

SUPERCHARGING YOUR COLLEGE SAVINGS PLANS

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There is a socially conscious fund plus a number of funds based on the age of the donee and the expected investment horizon. Detailed information can be found at www.scholarshare.com.

While the California Plan is typical, most advisors think a number of plans are better. If you would like the names of some qualified advisors to help sort this out, please don't hesitate to call us.

Different states offer different benefits and restrictions and it is therefore important to do the necessary research, keeping in mind that you will have the option to move to a new plan if circumstances dictate.

In summary, Section 529 Plans work well for people who:

- Seek a tax advantaged savings plan for college education.
- Are willing to give up some investment control while retaining a menu of choices.
- Want to give larger amounts in lump sum to their children (or other minors).
- Want to make larger gifts immediately.

In addition to Qualified Tuition Programs, other gifting options include California Uniform Transfer to Minors Act gifts, Education IRAs, Children's Trusts and Crummey Trusts. These will be reviewed in the next issue of *Perspectives*.

Matthew Wesley, Esq. and Golnar Yazdi, Esq. are members of Carr, McClellan's Family Wealth & Tax Planning Group.

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CARR
McCLELLAN
INGERSOLL
THOMPSON
& HORN

216 Park Road
Burlingame, CA 94010
Tel: (650) 342-9600
FAX: (650) 342-7685

www.cmithlaw.com

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PLANNING AND PREVENTION

By Mark A. Cassanego, Esq.

As attorneys we serve our clients in many different ways. We often are called upon to provide advice and counsel in business as well as family settings. Just as often, we assume the role of our clients' champions and advocates. Whether we practice business law or litigate, our primary goal is to assist our clients to achieve their objectives. We accomplish this by applying our knowledge and experience to the planning and the prevention of controversy and ambiguity.

In this issue of *Perspectives*, we are providing you with some planning and prevention guidelines for a variety of circumstances. **Denise Trani-Morris** summarizes new legislation that impacts both employers and employees in the important area of identity theft. Denise's article points out the need for all of us to take steps to prevent the drastic consequences of having our identity stolen.

Planning for college and other educational expenses is the theme of **Matt Wesley's** and **Golnar Yazdi's** article on Section 529 Plans. The recently enacted Economic Growth and Tax Relief Act of 2001 offers a powerful new tool to provide for the ever-increasing cost of education.

While Matt and Golnar discuss planning issues that touch on the early part of the life cycle, **Dan Morris** gives some guidance relating to issues often faced by families toward the end of the life cycle. Planning for the possibility that the elderly might be incapacitated by Alzheimer's disease or other forms of dementia can avoid much controversy and ambiguity at a time when a family may least be able to cope with it.

Business planning that addresses issues of ownership succession is as essential as planning one's estate and for the possibility of future mental incapacity. **Mike Telleen** provides a primer on business buy-out agreements which is a must read for every business owner or entrepreneur.

Finally, **Darcy Hoellwarth** gives property owners some very practical advice on why and how to prevent unwanted liens from being placed on their leased properties. As always, we hope you find these articles instructive and interesting. If you have any questions regarding them, please do not hesitate to contact their authors. We stand ready to assist you plan for the achievement of your goals and to prevent unwanted stops along the way.

RECENT DEVELOPMENTS IN THE FIRM

Now that our firm's building and offices have been remodeled, we have turned our attention from physical to technological upgrades. These improvements are not as evident as the physical changes we have made, but they are equally, if not more, important.

The firm has recently installed and upgraded its MS Office Suite of software and a myriad of other software applications used by attorneys and staff to provide efficient and up-to-date services to our clients. These software applications range from database management and document production to tax and financial programs that allow attorneys and staff to perform complex document production and assembly and sophisticated analyses. As we continue to move toward converting Carr, McClellan to an "electronic office," we are keeping pace with the largest law firms while continuing to provide the personalized service for which we are known. Because of the upgrades, our attorneys and staff are able to serve you more efficiently and economically.

We have also expanded our methods of communication and data transmission in new and exciting ways that speed up the process of practicing law. For instance, we have installed digital scanning equipment that will allow us to convert original paper documents to digital form that can be indexed, cross-referenced and accessed electronically. New faxing capabilities allow attorneys and paralegals to receive incoming faxes right at their desktops. The new software enables attorneys to receive and send information, documents, and forms via e-mail in a portable document format (PDF). These new and expanded capabilities will enable us to deliver information to clients and courts in more convenient and efficient ways.

