to adopt it this year. Bar committees in Arizona, Connecticut, Indiana, Mississippi, Nebraska, New York, Pennsylvania and Utah are currently or are about to start

their review of RULLCA,

3 *See* Idaho Code §§ 30-6-110 and 30-6-409.

4 Email dated September 7, 2008 to Senator Brent Hill.

5 Idaho Code § 30-6-110.

6 Idaho Code § 30-6-701(1)(e).

7 Idaho Code § 30-6-104(3)

8 A "put right" is a right or an option of a holder of a security of a company to require the company purchase some or all of the holder's securities, usually at a specified time and for a specified price. *See* Black's Law Dictionary 1237 (6th Ed. 1990). That right was not incorporated into RULLCA from the 1994 ULLCA.

9 *See* Idaho Code §§ 30-6-901 – 906.

10 *See* Idaho Code §§ 30-6-1001 – 1002.

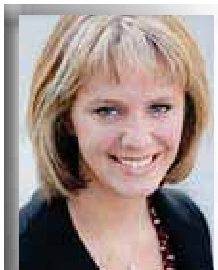
11 Idaho Code § 30-6-1104.

Fiduciary Duties in Limited Liability Companies

Nicole C. Trammel
Hawley Troxell Ennis & Hawley LLP

Introduction

On March 18, 2008, Idaho became the first state to adopt the Revised Uniform Limited Liability Company Act (the "RULLCA"), drafted by the National Conference of Commissioners on Uniform State Laws ("NCCUSL").[1] The Idaho Uniform Liability Company Act (the "New Act") became effective on July 1, 2008, and applies to all Idaho limited liability companies formed after that date. The prior act continues to apply to pre-existing limited liability companies until July 1, 2010, unless the company elects to "opt-in" to the New Act. As of July 1, 2010, all limited liability companies will automatically become subject to the New Act, regardless of whether the pre-existing limited liability companies have "opted-in."[2]


Nicole C. Trammel

Since its inception in the 1990s, the limited liability company ("LLC") has become the preferred business entity choice for many business relationships because of its flexible nature and the ability to mold the entity to fit virtually any desired business structure. The LLC is a hybrid entity merging contract principles and statutory principles, as well as concepts from both corporate law and partnership law. To this end, the RULLCA essentially consists of "default rules," which apply in the absence of the parties' contractual agreement to contrary or different terms.[3] For the most part, the parties may draft around these default rules. While it remains true under either Idaho's prior limited liability company act[4] (the "Prior Act") or the New Act that parties should take care when forming an LLC to draft around default rules that do not fit the parties' desired relationship, it is noteworthy that the New Act takes an innovative approach with regard to certain default rules, including its fiduciary duty provisions, which essentially codify many of the fiduciary duties formerly imposed on corporations and partnerships by statute or common law. Because of these new innovations and a recent Idaho Supreme Court decision which establishes that at least some pre-existing LLCs are also subject to fiduciary duty rules, parties may wish to "opt-in" to the New Act and draft around certain provisions to ensure that members and managers are not subject to unexpected liability for breach of fiduciary duties.

The Operating Agreement

The operating agreement is the key governance document for LLCs. The New Act defines an operating agreement as "the agreement, whether or not referred to as an operating agreement, and whether oral, in a record, implied or in any combination thereof, of all members of a limited liability company, including a sole member."[5] This new definition of "operating agreement" is expansive - based on this definition, an operating agreement could be written or oral, express or implied, and could even be formed unintentionally. An LLC is bound by its operating agreement; and a person who becomes a member of the LLC is deemed to assent to the operating agreement, whether or not she or he manifestly assented.[6] As a result, once an LLC comes into existence and has at least one member, the LLC necessarily has an operating agreement.[7] In other words, under the New Act, an operating agreement is inevitable.

Since the New Act provides default rules that govern any matters not otherwise addressed in the operating agreement, it is important to note that if the LLC does not have a written operating agreement, or if its operating agreement does not contain provisions governing certain matters, the default rules will govern the parties' relationship. Accordingly, members and managers forming an LLC should take great care to draft around any default rules that do not fit their desired business relationships. In particular, the parties should properly define the scope and parameters of the parties' fiduciary duties to the extent the New Act allows them to draft around its fiduciary duty provisions – especially if the intended duties are not consistent with the default rules set forth in the New Act. In so doing, it is important to remember that an operating agreement is a fluid document, and may theoretically be amended by oral or written conduct. Although the parties cannot completely circumvent all of the default rules, the New Act provides substantial flexibility to draft the document to meet the parties' reasonable expectations.

Fiduciary Duties and the RULLCA

Until recently, the existence, scope and extent of fiduciary duties owed by members and managers in an Idaho LLC remained an open question. However, in *Bushi v. Sage Health Care, PLLC*, the Idaho Supreme Court addressed the question of fiduciary duties under the Prior Act.[8] In *Bushi*, a case dealing with a member-managed LLC, the court held that, under the Prior Act, members of an LLC do indeed owe one another fiduciary duties.[9] In reaching this decision, the Court specifically noted the New Act's fiduciary duty provisions, and that the majority of state courts considering the issue have concluded that members owe one another the fiduciary duties of trust and loyalty. Although the Court did not elucidate the precise parameters of these duties, it is clear that, under both the Prior Act and the New Act, members of a member-managed LLC owe fiduciary duties to one another.[10] Since the New Act expressly imposes fiduciary duties on both members and managers, it may be prudent for pre-existing LLCs to take advantage of its clear rules, and re-draft their operating agreements to the extent their current business relationship could be deemed to violate the fiduciary duty provisions of the New Act, or fiduciary duties that might be applicable under *Bushi*.

As the drafters wrote in the Comments to RULLCA, "[o]ne of the most complex questions in the law of unincorporated business organizations is the extent to which an agreement among the organization's owners can affect the law of fiduciary duty." Since a limited liability company is both a creature of contract and a creature of statute, the drafters sought a balance between "cabining in" the fiduciary duties, by establishing the duties in full, unwavering statutory prescriptions, and leaving them "uncabined," subject only to the terms of the parties' contractual obligations to one another. In addition, the drafters did not intend the fiduciary duties set forth in the New Act to be exclusive, but rather sought to "[permit] contractual innovation within the framework of a mandatory core of minimum statutory fiduciary duties."[11] To accomplish this balance, the drafters ultimately set forth certain fiduciary duties in the statute as "default rules," but allowed the parties, through the operating agreement, to alter and even eliminate some of these duties, subject to the limitation that such alterations and restrictions must not be "manifestly unreasonable."

Accordingly, the New Act expressly provides that a member of a member-managed LLC owes to the company and the other members the fiduciary duties of loyalty and care and the contractual duty of good faith and fair dealing.[12] In a manager-managed LLC, these fiduciary duties apply to the managers but not the members.[13] The duty of loyalty includes:

- The duty to account to the company and hold as trustee for it any property, profit or benefit derived by the member or manager in the conduct or winding up of the company's activities, from a use by the member or manager of the company's property, or from the appropriation of an LLC's opportunity;

- The duty to refrain from dealing with the company in the conduct or winding up of the company's activities as or on behalf of a person having an interest adverse to the company; and
- The duty to refrain from competing with the company in the conduct of the company's activities before the dissolution of the company.[14]

Subject to the business judgment rule,[15] the duty of care of a member of a member-managed LLC (or a manager of a manager-managed LLC), in the conduct and winding up of the company's activities, is to act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the member or manager reasonably believes to be in the best interests of the company. In discharging this duty, a member may rely in good faith upon opinions, reports, statements or other information provided by another person that the member or manager reasonably believes is a competent and reliable source of information.

Notwithstanding its pronouncement of certain fiduciary duties, the New Act expressly allows an operating agreement to restrict or eliminate certain aspects of fiduciary duties of members and/or managers of the company, so long as such restrictions are not "manifestly unreasonable." For example, the operating agreement may restrict or eliminate the duty to account to the company and to hold as trustee any property, profit or benefit derived by the member in the conduct of winding up the company's business, from a use by the member or manager of the company's property, or from the appropriation of a limited liability company opportunity. In addition, the operating agreement may restrict or eliminate the duty to refrain from dealing with the company in the conduct or winding up of the company's business as or on behalf of a party having an interest adverse to the company. Finally, the operating agreement may restrict or eliminate the duty to refrain from competing with the company in the conduct of the company's business before the dissolution of the company.[16] For example, in a real estate transaction, where the members form an LLC for one purpose, but the parties intend that each member may continue to engage in additional, unrelated projects, it would be important to draft around these duties to provide that the members may enter into additional, separate real estate transactions without violating the duty of loyalty. Similarly, health care entities often lease property owned by one of the members. In this instance, the operating agreement should provide that the member may lease the building to the entity without violating the duty to account to the company for the profits derived from the lease.

Since the New Act expressly imposes fiduciary duties on both members and managers, it may be prudent for pre-existing LLCs to take advantage of its clear rules, and re-draft their operating agreements...

In addition, an operating agreement may, so long as it is not "manifestly unreasonable," identify specific types or categories of conduct that do not violate the duty of loyalty; alter the duty of care except to authorize intentional misconduct or knowing violation of law; alter any other fiduciary duty including the elimination of particular aspects of that duty; and prescribe standards by which to measure the performance of the contractual obligation of good faith and fair dealing.[17] Along similar lines, the operating agreement may specify the method by which a specific transaction or act that would otherwise violate the duty of loyalty would be authorized or ratified by one or more disinterested and independent persons after full disclosure of all material facts.[18]

In sum, the New Act provides four separate methods through which those with management power in a limited liability company can proceed with conduct that would otherwise violate the duty of loyalty:

(i) the operating agreement might eliminate the duty or otherwise permit the conduct, without need for further authorization or ratification;
(ii) the conduct must be authorized or ratified by all members after full disclosure;
(iii) the operating agreement might establish a mechanism other than the informed consent for authorizing or ratifying the conduct; or
(iv) in the case of self-dealing the conduct might be successfully defended as being or having been fair to the limited liability company.[19]

For example, with the real estate entity, the operating agreement could expressly permit the members to enter into certain ventures which might otherwise be deemed to violate the duty not to compete with the LLC, or it could eliminate the duty not to compete entirely. In the health care LLC, the operating agreement might expressly provide that a member may lease the member's individual property to the entity, without accounting to the entity for the profits derived from the lease. Alternatively, the New Act provides defenses if the conduct is challenged. The additional members could ratify the conduct in accordance with the New Act's ratification provisions, or the LLC could assert and attempt to prove that the conduct was otherwise fair to the company.

Although the parties may draft around the New Act's fiduciary duty rules, provisions seeking to limit or eliminate such duties will be subject to a claim that they are "manifestly unreasonable." Under the New Act, state courts are tasked with a determination of whether such a provision is "manifestly unreasonable."[20] However, the New Act does provide some guidelines for courts in making such a determination. According to the New Act, "the court shall make its determination as of the time the challenged term became part of the agreement, considering the circumstances existing at the time, and may invalidate the term only if, in light of the purposes and activities of the limited liability company, it is readily apparent that the objective term is unreasonable or the term is an unreasonable means to achieve the provision's objective."[21] Idaho courts have not yet been faced with this question. In any case, parties should take care in their drafting to follow the guidelines set forth by the New Act, and ensure the provisions are not manifestly unreasonable under the circumstances existing at the time.

Conclusion

The provisions of the New Act highlight the importance of written, well-drafted operating agreements which fit the parties' expectations as to how their business relationship is structured. In addition, the *Bushi* ruling makes clear that members of pre-existing LLCs owe fiduciary duties to other members and to the company. With the adoption of the New Act, however, the good news is that LLCs have the opportunity to "opt-in" to the New Act and invoke its provisions to draft around the default rules, and mold the LLC to fit the parties' business expectations.

About the Author

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Prior to joining Hawley Troxell, Nicole served as law clerk to the Honorable Justice Jim Jones of the Idaho Supreme Court.

Endnotes

[1] Idaho Session Laws 2008, ch. 176, p. 480 (approved on March 18, 2008).
[2] Idaho Code § 30-6-1104.
[3] While the Prior Act also utilized the concept of default rules, RULLCA revised and altered and expanded many of these defaults.
[4] Chapter 6, title 56, Idaho Code (2008).
[5] Idaho Code § 30-6-102(15).
[6] Idaho Code § 30-6-111(1), (2).
[7] NCCUSL Comment to RULLCA § 110.
[8] Bushi v. Sage Health Care, PLLC, 146 Idaho 764, 203 P.3d 694 (2009).
[9] Id., 203 P.3d at 699.
[10] In Bushi, a member of a member-managed LLC asserted breach of fiduciary duty claims against the other members. Thus, this case only establishes that members in a member-managed LLC owe one another fiduciary duties. The scope of a manager's fiduciary duties in a manager-managed LLC remains unclear under the Prior Act.
[11] See Sandra K. Miller, What Fiduciary Duties Should Apply to the LLC Manager After More Than a Decade of Experimentation?, 32 J. Corp. L. 565, at 614.
[12] Idaho Code § 30-6-409.
[13] Idaho Code § 30-6-407.
[14] Idaho Code § 30-6-409(1), (2).
[15] The business judgment rule is the principle, taken from corporate law, that a court will not second-guess the business judgment of a corporation's officers and directors, absent conflicting interest transactions, self-dealing, or other indicia that such decision may be suspect.
[16] Idaho Code § 30-6-110(4)(a).
[17] Idaho Code § 30-6-110(b)-(e).
[18] Idaho Code § 30-6-110(5).
[19] NCCUSL Comments to RULLCA § 409(e); Idaho Code §§ 30-6-110(d)(1), (2), 409(f), 110(e), 409(e).
[20] Idaho Code § 30-6-110(8).
[21] Idaho Code § 30-6-110(8).

Critique of the Idaho Uniform Revised Limited Liability Company Act

Winston Beard
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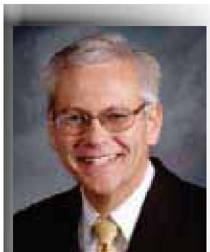
On July 1, 2008, Idaho became the first of only two states to adopt the Uniform Revised Limited Liability Company Act.[1] The 2007 Idaho Legislature had the opportunity to provide Idaho with limited liability company (LLC) laws particularly suitable for medium sized entities with simple capital, management, authority, and management liability structures. The new Idaho Limited Liability Company Act fails to meet that need. That failure arises in significant part from the fundamental assumptions on which the Act is premised. In effect, the Act undermines the very concept of limited liability by treating managers and owners like trustees. It adds new complexity making Idaho LLCs unfriendly to business.