Our document management system now enables attorneys to store greater amounts of information and retrieve that information through multiple means including key word searches. Having more information "at our fingertips" allows us to respond more quickly to issues as they arise, making all of us more productive in our practices.

With the upgrades to both our physical and technological infrastructures in place, we anticipate providing years of increased value and service to our current and future clients.

Mark A. Cassanego, Esq. is President of the Firm.

PROTECTING SOCIAL
SECURITY NUMBERS:
DO YOUR ADMINISTRATIVE
PRACTICES VIOLATE
A NEW LAW?

By Denise Trani-Morris, Esq.

Many employers include their employees' social security numbers on everything from health insurance forms to employment applications. However, some of these practices may need to change. Facing growing concern over identity theft, the California legislature passed Senate Bill 168, now California Civil Code Section 1798.85.

This new law went into effect on July 1, 2002. All employers, both individuals and businesses, should be aware of its provisions.

The law aims to minimize the likelihood that a social security number (SSN) ends up in the wrong hands. It protects everyone's SSNs, including employees, clients, and customers. To remain in compliance, business owners may need to change some of their current administrative practices.

The following summarizes the prohibitions under the new law.

- **Publicly displaying an individual's SSN in any manner.** This includes intentionally posting SSNs or making them available to the general public.
- **Printing an individual's SSN on a card required for that person to access products and services.**
- **Requiring an individual to transmit his/her SSN over the Internet,** unless the connection is secure or if the SSN is encrypted.
- **Requiring an individual to use his/her SSN to access a website,** unless a password or unique personal identification number is also required to access the site.
- **Printing an individual's SSN on materials that are mailed to him/her.** There are two important exceptions to this rule: (1) a SSN may

"EMPLOYERS WHO USE EMPLOYEE SSNS AS IDENTIFICATION NUMBERS SHOULD THEREFORE CONSIDER IMPLEMENTING A DIFFERENT SYSTEM."

appear on mailed materials as long as a state or federal law requires that the SSN appear on the document (i.e., a W-2 form mailed to the employee); and (2) applications and forms sent by mail may include SSNs; however, the statute does not define "form" or "application."

Employers should avoid defining the term "form" too broadly and avoid sending any document that does not meet the layperson's definition of the term "form," in an effort to avoid legal challenge.

If a current practice violates Section 1798.85, an employer can still be excused from compliance if **each** of the following four conditions are met: (1) the use is continuous and has not stopped for any reason; (2) the employer provides individuals with an annual disclosure of their right to stop this use; (3) if an individual makes the request, the employer changes the procedure within 30 days at no fee to the individual; and (4) service may not be denied to those individuals because they ask employers to stop using their SSNs.

Employers are not prevented from using SSNs as part of their internal verification procedures or for administrative purposes. However, the statute does not define what constitutes an "internal procedure" or "administrative purpose." Employers who use employee SSNs as identification numbers should therefore consider implementing a different system.

The key to this statute is the legislature's desire to minimize the likelihood that a SSN is mailed, posted, or sent through the Internet, where it is most vulnerable to theft. Nonetheless, this new law contains several vague terms and raises many questions. If you have concerns about how Section 1798.85 may impact your business, contact your legal advisor.

Denise Trani-Morris, Esq. is a member of Carr, McClellan's Labor and Employment Group and its Litigation Group. She was assisted with this article by Susan Isard, a summer associate working with Carr, McClellan.



with all statutory requirements. Keep in mind, an owner may have actual knowledge or constructive knowledge of an improvement. For instance, if Owen knew that Tom might install the closet systems and the lease did not require Owen's consent, it is Owen's duty to inquire if such construction has begun. Once the construction starts, Owen has 10 days to object and file a Notice of Nonresponsibility, regardless of whether he is actually aware construction began or not.

Scenario Three

This is the same as Scenario Two, except before Tom signs the lease he tells Owen he wants to install the closet systems. Owen is thrilled about the improvements on his property, especially since he isn't paying for them. He writes into the lease that Tom may install the closet systems if he chooses. Tom hires Carl and performs the work. Tom fails to pay him so Carl files a mechanics' lien.

What should Owen do? If a tenant is required to obtain the owner's consent before making improvements and he proceeds with improvements over the owner's objections, the owner may escape the effects of a mechanics' lien by properly filing a Notice of Nonresponsibility. However, the law is uncertain in situations where the lease authorizes the tenant to make certain improvements but does not require the owner's consent. Depending on the facts, the owner's interest in the property may be subject to the mechanics' lien.

Scenario Four

Owen also owns a lakefront vacation home in Tahoe and has rented it to Terry Tenant, Tom's brother, for the summer. During Terry's tenancy, Owen finally receives approval to build a pier on the lake in front of his house. He planned to build the pier after Terry's lease ended, but Terry convinced him to move forward with the pier by promising to hire the contractor and monitor the work. Terry reassured Owen that all he needed to do was approve the plans and reimburse him for the payments. Owen prepared a new, longer lease that included Terry's obligations to build the pier, which was signed by Terry.

Terry hires Perry's Piers to do the work. Owen approves the estimated costs and writes Terry a check to cover the work. When the project is nearly complete, Perry requests payment from Terry but Terry's check bounces. Thus, Perry records a mechanics' lien against the Tahoe property.

What should Owen do? Regardless of the protections afforded by the proper posting of a Notice of Nonresponsibility, if the lease requires

"A CAREFULLY DRAFTED LEASE IS THE OWNER'S BEST PROTECTION AGAINST MECHANICS' LIENS AND LIABILITY."

that the tenant construct certain improvements which benefit the property, the owner is deemed to have ordered the work. In this case, Tom is considered Owen's agent for purposes of hiring the contractor. Therefore, the contractor's mechanics' lien will be effective against both Tom's leasehold interest and Owen's interest. In addition, Owen may be personally liable for the contractor's bill. The law states that if a property owner exercises any control over construction or payments to a contractor, the owner may be deemed to be a "participating owner" even though he did not contract directly with the contractor. He may therefore be responsible for paying the bill.

Conclusion

After reading about Owen's dilemmas, property owners may think that the safe course of action is to file a Notice of Nonresponsibility regardless of whether any construction is taking place. Don't. First, the notice will be ineffective if filed before the commencement of construction. Second, a Notice of Nonresponsibility will affect title to the property. In fact, a title company may choose not to issue insurance since the notice indicates that a third party has an interest in the property. Finally, a Notice of Nonresponsibility will never protect the owner when, as in Scenario Four, the owner expressly requests the work.

In the end, a carefully drafted lease is the owner's best protection against mechanics' liens and liability. The lease can require the tenant to obtain the owner's consent before making improvements and to notify the owner of all construction on the property. This way, the owner can protect his property interest and be provided with other protections and assurances.

Darcy E. Hoellwarth, Esq. is a member of Carr, McClellan's Real Estate Group and its Corporate and Business Group.



the company or by the other owners. Either approach provides practical and tax advantages and disadvantages, which should be reviewed with your attorney, accountant and life underwriter (if the buy-out will be funded with insurance).

How do the owners decide on a price? This is sometimes the most difficult part of structuring a buy-out agreement, especially if the business is new and the owners have no real idea of how the business might grow. Formulas based on book value, appraisal, or annual agreement of the owners should be considered. It is advisable for the owners to give the valuation issue some thought before they meet with the attorney who will be drafting the agreement, and to then discuss alternatives with the attorney.

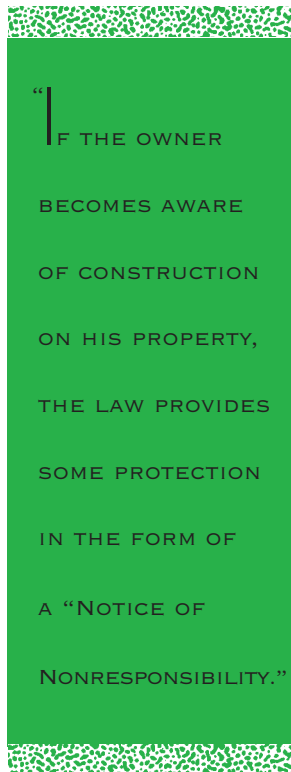
How will the buy-out be funded and paid? Funding and payment terms can take a number of different forms, often as alternatives in the same agreement. A buy-out on death is often funded by life insurance owned by the company or the other owners. Since death of an owner is usually unexpected and disruptive to the business, life insurance can provide a welcome source of funds without putting undo financial pressure on the company or the other owners. It also allows the heirs to be paid largely, if not entirely, in cash. A buy-out on disability is sometimes funded by insurance as well, although this is less common. Your life underwriter, as well as your attorney and accountant, can help you evaluate your choices here.