Winston Beard

Assumptions

The new Idaho Uniform Limited Liability Company Act (IULLCA) was framed around the following assumptions:

- Fairness is paramount. Fact and circumstances tests are common in the IULLCA. There are few solid guidelines for business.
- Partnership law serves as the model. LLCs were initially patterned after partnership law to avoid having too many corporate characteristics under tax law. The check-the-box rules of the Internal Revenue Service (IRS) made that unnecessary.[2] Most states have followed the assumption that LLCs are a new entity and that neither partnership nor corporation law serves as a pattern. The new Idaho LLC law rejects that approach.[3]
- Capital is irrelevant. The new LLC law does not define capital and does not allocate rights on the basis of capital. Capital is central to business persons and central to the IRS, but it is irrelevant under Idaho LLC law.
- **Management is not needed**. The new law assumes members are equal and management structure is not necessary. It simultaneously exposes management to greater liability than exists under any other Idaho entity law, except for general partnerships.

Operating agreement

The operating agreement has always been central to an LLC and most lawyers assume that LLC law is premised on freedom of contract so the operating agreement will always control. That is no longer the law in Idaho.

IULLCA assumes that an operating agreement exists the minute the articles of organization are filed.[4] The question is only what is the operating agreement. The operating agreement can be oral (discussion at lunch by organizers), based on emails, course of dealing, or tax returns.[5] The official comments to the IULLCA state that the operating agreement includes not only "all relations inter se the members and the limited liability company," but also all "activities of the company and the conduct of those activities."

Operating agreements are governed by the complex rules set forth in sections 110-112.[6] Idaho Code § 30-6-110(3) sets forth eleven items that the operating agreement may not do. Section 110(4)-(7) defines what portions of IULCCA the operating agreement may modify if the modification is not manifestly unreasonable.[7]

To further complicate the matter, Idaho Code § 30-6-102(15) has two pages of official comments trying to interface IULLCA with the statute of frauds and § 30-6-107 incorporates the parole evidence rule.[8] There are no meaningful guidelines on whether a requirement that the operating agreement be in writing is enforceable.[9]

Thus a written operating agreement cannot be relied upon unless there is a current certification of all members that (i) there are no other oral agreements or unanimous consents changing its terms and (ii) the business is operated in accordance with the operating agreement.

Capital structure

Since the IULLCA assumes the entity has no capital, there are no provisions in the Act that define capital, create capital accounts, or regulate rights based on capital. That deficiency can be corrected in the operating agreement.

The official comment to 53-2-503 (ULPA) expresses the concept of the IULLCA drafters: "Nearly all limited partnerships will choose to allocate profits and losses in order to comply with applicable tax, accounting and other regulatory requirements. Those requirements rather than this Act, are the proper source of guidance for that profit and loss allocation." To create capital accounts and allocate rights based on capital, the drafter of the operating agreement must be thoroughly familiar with the IRS 704 regulations. If profits and losses are not allocated in proportion to properly maintained capital accounts, the IRS doesn't have to follow the operating agreement.[10] I have found few Idaho lawyers that have a working knowledge of the IRS 704 rules. Often capital accounts are created by assigned percentages that do not change as the capital accounts change. Those operating agreements clearly violate the 704 rules.

The concept adopted in many states is to allocate rights to vote and to receive annual and liquidating distributions on the basis of "agreed capital."[11] So if A contributes $1 million, B contributes his knowledge and his possession of market opportunities, and it is agreed A has a 60% interest, then B's intangible asset has an agreed value of $667,000. The agreed value concept controls rights in the Idaho Limited Partnership Act,[12] but the new IULLCA reverts to very old general partnership law.

The LLC default rule is that all rights are allocated by the head count. Thus, if $100,000 is to be distributed to A, with a capital account of $1, and B, with a capital account of $1 million, they each receive $500,000. Also, they have the same voting rights. Obviously this is not acceptable in any business setting so an operating agreement that follows the 704 rules is essential. If the drafter fails to properly draft the agreement, or if the written agreement is irrelevant because course of operations varies from the agreement, there is no agreed capital safe harbor to fall back on. This leaves the majority contributor vulnerable to the unreasonable demands of the minority and requires the majority investor to monitor compliance each year to make sure the operating agreement is being followed.

The 704 rules require the use of fair market value capital accounts and the book-up of those accounts upon any withdrawal or addition of contributed capital. The 704 rules make arbitrarily assigned percentage capital accounts highly suspect. It is necessary for intangible capital to be valued at the time it is contributed, and it is important for services not to be considered capital until the services are performed and not otherwise paid for. None of these basic rules are in the IULLCA, which reflects the drafters' concept that the IULLCA was not designed for businesses with capital.

Contributions

Idaho Code § 30-6-102 states that a contribution is any benefit provided by a person to an LLC in order to become a member. The contribution can include a promissory note, services, or intangibles. The use of a promissory note, not yet performed services, or unspecific intangibles may violate the Idaho Constitution.[13] Idaho Code § 30-6-102 does not include a requirement of a writing to prove the agreement to contribute or to prove an employee was performing services for an oral promise of an interest in the LLC. An employee can sue for what he perceives was a verbal promise of an interest in exchange for work. Both the LLC and its creditors can enforce oral promises to contribute that may have been made over lunch. This rule is the opposite of the rule applicable to old Idaho LLC's.[14] This requires one more provision in the operating agreement to change the new rule back to the old rule.

Allocations and distributions

The IUCLLA has no provisions governing allocations. Idaho Code § 30-6-404 governs distributions and provides for distributions to be equal to each member. The drafters got this backwards from a business perspective since allocations need to be defined while distributions do not need to be defined so long as they impact the capital accounts. Allocations of profits and losses are reported on K-1 statements and must follow the 704 rules. One of the great advantages of an LLC is that distributions are totally flexible since they are not taxable. The distributions must impact the capital accounts, but they are not governed by the capital accounts. Most operating agreements that I see specify fixed percentages for both allocations and distributions. Fixed percentages most likely violate the 704 rules on allocations while destroying the flexibility of an LLC on distributions. They prevent the LLC from being used as a vehicle for retirements and flexible buy-ins and buy-outs. At a minimum, the default IULLCA rule that distributions are based on head count and not capital must be changed in the business entity operating agreement. Even that change leaves unaddressed the issue of how allocations are made. Since there is no default rule in the statute, the business entity operating agreement should establish rules consistent with the 704 provisions.

An Idaho LLC cannot make a distribution if it is not able to pay its debts as they become due or if the liabilities exceed the assets.[15] If a distribution is made in violation of Idaho Code § 30-6-405, the following section provides all those consenting to the distribution are personally liable to pay the LLC the amount of the illegal distribution. These provisions significantly weaken the limited liability shield of the LLC particularly where the value of real estate assets may be in decline while rents continue as normal. This means even the single member LLC set up to hold real estate may have little practical purpose.

Authority

In business, the offices of president or CEO, treasurer, secretary, and manager have traditionally carried statutory apparent authority. Official comment (a)(1) to § 30-6-301 rejects the concept of statutory apparent authority. That means no one has the right to rely on a person's status as a member, manager, or officer of an LLC.

The concept of apparent authority is not rejected; it is just turned into a fact and circumstances test. The IULLCA solution to the uncertainty of a fact and circumstances test is a statement of authority[16] that is filed with the Secretary of State's office.[17] Can a CPA rely on the representations of the president or manager of an LLC? Only if there is a statement of authorization on file or a specific authorization by the members. The same is true with attorneys seeking to know the LLC's position in litigation or contract negotiations. Absent a filed statement of authority, attorneys have no right to rely on the engagement by a member or manager of an LLC on the basis of the person's position. Apparent authority could be created by a holding out by the company, but the holding out must be something other than the conferring of a title. Whether an annual statement creates apparent authority will be determined on a fact and circumstances test. The only safe position is to require the filing of a statement of authority.

At a minimum, the default IULLCA rule that distributions are based on head count and not capital must be changed in the business entity operating agreement.

Internal management

Idaho Code § 30-6-302(3) reminds us that the apparent authority and the statement of authority apply only on external authority issues. They do not control internal authority; so, again the office of a person and even a statement of authority filed with the Secretary of State does not create internal authority.

IULLCA fails to provide any internal management structure. The rules in Idaho Code § 30-6-407 state each member or manager has equal authority. Comment (c)(3) states: "subsection (c) (3) does not describe board management." The effect of section 407 is that each member or each manager has the same authority as any other member or manager. If there are three managers, each manager has full authority to act but without any statutory apparent authority. The three do not need to meet to confer and vote. Each is fully empowered to act on his/her own. If a difference arises, the difference is to be resolved by a vote of the majority.[18] Thus, so long as a manager acts without consulting and is therefore not aware of a difference he/she can act with full authority. This management structure motivates members not to talk to each other and to act before discussion. It is imperative that the business entity operating agreement undo the statutory provisions and set up an internal management structure that makes sense.

Management liabilities

IULLCA sets up four categories of duties for those who manage an LLC. Idaho Code § 3-06-110 restricts a practitioner's ability to eliminate or modify those duties. First, IULLCA adopts the covenant of good faith and fair dealing. That covenant cannot be eliminated or modified, although standards to measure performance can be specified and the Act allows for indemnification and limitations on damages.[19] Second, the IULLCA adopts a due care standard subject to the business judgment rule. The due standard of care is similar to the corporate standard. The duty of care cannot be eliminated but can be altered if the alteration is not manifestly unreasonable and does not affect knowing and intentional acts.[20] The first two duties and the restrictions on them are consistent with business practices and should not pose a problem to Idaho lawyers.

Third, IULLCA recognizes uncabined duties. The Revised Uniform Partnership Act, Uniform Limited Liability Company Act, and the Uniform Limited Partnership Act cabined the duties and stated the duties of management included only those set forth in those laws. The new IUCLLA reverses those positions and allows a judge to impose unspecified and unknown duties.[21] Idaho Code § 30-6-110(4)(d) allows the uncabined duties to be modified but does not allow them to be eliminated. Thus, to modify the uncabined duties they must first be set out in the operating agreement. Since most attorneys would be unwilling to enumerate the uncabined duties, those unspecified duties will be included in most operating agreements by default and without modification.

Fourth, the duty of loyalty is set forth in Idaho Code § 30-6-409(2)(a) picks up language from partnership law and from the old Idaho LLC law. However, it is inconsistent with business standards. It includes the duty to "account to the company and to hold as trustee for it any property, profit or benefit derived by the member" in the conduct of the company's activities, from use of the company property, or appropriation of a business opportunity. It also includes a prohibition on related party transactions and competitive activities.

The concept of "holding as a trustee" is foreign to business. The role of a trustee is not to take risk. The role of business is to take risk. Concepts of trustee, fiduciary, and prudence have all been deleted from the Model and Idaho Business Corporation Act.[22] The breadth of the IULLCA standard is troubling. It includes any property, profit or benefit. Thus, any compensation, any fringe benefit, or any distribution is to be held in trust for the benefit of the corporation. Every member or manager is personally liable to pay back to the LLC all benefits received. That goes a long ways towards destroying the concept of limited liability. Idaho Code § 30-6-110 allows the duty of loyalty to be eliminated or modified if the modification is not unreasonable. There is a strong risk that elimination would be viewed as unreasonable so modification is the only safe course of action. Presumably, a modification to exempt approved compensation, distributions, and benefits would fall within the ambit of a reasonable modification. However, this modification must be in the operating agreement.

The duty of loyalty also includes the prohibitions on related party transactions, business opportunities, and competitive activities. Conflicting interest transactions are made subject to a defense of fairness and all of the prohibitions are made subject to a defense of approval or ratification.[23] The concern with these duties is that most closely held entities involve related party transactions, allocations of business opportunities, and allowance of some competitive activities by the members. The Delaware Limited Liability Company Act took a much simpler approach. It approves all related party transactions unless the operating agreement provides otherwise.[24]

Direct actions

Idaho Code § 30-6-901 allows a member to maintain a direct action against any other member or manager to enforce the member's rights or protect the member's interests provided the member can show injury to the member that is not solely injury to the LLC. Few lawyers will have difficulty showing injury to the member; thus, direct actions can be expected to be plead and allowed in almost all situations. Idaho Code §§ 30-6-110(i) provides the operating agreement cannot unreasonably restrict the right of a member to maintain a direct action. Thus concerns about the threat of direct actions cannot be effectively dealt with in the operating agreement. This adopts a radically different policy than the independent panel that can substitute for court action in the corporate shareholder setting.[25] One must wonder why corporate shareholder lawsuits are discouraged, while LLC member lawsuits are encouraged. The prospect of direct member suits further erodes the limited liability shield of an Idaho LLC.

Compensation

Idaho Code § 30-6-407(6) provides that a member or manager does not have claim for compensation for services except in connection with winding-up an LLC. The default rule means that payments made to a member for services are charged against his capital account. The operating agreement needs to expressly provide that routine payments to members working in the LLC are to be section 707 guaranteed payments and thus chargeable as an expense. If the payments are charged to the capital accounts, the capital account of the one being paid the most will decrease and his ownership and rights may similarly decrease. I have seen accountants charge unequal monthly compensation to the capital account resulting in unintentional changes to carefully balanced ownerships. Every operating agreement in a business setting needs to reverse the Idaho Code § 30-6-407(6) rule and distinguish between IRC § 707 distributions and IRC § 704 distributions.

Liquidation

The liquidation rules under IULLCA are the same as under the old LLC law. That rule provides for contributed capital (not earned capital) to be returned and then the balance be distributed equally to members.[26] Thus, if A contributed $1 and B contributed $1 million and if the business a few years later has $5 million to distribute, B will have his $1 million returned. The remaining $4.0 million will be distributed $2.0 million to each. That means the one who took the greatest risk will get the least return on his money and the one that took the least risk will get the greatest return on his money. In a society that rewards successful risk taking, the economics of the IULLCA is backwards. The solution is to return the capital in proportion to the capital accounts.

Bushi v. Sage Health Care PLLC

In *Bushi v. Sage Health Care PLLC*, 203 P.3d 694 (2009), the Idaho Supreme Court confirmed my worst fears about IULLCA. Although *Bushi* was decided under the LLC law prior to the adoption of the Idaho Uniform Revised Limited Liability Company, its principles and logic will be easily applied to the new law. Applying *Bushi* to the new law leads to the following conclusions:

- IULLCA will be interpreted under the law of general partnerships and common law equity principles.
- Adherence to an operating agreement does not protect business owners even if the operating agreement is legal and even if it is applied consistent with the covenant of good faith and fair dealing.
- Uncabined duties are recognized in Idaho and are applicable to both members and managers.
- One of the uncabined duties is that members and managers of an LLC are considered true fiduciaries and must set aside their self interests and not use their positions to obtain financial gain that is not shared by those who disagree with them.
- Members of LLCs can sue directly for breach of duties. Bringing a derivative action is not necessary. Since duties are owned to members rather than to the entity, the member can always show actual or threatened injury to the member.