A lifetime buy-out will often be structured as an installment sale. The interest would be sold in return for a down payment plus a note providing for payment of the balance of the purchase price at interest and over an agreed-upon period of time. The note may or may not be secured or guaranteed. This mechanism allows for an immediate purchase of the entire interest without putting a substantial up-front cash drain on the company or the other owners.

There are a number of alternatives to be considered in structuring a buy-out agreement. Choices must be made relating to the purchaser, what triggers the buy-out, the purchase price, and how the price is to be funded and paid. Anyone who has been through the buy-out process will testify how important it is to make these decisions early in the formation of a business and to monitor and update the agreement over time.

Please contact us if we can be of assistance in structuring and preparing a buy-out agreement for your business.

L. Michael Telleen, Esq. is a member of Carr, McClellan's Corporate and Business Law Group.



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HOW PROPERTY OWNERS CAN AVOID MECHANICS' LIENS

By Darcy E. Hoellwarth, Esq.

Did you know that your property could be subject to a mechanics' lien for improvements constructed by your tenant? Here are four scenarios that illustrate this potential problem.

Scenario One

Owen Owner decides to lease his Burlingame property to Tom Tenant. Unbeknownst to Owen, Tom hires Carl Contractor to install closet systems throughout the house. Carl sends the bill to Tom but Tom never pays him. Tom files a mechanics' lien against the property.

What should Owen do? Generally, an owner who is unaware of improvements being constructed by the tenant on his property will not be subject to a mechanics' lien. The mechanics' lien is only effective against the interest of the person who engaged the services of the contractor – in this case, Tom's leasehold interest. Owen should be aware, however, that even though the mechanics' lien may only attach to Tom's leasehold interest, if Tom breaches the lease and terminates his leasehold interest, the improvements may remain subject to the mechanics' lien.

Scenario Two

The situation is the same as above, except this time, Owen drives by the property one afternoon and sees Carl's truck in the driveway. Owen calls Tom to inquire about the truck and Tom tells Owen about the closet systems. Owen objects and reminds Tom that all improvements on the house require his approval.

What should Owen do? If the owner becomes aware of construction on his property, the law provides some protection in the form of a "Notice of Nonresponsibility." This notifies the contractor that the owner does not accept responsibility for the work being performed. The notice must contain specific information and be properly posted and recorded within 10 calendar days after the owner first finds out about the construction.

Any minor defect in the notice makes the notice ineffective, so owners should strictly comply



SUPERCHARGING YOUR COLLEGE SAVINGS PLANS

By Matthew Wesley, Esq. and Golnar Yazdi, Esq.

Editor's note: This article is the first in a two-part series on ways that parents, grandparents (and aunts and uncles) can give assets to the children in their lives.

Thanks to the Economic Growth and Tax Relief Act of 2001 (EGTRA), what was once a sleepy and pedestrian way to save for college has become a powerful tool for financial planning. Qualified Tuition Programs are authorized by Section 529 of the Internal Revenue Code and are therefore often referred to as "529 Plans." Under EGTRA, 529 Plans now allow for saving in a tax-free environment. Capital appreciation and income on assets in 529 Plans are not taxed, and, so long as the funds are used for qualified educational expenses, the distributions also escape income taxation.

Qualified 529 Plans can be established by the donor for any member of the donor's family. This includes the donor, the donor's spouse, children, grandchildren and more distant progeny. It can also include stepchildren, siblings, stepsiblings, nephews and nieces, ancestors, in-laws, cousins, uncles and aunts. If the funds are not used for the educational expenses of the original plan beneficiary, new beneficiaries can be assigned.

These plans allow states and qualified private financial institutions to create tax advantaged plans to hold, manage and distribute college savings. Assets in these plans grow free of federal income tax and distributions used for qualified educational expenses are excluded from gross income. Distributions made before 2001 from state sponsored plans and before 2003 from private institutional plans are still included in gross income. These tax incentives create a powerful tool for accumulating money for college.

The amounts that can be contributed to 529 Plans are substantial. If such a gift is given all at once, the donor can elect to have the gift amortized over a five-year period using the \$11,000 gift exclusion to cover some or all of the



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gift. Thus, an individual could fund the plan with a lump sum of \$55,000 and a couple could contribute \$110,000 if they choose to split the gift. If a donor dies during this five-year period, the unamortized portion of the gift would be included in the estate.

529 Plan contributions that are within the limits, and made with proper tax elections, are not included in the estate of the donor because they are considered "completed gifts." If the funds are withdrawn for non-qualified expenses, they are included in the owner's income and there is a 10% penalty on the amount withdrawn.

Funds in 529 Plans can only be used for a limited number of educational expenses – called "qualified educational expenses." These expenses are associated only with college or university education and include tuition, fees, books, supplies and equipment. Under EGTRA, living expenses, such as room and board, are qualified based on a complex formula derived from federal financial aid laws. Most schools have calculated the qualified amount for its students' families.

Currently, almost every state offers a 529 Plan and many private companies have charged in to compete. These plans vary dramatically. They can have different contribution limits, costs and eligibility requirements. Plans also vary on age restrictions and minimum and maximum contribution limits. Many states allow non-residents to invest in their 529 Plans. Under EGTRA, the ability to move accounts to new plans once every 12 months has created greater investment flexibility. New rules also allow account owners to switch between different investments within the same plan once a year.

As a practical matter, the most important difference between the plans is the menu of investment choices available to investors and the fees charged for fund management. Discovering the ins and outs of the various plans can require some real legwork. One terrific place to start your research is at the website www.savingforcollege.org.

By way of illustration, California's 529 Plan is fairly typical. It has no age restrictions on gifts, requires a minimum deposit of \$15 per pay period, and contributions of as little as \$25 thereafter. Maximum contribution limits are based on the age of the donee and range from \$124,799 to \$174,684. Management fees run approximately 0.8% (84 cents per \$100 invested). Most of the investments are managed by TIAA-CREF and range from pure equity investments to fixed-rate guaranteed investments.

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PLANNING FOR FUTURE CARE: PROTECTING ELDERLY FAMILY MEMBERS

By Daniel R. Morris, Esq.

Planning for future care may be one of the most important decisions a person will ever make. Although everyone hopes to lead productive lives well into old age, it is wise to consider alternative possibilities. Statistically speaking, a sizable portion of the population will require assistance with financial management and personal care as they get older. By acting prudently now, informed and intelligent estate planning decisions can be made before incapacity becomes an issue.

The most common cause of dementia is Alzheimer's disease. The Alzheimer's Association estimates that about five percent of the population worldwide develops Alzheimer's disease by age 65, 10 to 15 percent by age 75, and 20 to 40 percent by age 85. Individuals with a parent diagnosed with Alzheimer's disease have almost twice the risk of developing it. Having a sibling with Alzheimer's also doubles the statistical risk.

Alzheimer's type dementia is chronic and progressive. At first, individuals diagnosed with Alzheimer's may have the requisite mental capacity to manage their own legal and financial affairs, but as the disease progresses, others will need to act in their best interest.

The individual's estate planning attorney, sometimes in consultation with his or her physician, usually determines whether the individual possesses the mental capacity to execute estate planning documents. If the individual is determined to lack mental capacity then appropriate legal and financial planning should begin as soon as possible.

Powers of Attorney and Living Trusts

Various estate planning documents can be prepared to authorize another person to make health care and financial decisions in the future when an individual suffering from Alzheimer's can no longer manage his or her affairs. Most often these documents include powers of attorney and a living trust.

A **power of attorney for financial affairs** gives a person an opportunity to authorize an agent (most often a family member or good friend) to make financial decisions for them when he or she is no longer competent.

A **power of attorney for health care** enables a person to appoint an agent to make important

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decisions regarding health care, including choices regarding health care providers, medical treatment, and even end-of-life decisions.

A **living trust** enables a person (called the grantor or trustor) to create a trust and appoint himself or herself as trustee and, in the event of incompetency, to appoint another person to act as trustee. The trustee (again, usually a trusted family member, friend or bank) is responsible for carefully managing and investing the trust assets on behalf of the grantor/trustor, regardless of whether or not the grantor/trustor is still competent.

Concerns About Conservatorships

Smart incapacity planning, including consulting with estate planning counsel and creating and executing estate planning documents, will help protect an individual suffering from Alzheimer's disease from potential financial abuse and fraud. And, as discussed below, having estate planning documents in place when an individual becomes incompetent can save several thousand dollars in legal fees and costs later.

If a person becomes incompetent before estate planning documents are executed, the options to protect that person's assets and ensure proper medical treatment are fairly limited.

In California, the court may appoint a **conservator of the person** if it is established by clear and convincing evidence that a person (the conservatee) is unable to provide properly for his or her personal needs for physical health, food, clothing, or shelter. A conservator of the person is responsible for the care, custody and control of the conservatee, including his or her education.