Business leaders are not fiduciaries. They owe duties to their business but those are not duties of a trustee. The role of a business leader is to take risk. A fiduciary's role is to avoid risk. A business person is expected to seek economic gain and is not a disinterested trustee who has no personal stake in the business. In small and medium size LLCs the member and most managers usually have a self interest. *Bushi* requires them not to protect their self interest. This may sound good to the Supreme Court, but businesses cannot operate under rules applicable to trustees. Business requires that decisions be made. Decisions always adversely affect someone. *Bushi* is simply impractical and will create an atmosphere of risk avoidance, failure to make difficult decisions, and a constant threat of litigation.

Conclusion

The positions of the IULLCA regarding operating agreements, the absence of statutory apparent authority, the disregard of capital, the absence of a management structure, the absence of an allocation structure, the preference for fact and circumstances tests, the lack of clear definitions and guidelines that businesses can rely on, and the invitations for direct suits by disgruntled members, makes the Idaho LLC an unacceptable choice for businesses. Some of the problems can be corrected by an operating agreement drafted by a lawyer familiar with the 704 rules. But the IULLCA makes it impossible even with good draftsmanship to eliminate the problems with the fiduciary duties and direct action issues. Rather than simplifying the operating agreement, the IUCCLA increases its complexity to a point that demands LLC specialization.

The IULLCA undermines limited liability by imposing personal liability on the members and managers for breach of trustee duties, for taking distributions, and for authorizing distributions when the balance sheet may be negative when based on fair market values. The problems in the IULLCA overwhelm its utility.

The proponents of IULLCA state that it is consistent with the Revised Uniform Partnership Act and other partnership laws. That misses the point. The question is whether the IULLCA will promote and facilitate business entities in Idaho and will it facilitate a rapid and cost efficient resolution of issues. The answer is a resounding no.

IULLCA and *Bushi* combine to make Idaho LLCs unfriendly to business. Business lawyers cannot reasonably advise their clients to take the risks inherent in forming or operating an LLC under IULLCA.

About the Author

Winston Beard *is an attorney and shareholder at the law firm for Beard St. Clair Gaffney and has been practicing law in Idaho since 1967. With over 40 years of experience Winston has successfully litigated cases within all practice areas, lobbied numerous bills through the Idaho Legislature, participated in acquisition evaluations, and served on various boards of directors. Winston has extensive experience in employment and commercial litigation, tax planning, anti-trust matters, trademarks, agribusiness, and software development businesses to name a few. Winston served for many years on the governing council of the Business & Corporate Section of the Idaho State Bar where he worked on improving Idaho's LLC laws. Winston is admitted in Idaho and Washington.*

Endnotes

[1] The other state is Iowa.
[2] *See* Prefatory note to IULLCA, preceding Idaho Code § 3-06-101.
[3] Prefatory note to IULLCA. paragraph 7, official comments to § 30-6-102(15).
[4] Second paragraph of Official Comment to Idaho Code § 30-6-110.
[5] Idaho Code § 30-6-102(15).
[6] The official comments for those sections cover seven pages in the Idaho
[7] The manifestly unreasonable standard is defined in IC § 30-6-110(8).
[8] Official comment to Idaho Code § 30-6-110(a)(4).
[9] Idaho Code § 30-6-110, Official Comment subsection (a)(4)[(1)(d).
[10] Internal Revenue Code § 704(b).
[11] *See* LLC laws of Nevada and Delaware.
[12] Idaho Code § 53-2-503.
[13] Article 11, §§ 9, 16.
[14] Idaho Code § 63-627.
[15] Idaho Code § 30-6-405.
[16] Idaho Code § 30-6-302.
[17] The statement of authority is only good for five years. Idaho Code § 30-6-302(10). It does not create internal authority. Idaho Code § 30-6-302(3). The statement of authority is probably essential in real estate transactions. Idaho Code § 30-6-302(6). The certificate of organization cannot include a statement of authority. Idaho Code § 30-6-201(3).
[18] Idaho Code § 30-6-407(2)(c).
[19] Idaho Code § 30-6-110.
[20] Idaho Code § 20-6-110.
[21] Idaho Code § 30-6-409 comment (a) and (b).
[22] Idaho Code §§ 30-1-830 and 831 and official American Bar Association comment to Idaho Code § 30-1-830.
[23] Idaho Code § 30-6-409 (5)-(6).
[24] Delaware Limited Liability Company Act § 18-107.
[25] Idaho Code §§ 30-1-740 to 747.
[26] Idaho Code § 30-6-708.

Director Fiduciary Duties in the Face of Insolvency

Melanie Rubocki
Perkins Coie

Introduction

For many companies, particularly small businesses and emerging growth companies, the current economic downturn has put an extraordinary strain on cash flow, and rendered many companies insolvent. The capital markets are frozen, and flat has become the new business model for growth. This puts an inordinate strain on the insolvent company's relationship with its creditors – but is a creditor owed any fiduciary duties? If a corporation is deemed to be in the "zone of insolvency," then its directors and officers owe its creditors the same fiduciary duties that they owe the corporation and its shareholders.


Melanie Rubocki

The following is a basic discussion of the relationship among the corporation, its directors and officers; the fiduciary duties directors and officers must discharge in fulfilling their roles; and how these duties are expanded to creditors when a corporation is facing the zone of insolvency.

The role of the directors and officers

The goal of any corporation is to maximize shareholder value. Directors are the steward of that objective. To that end, the director performs two basic functions: decision-making and oversight. Specifically, directors make fundamental decisions about strategy, establish corporate policies, monitor financial reporting and disclosure, oversee internal controls and legal compliance, and approve the hiring and firing of executive officers. Directors delegate the execution of their decisions to the executive officers who carry out the day-to-day operations of the corporation.

All aspects of corporate life, including the activities of its directors and officers, are governed first by state corporate law, then by corporate charter (which is publicly filed with the secretary of state of the state of incorporation), then by the corporate bylaws. In certain instances, corporations, their directors and officers are also subject to federal law, particularly if the company offers its securities for sale, regardless of whether it is private or public. Tax and accounting, employment, insurance and interstate commerce also give rise to federal jurisdiction over a business.

Fiduciary duties of directors and officers

Within this legal regime governing corporate life, grounded in state law are certain fiduciary duties that a director or officer must discharge in performing his or her role. In Idaho, as in most states, a director has two basic duties: care and loyalty. The duty of care relates to a director's responsibility to exercise appropriate diligence and independent judgment in decision-making and oversight. The duty of loyalty requires a director's conduct to be in good faith and in the best interests of the corporation – and to not be engaged in self-dealing. Officers are subject to the same fiduciary duties in managing the affairs of the corporation. These fiduciary duties extend to the corporation and its shareholders.

In most instances, corporate law protects directors and officers who fully discharge their fiduciary duties. In Idaho, this is statutorily mandated.[1] In addition, corporate charters can extend statutory protection by limiting director and officer liability "to the full extent permitted by law." Corporate bylaws (and/or stand-alone indemnification contracts) may further extend protection by providing directors and officers the contractual right for indemnification for all other acts not amounting to bad faith or breach of loyalty. As a final measure, sophisticated corporations provide substantial director and officer (D&O) insurance coverage[2] for all other liabilities incurred while acting in their capacity as a director/officer. But even limited liability has its limits.

Personal liability exposure

Despite the protections discussed above, a breach of fiduciary duties will expose a director or officer to potential personal liability. In reality, fiduciary duty cases are rarely clear-cut, there are often exceptions to the limited liability protection afforded and/or corporations are not always flush with the right resources to defend their directors and officers.

Whether a breach has occurred is generally ascertained by a court using a concept in law coined the Business Judgment Rule. The Business Judgment Rule protects the actions of directors and officers who discharge their fiduciary duties, even when a decision in hindsight turns out to be unwise.[3] Simplistically stated, if someone challenges a corporate decision, courts will review the decision-making process to determine that the directors/officers were disinterested in the matter, appropriately informed themselves before taking action and acted in the good faith belief that the decision was in the best interests of the corporation. Generally, courts will not review the wisdom of any business decision.

If a corporate decision does not pass the Business Judgment Rule review, a director or officer can be held personally liable for the negative consequences of that corporate decision. In addition to not passing muster under the Business Judgment Rule, certain corporate, tax and accounting, employment, and insurance laws impose additional personal liability on directors and officers for noncompliance. In specific cases the stakes can rise quickly because some infractions are criminal and yield substantial penalties, including jail.

Zone of insolvency: Expansion of scope of fiduciary duties

Veterans of corporate culture understand well the fiduciary duties owed to the corporation and its shareholders. However, very few understand that when a corporation enters the "zone of insolvency," the relationship between directors/officers and the creditors changes. At that point, the same fiduciary duties that are owed to the corporation and its shareholders are also owed to its creditors.

The borders of the zone of insolvency are often difficult to recognize. This difficulty is highlighted by the use of three tests to determine whether a company has entered the zone:

1. The Balance Sheet Test—liabilities exceed assets;
2. Cash-Flow Test—inability to meet continuing obligations (payroll, operating expenses) as due; or
3. Lack of Capital Test—company lacks capital to obtain financing for future operations

Courts have not identified one of the above tests as better than the other, and often a company may fail one test, but pass another. Similarly, some companies can operate within one of the two above zones for years without declaring bankruptcy. This can make it difficult for a company to fully comprehend the gravity of the situation they are facing.

Practically speaking, in the current credit climate, poor cash flow management can quickly render a company insolvent. Legally, a company is insolvent if (i) it is unable to pay its debts as they come due in the ordinary course of business or (ii) its liabilities exceed the reasonable market value of its assets. Over the last two decades, courts have upheld that when a corporation faces the "zone of insolvency," directors must consider the community of interests formed by the shareholders and the creditors in discharging their fiduciary duties.[4]

Probably the most problematic concern with regard to the murkiness of the Zone is its appeal to Monday Morning Quarterbacking. Once a company goes bankrupt, everyone can huddle around and note with certainty that it was "in the Zone." Recognizing this facet of the Zone as attorney, you may wish to counsel a company to consult with external financial experts, advisers, independent directors, or even a second legal opinion. The specter of personal liability in these situations is very real, so any steps to show prudence are likely well taken. It is also worth noting that a reviewing court is the most significant Monday Morning Quarterback since it will always have the benefit of hindsight to evaluate decisions made within the Zone. Directors and officers faced with this reality should be sufficiently swayed to fulfill their expanded duties.

Conclusion

As an attorney with a corporate client, if you find yourself in a situation where the directors or officers are asking questions about the Zone of Insolvency, a good rule of thumb is to advise your client as if the company is in the Zone. Directors and officers of a company on the verge of insolvency can be held personally liable for corporate decisions that fail to consider its creditors' interests along with the company's and its shareholders' interests. Directors and officers need to understand that they should not dispense with best business practices out of desperation for survival. They should always make business decisions in the best interests of the corporation and its shareholders… and its creditors, particularly when deciding who is going to get paid this month. A small payment to a creditor with priority may save directors or officers from being personally responsible for much larger payments in the future.

About the Author

Melanie Rubocki *is a partner in Perkins Coie's Business Practice Group, in charge of workload coordination for the national business practice, and head of the firm's Boise Business practice. Ms. Rubocki is listed in Chambers USA, "America's Leading Business Lawyers." She serves on the governing council for the Business and Corporate Law Section of the Idaho State Bar and was a member of both the Committee for Corporate Code Reform and the Committee for Limited Liability Act Reform. Ms. Rubocki received her law degree from the University of Notre Dame Law School, where she served as Executive Editor of the Journal of College and University Law Review, and her Bachelors of Science in Economics from the Wharton School of Business and her Bachelors of Arts in Psychology from the College of Arts & Science, both at the University of Pennsylvania.*

Endnotes

[1] Idaho Code §§ 30-1-830 (Standards for Directors) and 30-1-831 (Standards of Liability for Directors).

[2] With regard to the specific issues presented within this article, "Side A only" excess coverage may be considered for directors to ease some of their concerns within this area.

[3] In simplest terms, the law of corporations recognizes that shareholders generally want directors to take calculated risks, provided the expected benefits outweigh the expected costs. The Business Judgment Rule protects the necessary calculated risks of business decision-making from the 20/20 hindsight of shareholders.

[4] The absolute priority rule also likely comes into play once a company enters the zone. Under this rule the claims of equity holders are below those of secured and unsecured credit holders.

Understanding the Federal WARN Act and its Impact on the Sale of a Business

Nicole C. Snyder
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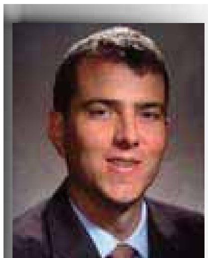
Recently the economic news has been bleak. One of the most difficult aspects of this news has been the ongoing reports of layoffs, plant closures, and bankruptcies. Closing a plant requires more than the last person out turning out the lights and locking the doors, and a round of layoffs requires more than collecting keys and name badges. Often these events require notice to provide workers with transition periods. Failure to provide notice could trigger significant monetary penalties. This article describes the applicability of the federal Worker Adjustment and Retraining Notification Act of 1988 (the WARN Act) and discusses the WARN Act's provisions in the context of the sale of a business.


Nicole C. Snyder


Scott E. Randolph

The federal WARN Act applies to plant closures and mass layoffs

Congress enacted the federal Worker Adjustment and Retraining Notification Act of 1988 ("WARN Act") to enable workers, their families, and local community leaders sufficient time to prepare for mass layoffs or plant closures.[1] The WARN Act obligates employers to provide at least 60-days notice to employees and local government officials of a covered plant closure or mass layoff.[2]

A covered plant closure is defined as "the permanent or temporary shutdown of 'a single site of employment,' or one or more facilities or operating units within a single site of employment, if the shutdown results in an 'employment loss' at the single site of employment during *any 30-day period* for *50 or more employees*, excluding any part-time employees."[3] A single site of employment includes a campus setting with multiple buildings.[4] A mass layoff includes reductions in an employer's workforce that are not the result of a plant closure, results in employment loss of at least 50-499 workers if they represent at least 33% of an employer's workforce or 500 or more employees.[5] An employer cannot escape the provisions of the WARN Act by implementing a series of small layoffs that collectively would exceed the threshold imposed by the WARN Act. For that reason, layoffs occurring within a 90-day period will be considered to determine whether the employer is subject to obligations under the WARN Act.

Employers subject to the WARN Act's provisions and anticipating a covered layoff and/or plant closure must provide, in clear written form, 60-days notice to employees of the impending closure and must identify the contact person for the impending layoffs or closure.[6] Employers with a valid seniority system must also include a statement whether bumping rights exist.[7] In that situation, the employer should make reasonable efforts to notify the employees who will be impacted, in light of the bumping rights offered to certain employees.[8] The employer must also give notice to the State Rapid Response Dislocated Worker Unit and notice to the highest local elected official where the layoffs or plant closure will occur.[9] If the employer's workforce is unionized or subject to a collective bargaining agreement, the employer must also provide notice of the closure or layoff to the employees' union representative(s).[10] An employer can, under some circumstances, provide notice to the state dislocated worker unit so long as it maintains and makes available the information upon request.[11]

An employer is only excused from providing the requisite 60-day notice to employees experiencing a covered layoff or plant closure in the following three circumstances:

(1) where the employer is having serious difficulties and is actively seeking funding and/or new business opportunities in an effort to resolve those difficulties, and the employer reasonably believes that advance disclosure of the layoff and/or plant closure would preclude the new business opportunities and/or funding sources;

(2) if the employer faces circumstances that are not reasonably foreseeable and causes the immediate need for covered layoffs and/or a plant closure;[12] or

(3) if the employer suffers a natural disaster causing the layoffs and/or closure.[13]

Part-time workers are also covered by the WARN Act's protections, though they do not count for determining whether a "mass layoff" or covered plant closure has occurred.[14] Whether an employee is "part-time" is determined by calculating whether the employee worked an average of 20 hours or less each week for the entire term of employment or the past 90 days, whichever is shorter.[15] Employees falling within the WARN Act's protection include those who lose their jobs or suffer an hours reduction of at least 50% for at least six months.[16] Covered employees include salaried, hourly, and managerial workers.[17]

The WARN Act's provisions do not apply to those workers who are offered a transfer to another facility within a reasonable commuting distance under some specific situations and do not apply to those workers who voluntarily resign or who are terminated for cause.[18] Temporary workers and strikers are not entitled to protections under the WARN Act.[19] Outside consultants and independent contractors who have an employment relationship with another firm are not covered by the WARN Act.[20]

The WARN Act provides for a penalty of up to 60-days wages for each affected employee if an employer fails to provide proper notice of a covered layoff or plant closure.[21] These penalties can be mitigated by wages actually paid to the employees.[22] Additionally, the WARN Act provides for a civil penalty of up to $500 per day, though this penalty may be avoided if the employer satisfies within three weeks its liabilities to covered employees.[23]

The WARN Act may apply in the sale of a business

The sale of a business may trigger WARN. If a covered plant closing or a mass layoff occurs as a result of the sale, then the proper party must give notice to the affected employees. If a plant closing or mass layoff takes place on or before the closing date of the sale, the seller is responsible for providing notice.[24] If a plant closing or mass layoff takes place after the closing date, the buyer is responsible for providing notice.[25]

In many transactions, a buyer offers employment to seller's employees before or at the time of closing. In this situation, WARN is not triggered: "Employees of the seller automatically become employees of the buyer for purposes of WARN. That means that even though there is a technical termination of employment when employees stop working for the seller and start working for the buyer, the technical termination does not trigger WARN."[26] In fact, there are court decisions finding that where the employees of the seller are hired by the buyer within six months after the sale of a business, there is no "employment loss" that triggers the statute's notice obligations.[27]

The following questions will help determine situations in which WARN applies in the sale of a business:

1. Does the seller have 100 or more employees total working

more than 20 hours per week? If not, then WARN does not apply. If so, then WARN may apply.

2. Does the seller have 50 or more employees at any single site of employment who will be laid off as a result of the sale? If not, then WARN does not apply. If so, then WARN may apply.
3. How many employees will lose their jobs with the seller and not be hired by the buyer? If it is fewer than 50 employees, then WARN does not apply. If it is more than 50 employees, then WARN may apply.

The WARN regulations encourage parties to a transaction to allocate responsibility for providing WARN notices prior to the closing date.[28] At times this may not be practical, as some buyers do not want to make commitments prior to closing as to which employees of the seller will be hired. As a result, the parties may be unable to agree which one of them should assume responsibility for WARN notices. If, however, the parties can agree to an allocation of responsibility for required notices, there are a number of provisions that can be provided in the purchase and sale agreement. The agreement should address whether the buyer will offer employment to any particular number of seller's employees at or before closing. The agreement should also address which party will have responsibility for providing WARN notices to employees who will not be offered jobs by the buyer.

The regulations also provide that if the seller is made aware of any definite plans on the part of the buyer to carry out a plant closing or a mass layoff within 60 days following the closing, the seller may act as an agent of the buyer and give notice to the affected employees prior to the closing if the buyer authorizes the seller to do so.[29] Note, however, that if the seller fails to give the notice, the buyer is still responsible to give the notice and for any failure to do so.[30]

Conclusion

Generally when a business is confronted with one of the situations requiring consideration of the WARN Act, everyone will likely be experiencing a high level of stress. You can help alleviate some of the stress by assisting your client through the requirements of the WARN Act. Whether a closure, a layoff, or a sale, WARN mandates that workers be given notice in order to provide them with an appropriate transition time. In light of the requirements and penalties, the WARNing is clear.

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Endnotes

[1] *See* 29 U.S.C. § 2101, *et seq.* The regulations applicable to the WARN Act are located at 20 CFR Part 639; *see also* 20 C.F.R. § 639.1(a) ("Advance notice provides workers and their families some transition time to adjust to the prospective loss of employment, to seek and obtain alternative jobs and, if necessary, to enter skill training or retraining that will allow these workers to successfully compete in the job market.").
[2] 20 C.F.R. § 639.1(a).
[3] *See* 20 C.F.R. § 639.3; *see also* Glossary, WARN Worker Adjustment and Retraining Notification (WARN) Act, Employer's Guide to Advance Notice of Closings and Layoffs, Federal Department of Labor, July 2003, available at http://www.doleta.gov/layoff/pdf/EmployerWARN09_2003.pdf.
[4] *See Bader v. Northern Line Layers, Inc.*, 503 F.3d 813, 817 (9th Cir. 2007) (interpreting 20 C.F.R. § 639.3(i) and concluding that employer's facilities located in different states do not constitute single site of employment for purposes of the Warn Act). The court in *Bader* rejected plaintiffs' argument that employees located outside of the administrative office were "outstationed." Instead, the court considered the site from which work was assigned and the site to which the employees were assigned to report. *Id.* at 820-21.
[5] 20 C.F.R. § 639.3(c).
[6] 20 C.F.R. §§ 639.4-5.
[7] 20 C.F.R. § 639.6.
[8] *See id.*
[9] *See* 29 U.S.C. § 2102(a); *Bader*, 503 F.3d at 817 (stating that "[t]he purpose of the Act is to give advance notice to workers and the community so that workers can prepare to seek alternative employment and communities can prepare for the economic disruption of a mass layoff") (citing 20 C.F.R. § 631.1(a)).
[10] 20 C.F.R. § 639.6
[11] 20 C.F.R. § 639.8(f).
[12] *See Childress v. Darby Lumber, Inc.*, 357 F.3d 1000, 1008 (9th Cir. 2004) (interpreting 20 C.F.R. § 639.9(b)(1)-(2) and concluding that the closure was caused by foreseeable business conditions making the exception inapplicable).
[13] 20 C.F.R. § 639.9.
[14] 20 C.F.R. § 639(3)(a)(3).
[15] 20 C.F.R. § 639(h).
[16] 20 C.F.R. § 639.3(e)-(f).
[17] 20 C.F.R. § 639.3(e).
[18] 20 C.F.R. § 639.3(f); 20 C.F.R. § 639.5(b).
[19] 20 C.F.R. § 639.5(c); 20 C.F.R. 639.5(d).
[20] 20 C.F.R. § 639.3(e).
[21] 29 U.S.C. § 2104(a)(1).
[22] 29 U.S.C. § 2104(a)(2).
[23] 29 U.S.C. § 2104(a)(3).
[24] 20 C.F.R. §639.4(c).
[25] *Id.*
[26] WARN Worker Adjustment and Retraining Notification (WARN) Act, Employer's Guide to Advance Notice of Closings and Layoffs, Federal Department of Labor, July 2003, available at http://www.doleta.gov/layoff/pdf/EmployerWARN09_2003.pdf, p. 13.
[27] *See e.g., Int'l Alliance v. Compact Video Services*, 50 F.3d 1464 (9th Cir. 1995).
[28] *See* 20 C.F.R. §639.4(c)(2)("It may be prudent for the buyer and seller to determine the impacts of the sale on workers, and to arrange between them for advance notice to be given to affected employees or their representative(s), if a mass layoff a mass layoff or plant closing is planned.")
[29] *See* 20 C.F.R. §639.4(c)(1).
[30] *See* 20 C.F.R. §639.4(c)(1).

What's it Worth? Important Issues in Business Valuations

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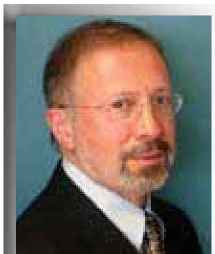
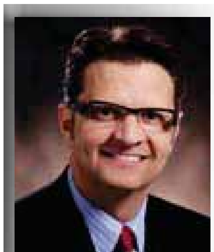
Introduction

In the popular PBS series *Antiques Roadshow*, professional antique appraisers travel to various regions answering the recurring question of curious owners, "what's it worth?" These appraisers value anything from vintage sheet music to old duck decoys to precious art. Oftentimes, their conclusions echo the adage that "one person's trash is another person's treasure." Sometimes the hope of cashing in on Aunt Betty's collection of Betty Crocker cookbooks is realized. Other times, Uncle John's vintage Victorian gas lamp is exposed as a poorly crafted knock-off.


Richard M. Teichner


Erik J. Bolinder

In much the same way, parties with interests in the same business may have vastly different perceptions of the value of their interests. Attorneys often need to help their clients establish accurate values. This article discusses some of the common issues to consider in attempting todetermine business values.

Situations often requiring valuations

In the practice of law, many different situations give rise to the need to establish the value of a business. Some examples include:

- drafting or assisting with implementing buy-sell provisions in agreements between and among shareholders, partners and limited liability company members.
- business acquisitions and mergers.
- change in business ownership or control among shareholders.
- business dissolution.
- litigation matters where a measurement of economic damages is the diminution in the value of a business.
- bankruptcy matters and determining whether to keep operating a business and/or sell it, or liquidate it.
- marital dissolution proceedings.
- condemnation proceedings.
- gifting for estate planning purposes.
- establishing values of a decedent's estate.

Common terms applying to valuations

To understand the valuation process, one must first understand some of the common valuation terminology, including the following:

Approach—there are three general approaches for establishing business values. Depending on the circumstances, one of them may be used or a weighted average of more than one of them may be used:

- o the *income approach*: past or future income or cash flow streams are applied to a capitalization rate or discount rate;
- o the *market approach*: values or sales of comparable businesses, or interests in comparable businesses, are the bases for value of the subject business; and/or
- o the *asset approach* (or asset-based approach, adjusted net asset approach, and other variations on the term): a value for each balance sheet item is determined (including intangibles, which may or may not appear on the balance sheet) and then added together (assets less liabilities).

Method (or methodology) — Examples of methods include:

- o for the *income approach*: capitalization of earnings, capitalization of excess earnings (i.e., after calculating a return on assets) or discounted future earnings plus residual value;
- o for the *market approach*: use of comparable public company data and of comparable merger and acquisition data; and
- o for the *asset approach*: establishment of fair market value, replacement value or liquidation value of the assets and liabilities.

Standard of value — Examples of standard of value are *fair market value* (i.e., buyer and seller are willing parties, but are not compelled to enter into the transaction and have "reasonable knowledge of the relevant facts" (as paraphrased and quoted from IRS Revenue Ruling 59-60 and sections of the estate and gift tax regulations)), *fair value* (which may have different meanings, depending on the jurisdiction or the parties involved), *intrinsic value* (usually means value to the holder), *investment value* (the value to a particular investor or a strategic buyer), *forced liquidation value*, or *voluntary (or orderly) liquidation value*.

Premise of value — There is some overlap in the meaning of this term with the term standard of value, but premise of value essentially refers to whether the entity is valued on a going concern basis or a liquidation basis.

Capitalization and discount rates — These rates are used under the income approach and may be determined by various means (a comprehensive discussion about these rates is beyond the scope of this article).

A *capitalization rate (or "cap rate")* is applied to an earnings figure that is expected or is most likely to occur, i.e., a projected earnings amount for the following year that is indicative of the earnings for all future years. Depending on the circumstances, this projected earnings figure may be based on the average or weighted average of prior years' net income, pre-tax income, EBIT, EBITDA, cash flows or some other measurement of earnings. Of course, the historical data needs to be adjusted for any anomalies or anything else that is not recurring or representative of future events.

A *discount rate* is applied to the stream of future earnings for a specified number of years and the sum of the present value of each year's discounted earnings is then added to the value of the business as of the end of the last year specified (i.e., terminal value). This terminal value is normally determined by applying a capitalization rate to the earnings in the final year and then discounting this capitalized earnings amount to present value.

A *discount rate* applied to a stream of future earnings inherently includes a growth rate and thus is higher than a capitalization rate applied to a projected earnings amount (unless there is negative growth, in which case the discount rate would be lower than the capitalization rate).

- **lack of marketability (or non-marketability) discount**—the extent of the discount principally depends on the time it may take for the business or, more commonly, the business interest to become liquid to the seller, i.e., when cash from the sale is received.
- **lack of control discount**—applied when the ownership interest in the business is fifty percent or less. When a business interest being valued is less than one-hundred percent but fifty percent or greater, however, a discount may still be appropriate by virtue of having less than complete control. The lack of

control or non-controlling interest discount is applied to the owner's pro rata portion of the total value of the entity. The amount of the discount is based on limitations associated with the business interest as a result of agreements, statutes, practicalities or other factors. This discount is applied before the marketability discount is applied, i.e., as if the minority interest is completely liquid.

- **control premium**—this premium is generally applicable when an interest in a business being valued is or will become one of control or partial control (unless, as is sometimes the case, the value of the business is based on financial data that was already adjusted as if there had been a controlling interest).

In the process of determining how the above terms (and possibly others not mentioned here) might apply in a situation, the valuator needs to gather extensive information on the business or entity (both quantitative and qualitative), the industry in which it operates, and economic conditions and other items that impact the value. This kind of information, along with knowledge regarding the purpose(s) of the valuation and the parties involved, is assessed and analyzed in deciding the application of the various factors for determining value.

Sometimes the valuator is unable to obtain all necessary information to arrive at a conclusion of value due to unavailability or other limitations on the scope of the valuation work performed. In such instances, the parties may accept (or must accept under the circumstances) something less than a conclusion of value, as long as the valuator is comfortable providing a qualified valuation based on the information obtained. In this regard, among the various organizations that establish reporting standards and terminology for credentialed valuators, some differences exist in the way limited scope situations should be treated. However, for the most part these organizations have established very similar principles and practices for valuation engagements and the valuation process. The applicable standards may preclude the valuator from issuing any type of report if sufficient documentation and other information is not obtainable.

The valuator needs to consider whether certain adjustments should be made to the financial statements so that they are stated on a basis equivalent to that of the comparable companies.

The term "appraisal" as used in referring to the appraisal of business interests or other assets is often used interchangeably with the term "valuation." In some circles there are subtle differences between the terms, but for all intents and purposes they are synonymous, as are "appraiser" and "valuator."