Similarly, a **conservator of the estate** may be appointed by the court if it is established by clear and convincing evidence that the conservatee is substantially unable to manage his or her own financial resources or resist fraud or undue influence. A conservator of the estate manages and controls the conservatee's estate.

A petition to establish a **conservatorship** can be filed with the court by the conservatee's spouse or domestic partner, any relative, interested state or local governmental agency, friend or even the proposed conservatee. The proposed conservatee has the right to a jury trial with respect to the petition to establish a conservatorship.

Although a person's assets and physical well-being can be protected under a conservatorship, the process presents several drawbacks.

First, conservatorship proceedings are open to the public. Nearly anyone can obtain access to the court's files, which contain medical declarations pertaining to the proposed conservatee's physical and mental condition. Moreover, addi-

tional declarations are commonly filed in support of conservatorship petitions in which family and/or friends recite instances of questionable conduct on the part of the proposed conservatee. Needless to say, such documents can be embarrassing to the proposed conservatee and cause unnecessary conflict between the proposed conservatee and his or her physician, family and friends.

Second, the conservatorship process is also expensive. The person who files the petition is nearly always represented by an attorney. In many instances, the court is required under the law to appoint independent counsel to represent the proposed conservatee's interests. The court most often orders that both of these attorneys be paid from the proposed conservatee's estate. A court investigator is usually appointed prior to the hearing on the conservatorship petition to interview various individuals connected with the case and to report his or her findings to the court. The court investigator's fees are also usually paid from the proposed conservatee's estate.

Third, the proposed conservatee may lose certain civil liberties. Depending on the degree of mental impairment, the court can order that the proposed conservatee be disqualified from voting in public elections and/or lacks the capacity to consent to marriage. Moreover, the establishment of a conservatorship of an estate is considered a legal determination that the conservatee lacks the capacity to enter into any contract.

Fourth, and perhaps most importantly, the conservatorship process is adversarial in nature and oftentimes permanently polarizes family members. Sometimes a hotly contested issue is whether or not the proposed conservatee really needs a formal conservatorship – i.e., is the individual clearly unable to manage his or her own financial resources or resist undue influence or fraud? Other times, everyone agrees that a conservatorship is necessary, but no one can agree on **who** should serve as conservator. More often than not, this is a “control” issue because whoever is appointed conservator of the estate usually controls most of the assets and whoever is appointed conservator of the person has physical control over the proposed conservatee.

Whether you are planning for yourself or for family members, having the appropriate estate planning documents in place provides protection, peace of mind, and confidence. Furthermore, should incapacity become an issue, estate planning decisions made now will help avoid costly and divisive conservatorship proceedings later.

Daniel R. Morris, Esq. is a member of Carr, McClellan's Litigation Group.

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STRATEGIES FOR BUSINESS

BUSINESS BUY-OUT AGREEMENTS

By L. Michael Telleen, Esq.

What is a buy-out agreement? A buy-out agreement is a contract among the owners of a business that sets forth what happens when one of them leaves the business or wishes to sell his or her ownership interest. It may provide for a buy-out of an owner upon death, disability, retirement, or some other termination of employment. Buy-out agreements apply to corporations, partnerships, or limited liability companies.

Why are buy-out agreements important?

There are major advantages to having an agreement in place before a buy-out event occurs. The situation may be planned or unexpected; for instance, the owner of an interest in a closely-held business could die, become disabled, or leave the business, either voluntarily or involuntarily. There is usually little market for the interest of one owner in a closely-held business.

If no mechanism is in place to purchase the interest of the departing owner, he or she (or his or her heirs) may be saddled with an interest which carries no income benefits. In addition, the other owners may be left with a “partner” who is not participating in the business but attempts to use whatever leverage he or she might have to force the others to pay “dividends” to owners. An unhappy outside owner can also be a distraction for those trying to run the business.

Who does a buy-out agreement protect?

A buy-out agreement protects the company in that it allows for peaceful termination of the departing owner's interest without having to undergo unpleasant negotiations at what may already be a stressful time. It protects the departing owner or his or her heirs by giving them a market for the interest which may not otherwise be marketable. It protects the remaining owners by shielding themselves from an unwanted “partner,” including the departed owner, his or her heirs or someone to whom the interest might be sold.

How is a buy-out agreement structured? It can be structured to provide for a purchase by