Examples of valuation scenarios

The following illustrate how the purpose of the valuation and intention of the parties have an effect on which of the above terms that may apply apply:

Sales/transfers of entire businesses

A threshold question is whether the net assets or the capital stock (in the case of a corporation) or another form of equity holding in the entity, is being sold. Besides the assumption of actual liabilities in one instance and not in the other having a direct effect on value, there are other items impacting the value relating to a potential sale of a business. These include: (1) the existence of contingent liabilities and possible unknown liabilities at the time of consummation (usually more so in stock sales, but will depend on indemnifications and the ability to enforce them); (2) the presence of simultaneous agreements, such as consulting contracts for management personnel retained after the sale, provisions for non-competition, and licensing arrangements; (3) if a company is a corporation, whether it is a C or S corporation and the affect of distributions to stockholders; (4) whether the entity or the owners are subject to income taxes on earnings (e.g., determined by whether the company is a C corporation or an S corporation, or a partnership or a limited liability company); and (5) sales tax and other transfer taxes that may be imposed.

Another issue to consider when establishing a value for a potential sale of a business is that often the buyer and seller and other parties involved may have presupposed that the sales/purchase price is to be based on fair market value or on some other standard of value. The term "fair market value" may suggest something different to the buyer than to the seller. Therefore, he party or parties for whom the valuation is performed must be clear on the standard of value that is to be applied.

The generally accepted definition of fair market value ("FMV") is a hypothetical value arrived at when the buyer and seller are willing parties, but are not compelled to enter into the transaction and have "reasonable knowledge of the relevant facts."[1] In reality, there are numerous possible scenarios to a sale. Examples include: a buyer looking for a strategic purchase and/or a seller looking for such a buyer who will pay a premium; the seller may be eager or forced to sell for some reason; the buyer may want to be very active in the business and have it as a means to provide a steady income in the form of compensation; or the buyer may want to be only a passive investor and is willing accept a steady, but small rate of return.

Generally, when valuing a business for purposes of sale, the standard of value will be either FMV or investment value. FMV may be used, for example, when the seller has no particular preference as to a buyer and is not compelled to sell; an agreement calls for FMV; a FMV is necessary only as a starting point for negotiations (e.g., there may be compelling reasons to sell, the buyer might want to be active and might be looking for security); or the sale is to a related party, as the Internal Revenue Service requires FMV for income tax purposes (as well as for gift tax and estate tax reporting purposes). Investment value will normally be used when there is a possible synergistic buy/sell (although FMV could be a starting point) or when an investor is looking for a particular rate of return.

The approach used when the standard is FMV will depend mainly on the purpose of the valuation and available data. Usually, the market approach is a primary consideration and should be used, at least as one of the approaches, but only if sufficient information about sales and/or values for comparable companies are available. For certain personal service businesses, and especially professional practices such as law, accounting and smaller medical practices, the market approach may not be a good indicator of value due to the shortage of sufficient market data. The market approach, however, may not always be practicable for other privately held businesses. The number of companies similar to the business being valued might be insufficient so that producing a meaningful comparison is not possible, or because important quantitative data about the companies are incomplete and/or information about relevant qualitative factors is lacking.

Generally, for privately held businesses, if the market approach can be used, it will usually be done in conjunction with the income approach. The two approaches will be weighted (not necessarily equally) in arriving at a value. Even if comparable market data is relatively scarce, the market approach should be considered and, if at all possible, be given some weight or at least be used as a "sanity check" against the results arrived at in using the income approach. The asset approach may be used in conjunction with either or both the market and income approaches. The asset approach is usually the sole approach in situations such as when a business has a history of losses, or in the event of liquidation or in other piecemeal valuation situations. This is because the value of the net assets of the business will normally realize a greater fair market price than will the income stream (if any) of the business as a going concern.

As for the method applied, this first depends on the approach that is used, as each approach has its own distinct available methods. For the income approach, the method will be determined based on the type of business being valued (e.g., service, manufacturing), its financial history, and various other influences. For the market approach, the data that is best available and most relevant is what should determine the method.

When valuing a start-up business or one whose major asset(s) is intellectual property, the method and other factors need to be considered very carefully. The valuator might find other businesses or similar types of intellectual property with historical data and having some characteristics similar to those expected of the subject business, and/or might find justification for using an estimated future income stream for the subject business as a basis for the valuation. In most cases, however, the uncertainties are greater with start-ups and with untested intellectual properties than with an established business or income stream. Accordingly, forecasts of expected income and other factors will often need to be used as bases in arriving at a value in these types of businesses.

Transfers of a partial interests in businesses

When a partial interest in a business is valued, such as for the purpose of a potential sale, gifting or estate tax reporting, lack of control and marketability discounts will normally be applied to the holder's portion (percentage) of the full value of the entire business. Since a non-controlling interest holder is usually at the mercy of those in control, however, applying a lack of control discount to the value of this interest when it is based on expected cash flows , will normally be redundant and thus not indicated. The purpose of the valuation will determine whether the method of applying a capitalization/discount rate to the expected cash flows attributable to the non-controlling interest should be used; whether the value of the entire business should be determined, and then a lack of control discount applied to the percentage interest in the business; or whether some other method is most appropriate. Another method, under the market approach, may be applied if there have been recent minority interest (or lack of control) transactions similar to the subject interest. Values determined in similar transactions may be used as the guideline.

In certain situations, there may be two or more tiers of lack of control discounts. Such situations are frequently seen in the gifting of partial interests in family limited partnerships or limited liability companies. An entity itself may own non-controlling interests in assets, which are discounted, and then the interest in the entity (with the value of its assets having been discounted) is further discounted for the fact that it is a non-controlling interest. Presently, there are campaigns in Congress and the current administration to do away with such discounts for gift tax purposes.

For lack of marketability discounts, and in many cases for lack of control discounts, there are various studies and other data that should be referred to and properly applied based on the specific set of circumstances of the partial interest being valued. Too often "rules-of-thumb" or data that are not complete are used or misapplied. A thorough analysis of all relevant information must be performed for arriving at appropriate and supportable discounts. In gift tax, estate tax and other tax cases, the tax courts and appellate courts in recent years have scrutinized discounts more closely and demand that discounts are based on objective criteria.

Business disputes and litigation

In adversarial situations, there is often difficulty in obtaining all the information necessary to arrive at or opine to a value. When these conditions exist, there may be enough basic information so as to estimate a value, or make assumptions under different likely scenarios that lead to a range of values.

Frequently, the nature of the dispute or litigation will determine the standard of value and other applicable factors. In an action involving a damaged or dissenting shareholder, for example, each side may have different views on what should be the appropriate standard of value, approach, method, capitalization/discount rate, and so forth. If the action is brought under the statute of a state dealing with dissenting shareholder matters, the standard of value required is usually "fair value". The term "fair value" has different meaning among jurisdictions. Thus the valuator must have a clear understanding of how "fair value" is to be applied. Idaho Code Section 30-1-1301(4) defines fair value in this context as follows:

> (4) "Fair value" means the value of the corporation's shares determined:
>
> > (a) Immediately before the effectuation of the corporate action to which the shareholder objects:
> > (b) Using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal; and
> > (c) without discounting for lack of marketability or minority status except, if appropriate, for amendments to the articles pursuant to section 30-1-1302(1)(e), Idaho Code.

The term "value" is not directly defined, but rather is to be "determined" using "customary and current valuation concepts and techniques…". The Official Comment to Section 30-1-1301 states, in part, "Subsection (b) adopts the accepted view that different transactions and different contexts may warrant different valuation methodologies."[2] The statute gives deference to the idea that valuation methods may indeed evolve, consistent with business climates and evolving economic conditions.

Diminution in value may be another way to quantify economic damages from the loss of a company or a substantial reduction in the level of its business. Diminution in value is measured from the date immediately preceding the occurrence of the event to some specified date afterwards. FMV is usually used for both valuation dates. Clearly, this is only one way to measure the loss and, in many cases, not the preferable way. Arguably, a different standard of value (and other factors) might be considered more appropriate in the circumstances. For example, if an individual owns a business that generated a relatively constant rate of return for many years, after he draws a "reasonable" salary, then the loss of the business to him might be based on what the business is worth to him (e.g., investment value), which is a steady rate of earnings using a low-risk capitalization rate. The security of his receiving the consistent compensation from the business, his age and the likelihood of obtaining similar work elsewhere are some factors that may be used to assess damages in addition to the loss of the business.

When to "normalize" financial statements

As part of the process of performing a valuation for a business on a going concern basis, the earnings and other components of the financial statements are used as the basis for determining value. With the income approach, a capitalization/discount rate is applied to earnings, and such rate is derived, in part, by comparing elements of the financial statements and various financial ratios to corresponding data of other, comparable companies. With the market approach, the values and/or sales prices of comparable companies are used as the basis for the subject company's value. Usually, information on comparable companies is obtained from various sources that compile financial data by industry, SIC code, NAICS code or some other meaningful categorization.

Some elements of the financial statements and other financial data of the subject business may not be considered “normal”, i.e., not equivalent to the corresponding financial information of comparable companies. The valuator needs to consider whether certain adjustments should be made to the financial statements so that they are stated on a basis equivalent to that of the comparable companies. Examples of the types of items that may warrant adjustment are owner salaries and perquisites. Other such adjustments are usually more prevalent when the form of earnings used as a factor in determining value is something other than cash flows. In these situations (which can be under the income approach, and are most certainly under the market approach as discussed earlier), the adjustments are usually made for conforming the financial statement reporting to generally accepted accounting principles, or to account for unusual or nonrecurring transactions or events.

There are circumstances where adjustments are not made, even though necessary to properly “normalize” the financial statements. For example, an adjustment will not be made for compensation where a minority interest is transferred, with the minority interest holder (and particularly the transferee) having a lack of control. Some other circumstances where adjustments, or certain adjustments, are not or might not be appropriate include when the standard of value is investment value, the approach is the asset approach, or when the purpose for the valuation is for litigation, property settlement in a marital dissolution, or bankruptcy.

When determining the applicability of certain normalizing adjustments, particularly for owner salaries and perquisites, the valuator needs to consider the implications of reducing the expenses for these items vis-à-vis absentee owners or the Internal Revenue Service. Parties who may gain access to the valuation documentation may draw inferences that the expenses actually incurred were excessive. Of course, the fact that certain expenses were reduced for the purpose of preparing a valuation does not automatically mean that owner compensation or other expenses were excessive. Also, inferences should not be drawn that the adjustments for reducing expenses were made to increase earnings and thus (artificially) augment the value.

There are many valid reasons for expenses to be normalized for valuation purposes. For example, in the case where actual owner compensation has been reduced for the normalized financial statements, the owner: (i) may have been performing various functions for many years and to replace him with other, newly hired personnel will cost less; (ii) may have special skills or personal customer relationships and, if there were a sale, will be retained on a consulting basis at a much reduced compensation amount, which, when added to a replacement’s compensation, will be less than the owner’s current compensation; or (iii) may have taken insufficient compensation in prior years to preserve the company’s working capital and thus his compensation in recent years included the shortfall. The parties involved in the valuation need to make certain they not only allow for the appropriate normalization adjustments, but also can support them.

Effectively using a business valuation expert

If an independent business valuation expert is called upon to assist in establishing a value and/or opine on a value, the expert must have access to all relevant information to determine which factors apply in the particular situation. The attorney and client need to allow and encourage open communication among themselves and the valuator. Too often the intentions of the parties are not apparent, understood or properly articulated, and the facts and circumstances surrounding the true purpose of the valuation are not adequately disclosed. Also, the valuator should know the identities of all the parties affected by the valuation. Certainly, the valuator has a responsibility to seek all information necessary to do a thorough job, but all other parties involved have to be willing to collaborate in the effort of providing whatever information they and the valuator may deem pertinent.

Conclusion

Much like the valuations given by the appraisers in *Antiques Roadshow*, a business valuation is only as accurate and useful as the information upon which the value is based. The antiques appraiser examines items carefully and often brings years of experience and specific research to determine an accurate value. Likewise, understanding not only the common terminology in business valuations, but also the applicability of the various valuation methodologies will help you, your clients and valuators determine accurate and useful business values that can withstand potential challenges.

About the Authors

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Endnotes

[1] (Paraphrased and quoted from IRS Revenue Ruling 59-60 and sections of the estate and gift tax regulations.)

[2] I.C. § 30-1-1301 Official Comment.

A comparison of the U.N. Convention on Contracts for the International Sale of Goods and Idaho's Uniform Commercial Code

Christine E. Nicholas
Moffatt, Thomas, Barrett, Rock & Fields

Introduction

In 1996, as in-house counsel I was handed a draft purchase agreement for my client's purchase of an ammonia plant located in Italy to be disassembled and shipped to Houston for refurbishment, then shipped to Canada and reassembled. My schedule to negotiate and close the purchase was tight, so I was quick to strike the seller-provided choice of law clause that incorporated the United Nations Convention on Contracts for the International Sale of Goods ("CISG" or "Convention").[1] We were in a rush to get the deal done, and I simply did not have time to undertake a review of this unfamiliar treaty that seemed to significantly modify how the Uniform Commercial Code would treat the deal. Today when I work on international agreements for the sale of goods, I am not so quick to exclude application of the Convention. I suggest you consider its application to your clients' international purchase or sale of goods.

Christine E. Nicholas

Background

The Convention is essentially an "international UCC," and was adopted by the United States in 1986.[2] Its signatories account for three quarters of all world trade.[3] The Convention applies to sales between parties that have places of business in different signatory countries. Excluded are (i) sales to consumers, (ii) securities transactions (including negotiable instruments), and (iii) sales of ships, aircraft, and electricity. Under the Convention, parties are free to exclude the application of the Convention or to vary the effect of any of its provisions.

International treaties are the supreme law of the United States, so the Convention is part of the law of Idaho. If a contract concerning the international sale of goods includes a choice of law clause that reads, "The rights and obligations of the parties under this contract shall be governed by and construed in accordance with the laws of the state of Idaho," such choice of law **includes** the CISG, which pre-empts the UCC. Parties may, however, explicitly exclude application of the Convention. The following contract provision should effect an exclusion of the Convention:

> *The rights and obligations of the parties under this contract shall not be governed by the United Nations Convention on Contracts for the International Sale of Goods. Instead, the rights and obligations of the parties under this contract shall be governed by the laws of the state of Idaho without regard to principles of conflict of law, and the United Nations Convention on Contracts for the International Sale of Goods is specifically disclaimed.*

Compare CISG and UCC

A number of the Convention's provisions are a compromise between civil law and common law principles, and vary from Idaho's UCC, Idaho Code Title 28 (the "UCC"). Major differences between the Convention and the UCC include:

Acceptance of Offer. Acceptance of an offer under the Convention is effective when it reaches the offeror and not when mailed.[4] This is contrary to the common law "mailbox rule," which makes acceptance effective on dispatch[5] and is incorporated in the UCC through Section 1-103.[6]

Revocation of Offer. The Convention retains an important effect of the common law mailbox rule -- an offer cannot be revoked once the offeree has sent acceptance. A Convention offer cannot be revoked if it indicates that it is irrevocable -- whether by stating a fixed time for acceptance or otherwise.[7] An offer is not revocable under UCC Section 2-205 if "by its terms [it] gives assurance that it will be held open . . . during the time stated or if no time is stated for a reasonable time . . . ". The UCC places a three-month time limit on the irrevocability of "firm" offers given without consideration by a merchant.[8] The Convention leaves unanswered the question of how long an irrevocable offer remains open. When no time for acceptance is fixed, acceptance must occur within a "reasonable time," taking due account of the circumstances.[9]

Battle of the Forms. Disputes arise when a buyer and seller exchange conflicting purchase orders and acknowledgments. The dispute usually centers around one of the following scenarios: (i) after the parties exchange conflicting terms, but before either party has taken further action, there is a rise or fall in the price of the goods – was there a binding contract, or may the disadvantaged party "renege;? or (ii) the parties perform after exchanging conflicting terms and conditions and a dispute arises – what terms and conditions apply?

Before the Uniform Commercial Code, most American jurisdictions followed the "mirror-image rule." Under this rule, varied terms of acknowledgement of a purchase order constituted a counteroffer and not an acceptance. As long as the parties did not actually perform, no contract was formed by a varying response. Either party could walk away from the arrangement. Typically, however, the seller delivered and the buyer received the goods in spite of conflicting forms. When the transaction was thus completed by performance, the common law assumed that a contract had been formed and the terms of the contract generally consisted of the terms of the original offer as modified by the acceptance.

The Uniform Commercial Code changed the common law mirror-image rule. Under UCC Section 2-207, a final form that is not intended specifically as a counteroffer will act as an acceptance, even though it contains different terms from the prior form. The different terms are considered as proposals for additions to the contract and, as between merchants, become part of the contract unless: (i) the offer expressly limits acceptance to its terms; (ii) the additional terms materially alter the offer; or (iii) notification of objection to the additional terms is given within a reasonable time after notice has been received.[10] The normal result under the UCC is to reverse the common law presumption that the last form governs, and to replace it with the result that the second-to-last form usually governs.

The Convention is consistent with the old common law mirror-image rule -- a reply to an offer that purports to be an acceptance but contains material additions, limitations, or other modifications is a rejection of the offer and constitutes a counteroffer.[11] Prior to performance, either party may be able to claim successfully that no enforceable contract exists. After delivery and acceptance, however, a contract will undoubtedly be deemed to have existed and the Convention generally favors the last party to submit materially different terms.

Accordingly, when dealing in international sales of goods it is best to either (i) avoid purchase orders altogether in favor of either a master purchase and sale agreement that contains all of the terms to which the parties agree for all shipments; or (ii) be the party that fires the last shot in the battle of the forms.[12]

Statute of Frauds. The Convention specifically provides that "a contract of sale need not be concluded in or evidenced by a writing . . . [and] may be proved by any means, including witnesses."[13] UCC Section 2-201 provides that a contract for the sale of goods for $500 or more is not enforceable unless the sales agreement is evidenced by a signed writing. Under the UCC, any amendment or modification to a contract must be in writing if the underlying contract is required to be in writing.[14]

Parol Evidence. Under the UCC, testimony concerning terms of a written contract and the parties' intent that contradict or vary from the written terms is generally inadmissible. The Convention does not expressly address this issue, but since it provides that a contract may be proved by any means -- including witnesses -- and it endorses oral contracts, the Convention abandons the parol evidence rule in favor of a more liberal approach that permits testimony that contradicts the terms of a written contract.[15] A 1998 Eleventh Circuit decision applied Convention principles to hold evidence of subjective intent of the parties could be considered and the forum's parol evidence bar did not apply in Convention cases.[16]

The court ruled that the buyer's attempt to raise applicability of the Convention as an issue at trial was untimely, and the buyer had waived any cause of action under the Convention.

Warranties and Disclaimers. UCC Section 2-313 provides that: (i) any affirmation of fact or promise by the seller relating to the goods creates an express warranty that the goods will conform to the affirmation or promise; and (ii) the seller's description of the goods or presentation of a sample creates an express warranty that all of the goods will conform to the description or sample. Under Article 35 of the Convention, goods do not conform to the contract unless they possess the qualities of goods that the seller held out to the buyer as a sample or model, and unless they are contained or packaged in the manner usual for such goods.

UCC Sections 2-314 and 2-315 set forth the familiar implied warranties of merchantability and fitness for a particular purpose. Article 35 of the Convention states that goods do not conform with the contract unless they "are fit for the purpose for which goods of the same description would ordinarily be used" and "are fit for any particular purpose expressly or impliedly made known to the seller" by the buyer. To disclaim UCC implied warranties, the contract must contain words of art or expressions in conspicuous writing satisfying UCC Section 2-316. No similar provision requiring conspicuous notice is contained in the Convention, which permits disclaimers of warranties as long as the parties "have agreed" in writing or orally.[17]

Rejection of Non-conforming Goods/Convention Unilateral Price Reduction. The UCC recognizes the "perfect tender" rule, under which a buyer is entitled to reject goods that fail in any respect to conform to the contract, even if a defect in the goods is not serious and the buyer would have received substantially the goods for which it bargained.[18] The Convention departs from the perfect tender rule. Under the Convention, a buyer may declare the contract avoided (i.e., terminated) only if the failure by the seller to deliver conforming goods constitutes a "fundamental breach" of the contract.[19] A breach is "fundamental" if it "results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract," and if the seller foresaw or reasonably would have foreseen such a result.[20]

Under UCC Section 2-513, a buyer is afforded a reasonable opportunity to inspect the goods. Under the Convention, however, the buyer must inspect the goods within as short a period as is practicable under the circumstances.[21] The Convention requires the buyer give notice to the seller specifying the nature of the nonconformity "within a reasonable time" after the buyer has discovered or should have discovered it.[22] UCC Section 2-602 also requires notice within a "reasonable time,"[23] but the Convention has been construed to require faster notice than does the UCC.[24]

Under UCC Section 2-601, a buyer may reject any goods that fail to conform to the contract and, under UCC Section 2-711, the buyer may cancel the contract and recover monetary damages, such as costs of cover. If a UCC-buyer accepts non-conforming goods and fails to properly revoke acceptance, under UCC Section 2-714 a buyer may recover damages (including incidental and consequential damages).

The Convention contains a pro-buyer, self-help remedy of unilateral proportionate purchase price reduction for the seller's delivery of non-conforming goods.[25] This remedy represents a concession to the demands of signatory civil law countries and is not available if the seller is able to cure non-conformity without causing unreasonable delay or inconvenience to the buyer.

Delivery Gap-Filler/Risk of Loss. Article 31 of the Convention provides a gap-filler with respect to place for delivery. If the contract does not state where the seller should deliver the goods, for a contract providing carriage (i.e., requires the seller hand the goods over to a third-party carrier for transmission to the buyer), Article 31 requires delivery to the carrier. If the contract does not involve carriage, the place for delivery is the place where the goods are to be manufactured or from where the goods are supplied, or otherwise at the place where the seller had its place of business when the parties contracted. Satisfaction of delivery obligations is distinct from allocation of risk of loss. Under the Convention, risk of loss passes to the buyer when the goods are handed over to the first carrier for transmission to the buyer if the contract involves carriage, and if the contract does not involve carriage, risk of loss passes when the buyer takes or should have taken over the goods.[26]

No Trade Terms. The Convention does not contain trade terms similar to the UCC. Parties to a Convention-governed agreement should include their own trade terms. Most parties include trade terms promulgated by the International Chamber of Commerce, known as INCOTERMS.[27] INCOTERMS include: (i) origin terms, such as EXW ("ex works" -- the named place where shipment is available to the buyer, not loaded, and seller does not contract any transportation); (ii) international shipping terms, where the seller may or may not pay carriage, such as FAS ("free alongside ship" -- the seller delivers the goods to the named ocean port of shipment) or CPT ("carriage paid to named port of destination" -- used for containerized shipments); and (iii) destination terms such as DEQ ("delivered ex-quay" -- seller will at its cost deliver the goods to the named port of destination, unloaded, not cleared). Familiarity with INCOTERMS is essential for the practitioner writing agreements for international trade.

Conclusion

Failure to recognize the applicability of the Convention may lead to loss of a case. The case of *GPL Treatment Ltd. v. Louisiana-Pacific Corp*[28] is a prime example. That case involved the sale of wood products by a Canadian seller to a U.S. buyer. The buyer's attorney did not raise applicability of the Convention in his pleadings. The court ruled that the buyer's attempt to raise applicability of the Convention as an issue at trial was untimely, and the buyer had waived any cause of action under the Convention. The material issue in the case was the seller's statute of frauds defense as allowed under the UCC. Awareness of the Convention, its application, and its differences when compared to the UCC will allow practitioners to make informed decisions as to the applicable law and to avoid undesirable outcomes in international transactions involving the purchase and sale of goods.[29]

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Christine E. Nicholas *practices with Moffatt Thomas Barrett Rock & Fields, Chtd. She received her BBA in management, cum laude, from the University of Massachusetts in 1982 and received her juris doctorate from the University of Idaho in 1985, where she was the Symposium Coordinator for the Idaho Law Review. Christine's practice areas include business, finance and real estate transactions. Christine served several terms on and is a former chair of the governing council for the Idaho State Bar Business and Corporate Law Section. She recently published "Teach an Old UCC Dog New Tricks, An Overview of the U. N. Convention on the International Sale of Goods," Business Law Today, Vol. 18, No. 1, Sept./Oct. 2008, for which she received a Burton Award for Legal Excellence.*

Endnotes

[1] United Nations Convention on Contracts for the International Sale of Goods, opened for signature April 11, 1980, S. Treaty Doc. No. 9, 98th Cong., 1st Sess. 22 (1983), 1489 UNTS 3, http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html ("CISG").
[2] *See generally*, Honnold, John O., *Uniform Law for International Sales under the 1980 United Nations Convention* (3rd ed., The Hague, The Netherlands: Kluwer Law International, 1999).
[3] *See* www.cisg.law.pace.edu. As of April 30, 2009, 73 countries are parties to the CISG. For a current list of signatory nations, *see* www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html. For official texts of international conventions and their status, *see* http://www.uncitral.org/uncitral/en/uncitral_texts.html.
[4] CISG, art. 18, para. (2).
[5] *See generally*, E. Allen Farnsworth, Farnsworth on Contracts § 3.22 (1998).
[6] I.C. § 28-1-103(3)(b) provides, "Unless displaced by the particular provisions of the uniform commercial code, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions."
[7] CISG, art. 16, para. (2).
[8] I.C. § 28-2-205.
[9] CISG, art. 18, para. (2).
[10] *See*, *e.g.*, *Tri-Circle, Inc. v. Brugger Corp.*, 121 Idaho 950, 829 P.2d 540 (Ct. App. 1992).
[11] CISG, art. 19.
[12] E. Allen Farnsworth in C. M. Bianca & M. J. Bonell, *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Gioffré: Milan, 1987), 175-184.
[13] CISG, art. 21. Be aware that a number of countries that ratified the Convention made a reservation eliminating this provision so their domestic statutes of frauds may apply.
[14] I.C. § 28-2-209(3).
[15] *See* Honnold at 121-123.
[16] *MCC Marble Ceramics v. Ceramica Nuova D'Agostino, S.P.A*, 144 F.3d 1384 (11th Cir. 1998).
[17] CISG, art. 35:
[18] I.C. § 28-2-601.
[19] CISG, art. 49.
[20] CISG, art. 25.
[21] *See, e.g., La Delizia v. Columbia Distributing*, http://cisgw3.law.pace.edu/cases/040909u1.html (W.D. WA 2004) (Oregon company's notice of non-conformity given 5 months after delivery of Italian wine was not timely under CISG).
[22] CISG, art. 38 (buyer must examine the goods "within as short a period as is practicable"), and CISG, art. 39.
[23] I.C. § 28-2-602.
[24] *See, e.g.*, Obergericht Kanton Luzern 8 January 1997, www.unilex.info/case.cfm?pid=1&id=241&do=case, CLOUT 192 (http://www.uncitral.org/clout/showDocument.do?documentUid=1081), English translation available at: http://cisgw3.law.pace.edu/cases/970108s1.html (Swiss court holds one-month as reasonable time under Article 39, following review of other countries that shows 8 days as reasonable time for notice of defect and several months as reasonable time under US law).
[25] CISG, art. 5.
[26] CISG, art. 67.
[27] *See*, www.iccwbo.org/incoterms/id3045/index.html.
[28] 894 P.2d 470 (Or. App. 1995).
[29] For more information on the CISG, *see* www.cisg.law.pace.edu -- maintained by Pace University School of Law. This site contains annotated text of the Convention, digested CISG cases, official advisory opinions and more, in a user-friendly format.

OFFICIAL NOTICE
SUPREME COURT OF IDAHO
Chief Justice
Daniel T. Eismann
Justices
Roger S. Burdick
Jim Jones
Warren E. Jones
Joel D. Horton
4th AMENDED - Regular Fall Terms for 2009

Boise	July 22 at 3:00 p.m.
Boise	August 19, 21, 24, 26 and 28
Boise	September 17 and 18
Pocatello	September 24
St. Anthony	September 25
Boise	**November 4**
Twin Falls	November ~~4~~, 5 and 6
Boise	November 9 and 12
Boise	December 2, 4, 7, 9 and 11

By Order of the Court
Stephen W. Kenyon, Clerk

NOTE: The above is the official notice of setting of the year 2009 Fall Terms of the Idaho Supreme Court, and should be preserved. A formal notice of the setting of oral argument in each case will be sent to counsel prior to each term.

OFFICIAL NOTICE
COURT OF APPEALS OF IDAHO
Chief Judge
Karen L. Lansing
Judges
Darrel R. Perry
Sergio A. Gutierrez
David W. Gratton
2nd AMENDED - Regular Fall Terms for 2009

Boise	August ~~18~~, 20, 25 and 27
Boise	September 10, ~~14~~, 15 and ~~29~~
Boise	October 13, 15, 20 and 22
Boise	November 10, 13, 17 and 19
Boise	December 8, 10 and 15

By Order of the Court
Stephen W. Kenyon, Clerk

NOTE: The above is the official notice of setting of the year 2009 Fall Terms of the Court of Appeals, and should be preserved. A formal notice of the setting of oral argument in each case will be sent to counsel prior to each term.

Idaho Supreme Court

Oral Argument Dates
As of July 16, 2009

Thursday, September 17, 2009 – BOISE

8:50 a.m.	State v. Watkins (Petition for Review)	#35687
10:00 a.m.	State v. Flegel (Petition for Review)	#35117
11:10 a.m.	Morgan, Jr. v. Sexual Offender Classification Board	#35913

Friday, September 18, 2009 – BOISE

8:50 a.m.	Thompson Creek Mining v. IDWR	#35175
10:00 a.m.	Paul Rhoades v. State	#35021
11:10 a.m.	Gardiner v. Boundary County	#35007

Thursday, September 24, 2009 – POCATELLO

8:50 a.m.	Christian v. Mason	#35331
10:00 a.m.	Henderson v. Henderson Investment Properties	#35138
11:10 a.m.	Wendy Knox v. State	#35787

Friday, September 25, 2009 – ST. ANTHONY

8:50 a.m.	Crump v. Bromley	#35666
10:00 a.m.	Ransom v. Topaz Marketing, LP	#35494
11:10 a.m.	Losee v. The Idaho Company	#34887

Idaho Court of Appeals

Oral Argument Dates
As of July 16, 2009

Thursday, September 10, 2009 - BOISE

9:00 a.m.	Feasel v. State, Dept. of Transportation	#35720
10:30 a.m.	State v. Mantz	#35540

Tuesday, September 15, 2009 – BOISE

9:00 a.m.	State v. Byington	#35697
10:30 a.m.	State v. Agency Bail Bonds	#35926
1:30 p.m.	Speech & Hearing Service v. Brown	#35393

Idaho Supreme Court and Court of Appeals
NEW CASES ON APPEAL PENDING DECISION
(Update 08/01/09)

CIVIL APPEALS

CONTRACT

1. Whether the court erred in ruling the oral settlement agreement that contemplated the conveyance of an interest in real property was enforceable and not within the purview of the Statute of Frauds.

Ogden v. Griffith
S.Ct. No. 35964
Supreme Court

EVIDENCE

1. Did the court err in not overturning the Idaho Board of Accountancy's decision that Duncan violated Idaho Accountancy Rule 004.01 by not making disclosures or seeking the consents required by AICPA 102.3?

Duncan v. Idaho State Board of Accountancy
S.Ct. No. 35804
Supreme Court

LICENSE SUSPENSION

1. Whether the Department's decision denying an administrative hearing was based upon an appropriate exercise of its discretion such that Truman's driving privileges should be suspended pursuant to its decision.

Truman v. Idaho Department of Transportation
S.Ct. No. 36082
Court of Appeals

POST-CONVICTION RELIEF

1. Did the court err in dismissing Kimball's second petition for post-conviction relief on the bases that the petition was untimely and improperly successive?

Kimball v. State
S.Ct. No. 34434
Court of Appeals

2. Did the court err in finding Carr failed to raise a genuine issue of material fact that would entitle him to an evidentiary hearing on any of his post-conviction claims?

Carr v. State
S.Ct. No. 35271
Court of Appeals

3. Did the court err in summarily dismissing Veenstra's petition for post-conviction relief?

Veenstra v. State
S.Ct. No. 35310
Court of Appeals

4. Does the law of the case doctrine prohibit the district court from deciding in opposition to the Court of Appeals' holding that counsel's deficient performance was not prejudicial?

Esquivel v. State
S.Ct. No. 35792
Court of Appeals

5. Did the court err in dismissing Barcella's claims, including prosecutorial misconduct?

Barcella v. State
S.Ct. 35502
Court of Appeals

6. Whether the court erred in summarily dismissing Villarreal's claim his guilty plea was invalid.

Villarreal v. State
S.Ct. No. 35935
Court of Appeals

PROBATE

1. Whether the calculation for final distribution of the estate is mathematically incorrect, resulting in a doubling of the reduction provided in the will.

Losser v. Tresco
S.Ct. No. 35619
Court of Appeals

SUBSTANTIVE LAW

1. Whether Lerajjareanra-O-Kel-ly, an indigent prisoner, is being denied equal protection of the law in that I.C. § 31-3220A does not provide for the payment at public expense of fees charged for service of process in civil actions when I.C. § 31-3220 (6) provides for payment of such fees for indigents who are not prisoners.

O-Kel-ly v. Schow
S.Ct. No. 35887
Court of Appeals

SUMMARY JUDGMENT

1. Did the court err in granting FIA Card Services' motion for summary judgment?

Capps v. FIA Card Services, N.A.
S.Ct. No. 35891
Supreme Court

2. Did the court err in finding the trustee followed statutory requirements in conducting the nonjudicial foreclosure and in granting summary judgment in favor of Black Diamond Alliance, LLC?

Black Diamond Alliance v. Kimball
S.Ct. No. 35189
Supreme Court

3. Whether the district court erred in granting summary judgment where nuisance and inverse condemnation were properly pleaded and supported.

Brown v. City of Pocatello
S.Ct. No. 35992
Supreme Court

CRIMINAL APPEALS

BAIL BONDS

1. Whether the district court abused its discretion in concluding the interests of justice did not require exoneration of the bond.

State v. Two Jinn, Inc.
S.Ct. No. 35772
Court of Appeals

EVIDENCE

1. Was the finding that Estes committed the infraction of exceeding the posted speed limit supported by substantial and competent evidence?

State v. Estes
S.Ct. No. 35767
Court of Appeals

2. Did the district court err by allowing the state to introduce testimony regarding typical methamphetamine use, packaging, and sales because this testimony was more prejudicial than it was probative?

State v. Ortiz
S.Ct. No. 35278
Court of Appeals

3. Did the court err in determining evidence of the victim's statements to police regarding the charged offense that indicated his personal racial animus were irrelevant and therefore inadmissible?

State v. Musick
S.Ct. No. 35141
Court of Appeals

JURISDICTION

1. Did the trial court err in denying Oatman's motion to dismiss in which she claimed lack of jurisdiction?

State v. Oatman
S.Ct. No. 35758
Court of Appeals

PLEAS

1. Whether the prosecutor's argument as to the agreed upon sentencing recommendation constituted a breach of the plea agreement and fundamental error.

State v. Juarez
S.Ct. No. 35828
Court of Appeals

SEARCH AND SEIZURE – SUPPRESSION OF EVIDENCE

1. Did the court err in denying Belden's motion to suppress a search warrant and in finding the warrant was supported by probable cause?

State v. Belden
S.Ct. No. 35284
Court of Appeals

Summarized by:
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~ LEGAL ETHICS ~

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FOR SALE

For Sale: Idaho Reports 1-145 except 62 and 65. 1-52 Leather bound. Also, executive desk and miscellaneous office furniture. For more information please contact Paul M. Beeks at: (208) 733-6684.

IDAHO LAW FOUNDATION

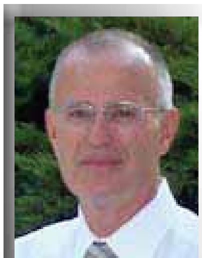
Helping the profession serve the public

Idaho Volunteer Lawyer Program plays pro bono matchmaker

By Dan Black
Managing Editor of The Advocate

The most satisfying cases, according to Boise attorney John Schroeder, come from "the matchmaker." That's what he calls the Idaho Volunteer Lawyer service, which screens cases for lawyers interested in pro bono work.

Sponsored by the Idaho Law Foundation, the matchmaking includes a preliminary investigation to find the most critical cases involving domestic violence or children's safety, according to IVLP Case Investigator Carrie House. She said families needing legal services find out about IVLP at domestic violence shelters, Idaho Legal Aid or through the Court Assistance Offices. IVLP referrals often involve child neglect, abuse and guardianship issues. Clients need to meet federal poverty guidelines and make an application. After the matter has been screened and investigated, it is sent to an attorney willing to take on pro-bono work.


John Schroeder

"The people they send over definitely need help," said Schroeder, who has done pro bono work from IVLP referrals for about 15 years.

"You can really accomplish something for these people," he said. "There is no way they can afford a lawyer. IVLP helps find the cases that are falling through the cracks."

Schroeder recently helped resolve a bitter six-year dispute. A Boise-area couple divorced in 2004 and continued a cycle of escalating conflict involving custody disputes, domestic violence, numerous violations of protection orders and jail time.

"It was almost anarchy," Schroeder said, and two children were witnessing everything.

Now, after establishing specific agreements on visitation, child support, and no contact orders, the matter is resolved.

"It's like night and day," Schroeder said. "The improvement is astronomical. You can really make a material difference in people's lives. There is a high degree of satisfaction."

Schroeder credits IVLP for making his pro bono work so rewarding.

"How am I going to find these cases?" he asked. "There is no way I have the time to go out and do the research, do the screening."

IVLP Legal Director Mary Hobson said a wide range of projects are available to fit an attorney's interests.

Funded by donations and grants to the Idaho Law Foundation, IVLP helps hundreds of low-income people in need of legal services every year. It welcomes attorneys and firms interested in helping. So far in 2009, 177 cases have been closed, and volunteers have logged 3,690 hours of work.

"I know if they send someone, this person really needs the help," Schroeder said.

To volunteer for pro bono work contact Carol Craighill at (208) 334-4500, or to donate to the Foundation contact Carey Shoufler at (208) 334-4500.

Students, volunteer lawyers team up for Boise wills clinic

One of the University of Idaho School of Law students who participated in a wills clinic earlier this year asked the Idaho Volunteer Lawyers Program (IVLP) to hold another one in Boise this summer.

"I was excited about offering a new clinic, and about the idea of recruiting experienced attorney volunteers to work with law students" said Mary Hobson, IVLP Legal Director.


Mary Grant

Mary Grant, a soon-to-be second-year law student, organized five other law students and worked with three volunteer attorneys on the project. **Chris Huntley**, The Huntley Law Firm, PLLC, presented an overview of the law pertaining to wills and powers of attorney to prepare participants. **Doug Fleenor,** Burkett Law Office, and **David Hyde**, Hyde & Haff, PLLC, supervised the clinic, which matched law students with low-income individuals and couples who needed wills.

"I was surprised and pleased at how diligent and thorough the students were," Fleenor said. "They took nothing for granted and asked really good questions."

Hyde added that he, "was pleased to participate in a project that accomplished two goals: giving the law students a chance for hands-on experience and helping pro bono clients."

The organizing student, Mary Grant said the clinic "provided an opportunity not only to work with volunteer attorneys committed to their practice but also lets us see the look of appreciation and gratitude on the faces of those we were able to serve. It is easy in the course of law school studies to get buried and forget why it is we all went to law school in the first place to use our knowledge and expertise to serve those who need our assistance."

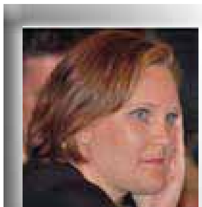
The other law students included **Allison Blackman, Leon Samuels, Laura Keys, Jaime MacNaughton, Kim Stretch, Katy Arnold** and **Dan Records**.

Jeremy Yamaguchi, Placentia, California's 19-year-old city councilman, speaks with a group of students about the importance of civic involvement at the Service Learning in Public Policy program in Valley Forge, Pennsylvania this summer.

First-hand experience shows students' hunger for civics, legal education

Carey Shoufler
Idaho Law Foundation
Law Related Education Director

After this summer, I know just what retired Supreme Court Justice David Souter is talking about. When I attended the American Bar Association Annual Meeting in Chicago, Justice Souter used his keynote address to call on American attorneys to "take on the job of making American civic education real again."



Carey Shoufler

Incoming ABA President Stephen Zack also shared his determination for a focus on teaching civics. His hope is that a renewed interest in civics and an understanding of the role of government will create a more informed citizenry. Like Souter, Zack called on members of the ABA to get involved.

"Every last one of us must go in and teach these students," he said. "We can't wait. We must begin to reach out to a new generation."

This summer, I saw first-hand how civic education can inspire young people. As Law Related Education Director, I helped lead a week-long public policy institute for high school students at the Freedoms Foundation. Students from all parts of the country gathered at the organization's campus in Valley Forge, Pennsylvania to participate in the inaugural session of the *Service Learning in Public Policy* program. Each participant choose a public policy topic they were interested in, attended lectures by experts in different areas of public policy, conducted field service and research on their chosen topics, and worked in small groups to put together and deliver public policy presentations.

As the project director of this institute, I learned that that young people are hungry to participate in the important decisions that will influence their lives, that they have really wonderful and sophisticated ideas, and that with a little guidance from caring, knowledgeable adults, they can engage in a way that can impact their communities. This experience refreshed my commitment to civic education and spoke to why attorneys must help provide law related civic education for young people, as both Souter and Zack have encouraged.

I know how busy attorneys can be, but I still would like to ask each of you to consider giving a few hours time to help Idaho students during the upcoming school year. With your help, Idaho attorneys can be at the forefront of realizing the vision for civic education presented by Justice Souter and ABA President Stephen Zack. More importantly, as I already know from my own experiences, a few hours of your time can make a world of difference in the lives of the young people in your communities.

Check for Opportunities next page.

Idaho Law Foundation

Helping the profession serve the public

Law Related Education volunteer opportunities available this fall

The Law Related Education Program relies on Idaho attorneys to help provide law related instruction to Idaho students at all grade levels and can tailor your volunteer experience to your availability and interest. Law Related Education opportunities for the 2009 – 2010 school year include:

- **High School Mock Trial Competition:** Participating teams prepare and present a hypothetical legal case. Attorneys serve as coaches for teams or judges for competitions.
- **Lawyers in the Classroom:** Lawyers and teachers partner to teach law-related and civic subjects four times during the school year. Law Related Education offers lesson plans and helps prepare lawyers for classroom visits.
- **When You Become 18: A Survival Guide for Teenagers:** This booklet helps young people understand their rights and responsibilities as they reach the age of majority. Attorneys visit high school classrooms to answer questions about the laws outlined in the guide.

To volunteer to help with any of the Law Related Education program activities, visit the Law Foundation website at www.idaholawfoundation.org, click the Opportunities for Service link at the top of the page and fill out the online form. For more information contact Carey Shoufler at (208) 334-4500 or cshoufler@isb.idaho.gov.

Conference explores important issues in Idaho

Several Idaho attorneys will be presenting at the ninth annual Idaho Council for History Education conference, co-sponsored by the Law Related Education Program. This conference will take place on October 1 and 2 at Boise High School. LRE topics include:

- *Lincoln and Bush and the Suspension of Habeas Corpus* presented by David Leroy and David Nevins
- *The Impact of Title VII on the World of Work* presented by Jill Bolton and Mary Huneycutt
- *The Labor Movement Then and Now*, a panel discussion facilitated by Ritchie Eppink and Chris Christensen

The Idaho Law Foundation invites Idaho attorneys located in the Boise area to attend these law related presentations.

For more information contact Carey Shoufler at (208) 334-4500 or cshoufler@isb.idaho.gov.

Idaho Immigration Law Pro Bono Network

and

Idaho Volunteer Lawyers Program

present a CLE

Representing Immigrants in Deportation Proceedings

Sept. 18, 8:30 a.m. – 1:30 p.m.
Idaho Law Center, 525 W. Jefferson, Boise

The Idaho Immigration Law Pro Bono Network is a group of private immigration lawyers, law students, law clerks, and organizations that have come together to address the need for no cost representation in removal proceedings. Learn how you can help improve legal representation in U.S. Immigration Court and receive free CLE credits when you pledge to help. To register: go to isb.idaho.gov/ilf and under announcements follow the link for IVLP CLE on Representing Immigrants in Deportation Proceedings.

Upcoming CLEs

SEPTEMBER

Annual Estate Planning Seminar
Sponsored by the Taxation, Probate and Trust Section
September 11 - 12, in Sun Valley
9.5 CLE Credits of which 1.0 will be ethics credit
Room Reservations Call 1-800-786-8259

Idaho Evidence Law
Sponsored by the Idaho Law Foundation
September 25, at the Law Center, Boise
Webcast Statewide
8:30 - 10:30 a.m.
2.0 CLE Credits **RAC**

OCTOBER

CLE Program Replays
October 1, the Law Center, Boise
9:00 a.m. - 1:00 p.m.
3.5 CLE Credits of which 2.0 are ethics **RAC**

Idaho Practical Skills
Sponsored by the Idaho Law Foundation
October 2, at the Boise Centre on the Grove
RAC

Divorce and Custody Basics
Sponsored by the Family Law Section
- October 2, in Blackfoot
- October 9, in Boise
- October 15, in Coeur d'Alene

6.0 CLE Credits (Pending Approval) **RAC**

Intellectual Property Program
Sponsored by the Intellectual Property Section
October 15, at the Law Center, Boise
Webcast Statewide
8:30 - 9:30 a.m.
1.0 CLE Credit

Ethics and the Pro Se Opponent
Sponsored by the Government and Public Sector Lawyers Section
October 30, at the Law Center, Boise
Webcast Statewide
8:30 - 9:30 a.m.
1.0 Ethic CLE Credit

NOVEMBER/DECEMBER

Introductory Collaborative Law Training
Sponsored by the Family Law Section
November 6-7, at the Hotel 43, Boise
8:30 a.m. - 5:00 p.m.
14 CLE Credits pending

The Complete Legal Negotiator
Sponsored by the Idaho Law Foundation
November 13, at the Grove Hotel, Boise
8:30 a.m. - 3:30 p.m.
6.0 CLE Credits

Headline News—Year in Review
Sponsored by the Idaho Law Foundation
- November 20, in Moscow
- December 4, in Pocatello
- December 11, in Boise

Rule 1.10 Revised—Screening for Conflicts
Sponsored by the Professionalism and Ethics Section
December 15, at the Law Center, Boise
Webcast Statewide
8:30 - 9:30 a.m.
1.0 Ethics CLE Credit

Trial Practice Ethics—An Interactive CLE
Sponsored by the Idaho Law Foundation
December 18, at the Oxford Suites, Boise
8:30 - 10:30 a.m.
2.0 Ethics CLE Credits

RAC: Reciprocal Admission Credit Approved

University of Idaho College of Law Professor Barbara Cosens leads an interdisciplinary program that examines law and water resources. She earned tenure this spring.

Science as a second language: Law professor crosses boundaries

By Donna Marie Emert
University of Idaho

One of the great challenges in the increasingly interdisciplinary education environment is language. In academia, miscommunication is often a "you say tomāto, I say "*Solanum lycopersicu"* issue. (Yep, that's "tom*ä*to.") Each discipline has its own language and culture.

As a geologist and an attorney, University of Idaho College of Law Professor Barbara Cosens understands the languages of both science and law. She leads a team-taught course in Interdisciplinary Methods in Water Resources as part of the university's unique Waters of the West (WoW) Program, which includes concurrent J.D./M.S. and J.D./Ph.D. degrees in Water Resources Engineering and Science, Water Resources Science and Management, and Water Resources Law, Management and Policy.

Cosens honed her understanding of environmental issues first. She earned a B.S. in Geology from the University of California at Davis in 1977 and an M.S. in Geology at University of Washington in 1982.

Cosens served as an Assistant Professor in the Environmental Studies Program at San Francisco State University and from 1991-2000 worked as both a mediator and negotiator in transboundary water disputes, serving as lead negotiator between the Montana Reserved Water Rights Commission and the National Park Service, U.S. Fish and Wildlife Service, the Chippewa Cree Tribe of the Rocky Boy's Reservation, the Gros Ventre and Assiniboine Tribes of the Fort Belknap Reservation and the Blackfeet Tribe.

"That background has been quite useful in understanding the actual relationship between various water rights, the interplay of water quality, the uncertainties involved in scientific information, and how the law address — or fails to address — those uncertainties," said Cosens.

"Hours spent at the kitchen table understanding their operations, interests and fears are invaluable to resolving disputes."

Cosens holds an LL.M. degree from Northwestern School of Law at Lewis and Clark College, where she graduated Summa cum laude in Natural Resource and Environmental Law in 2003. She received a juris doctor degree from the University of California, Hastings College of the Law in 1990, Magna cum laude and following law school, she clerked for Justice Lohr of the Colorado Supreme Court.

Her ability to comprehend and translate both scientific and legal principles — and her kitchen-table familiarity with the practical challenges facing diverse stakeholders in water rights disputes— provides insight into that sometimes murky place where theory meets practice.

"Under the western water law doctrine of prior appropriation, first in time is first in right," Cosens explains. "In practice, when the senior water right is a surface water right and the junior is a groundwater right that is connected to the same surface water source, actual application of the principle is extremely complex. Surface to ground water connection is generally not one-to-one, immediate, or observable to the naked eye. Water managers must rely on models to determine degree of impact from the groundwater pumping. Lawyers must understand both the uncertainties involved in use of a model and the data input to the model."

"With the caveat that this is an oversimplification, in general, civil litigation is designed quite well to settle disputes among competing economic interests," Cosens adds. "Thus, while the burden of a preponderance of the evidence, and concepts of finality such as res judicata may at times result in the "wrong" answer if studied from the viewpoint of science, they allow the parties to move on. The fact that we, as a society, accept this is extremely important to the stability of our economic well being and an amazing feat of our democratic system. In contrast, hard science does not move on when over 50 percent of the scientists agree. It is based on the principle of continued testing and revisiting of hypotheses. The two approaches collide in natural resource and environmental disputes in which economic interests seek finality and environmental and community interests seek the "right" answer from the viewpoint of science. In resolving disputes outside of the courtroom, both interests must be considered and accommodated if any lasting solution is to be found."

In addition to her teaching and research expertise, Cosens has played a leadership role in establishing the J.D. facet of the university's WoW program. Those successes also have been fueled by her facility with language.

"When the goal is sharing information and achieving consensus and insight, the language barrier that exists between disciplines can be formidable," confesses Jan Boll, University of Idaho WoW program director and biological and agricultural engineering professor.

"These complex issues demand integrated solutions. Barbara's ability to cross academic boundaries has helped us build a truly integrated program."

Cosens joined University of Idaho law faculty in 2004 and teaches Water Law, Water Policy, Law and Science, and Property Law. She earned tenure this spring. Her research focuses on the integration of law and science in water resource management and dispute resolution, and the recognition and settlement of Native American water rights.

"Barbara is a great asset to the program, to the University and to our students," said Boll. "She has a keen ability to listen, analyze, and synthesize information from different disciplines. That and her broad experience in water resources makes her the ideal faculty member in WoW to work across disciplines."

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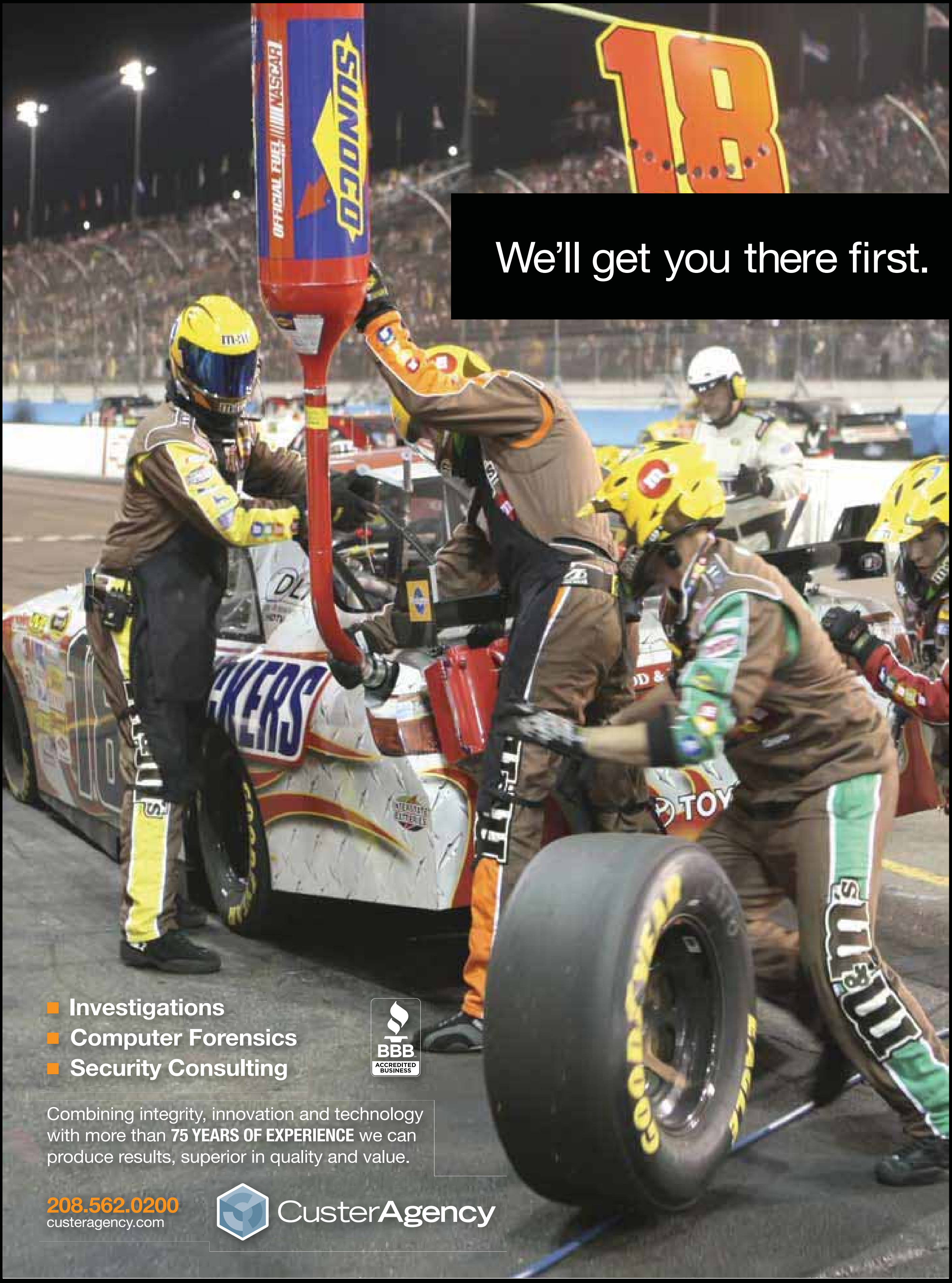

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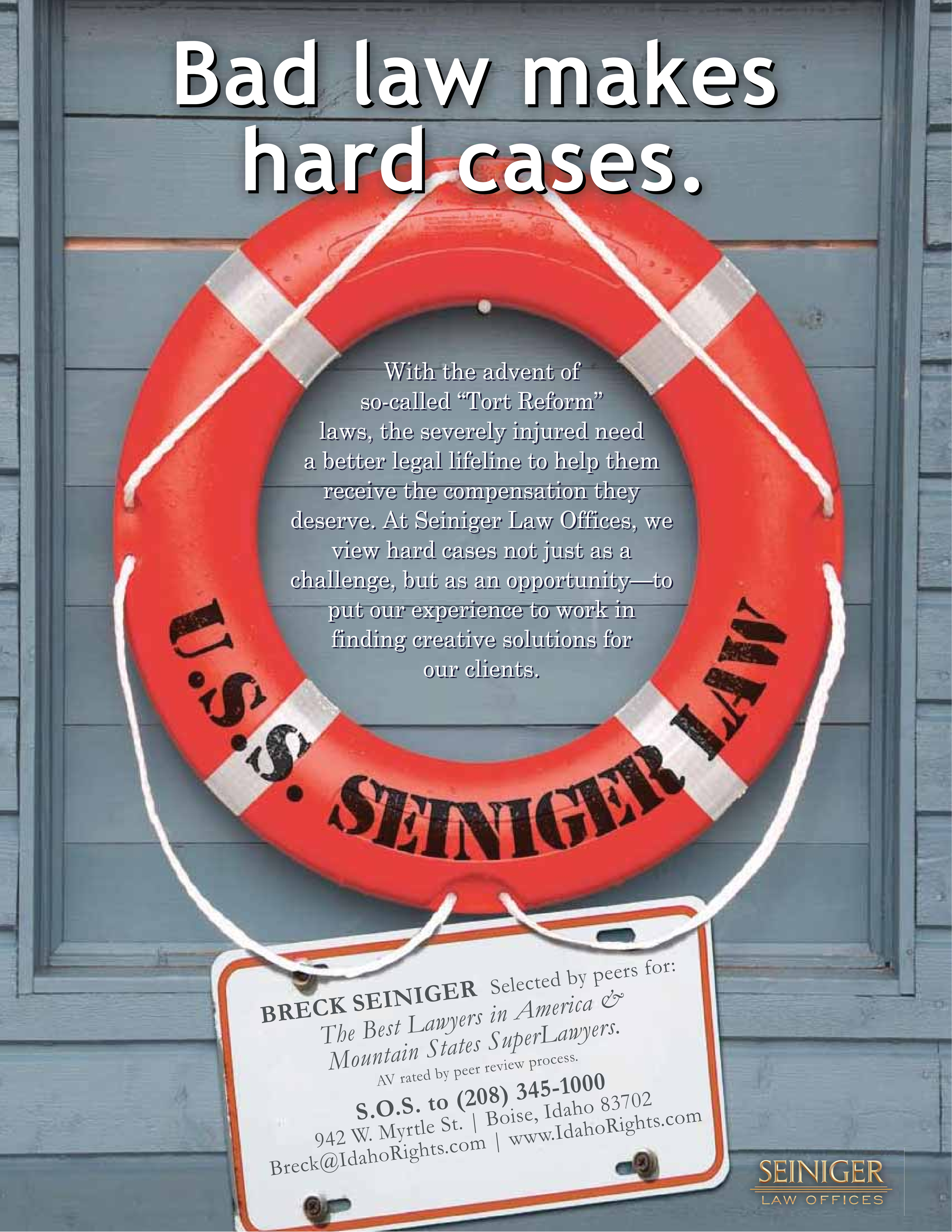
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