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Nick Kacher, Esq.
Senior Vice President & General Counsel
Email: nkacher@primerus.com
Phone: 1.800.968.2211
1.616.454.9939, ext. 3604

Table of Contents

The Business Skills Trust: Helping Younger Generations to Take a Leadership Role in the Family Business

By Jon J. Gallo, Esq. and
Stefanie J. Lipson, Esq.

Greenberg Glusker Fields Claman & Machtinger, LLP
1900 Avenue of the Stars, 21st Floor
Los Angeles, CA 90067
Tel: 310.553.3610
Fax: 310.553.0687

jgallo@greenbergglusker.com
slipson@greenbergglusker.com
www.greenbergglusker.com

In high-net-worth estate planning, trusts are commonly used to transfer wealth from generation to generation. The rationale for using trusts is often tax savings, coupled with protection from creditors and claims of a divorcing spouse. However, this rationale ignores an extremely important — but underused — function that trusts can play in an estate plan: educating the next generation to manage their inheritance responsibly.

Affluent families we work with are often concerned that their children and grandchildren lack the knowledge and skill to manage their inheritance responsibly on their own. Most clients decide that the better approach is to leave the inheritance in a trust, under which a third-party trustee manages the property until the beneficiary is ready to responsibly manage it on his or her own. Frequently, the arrangement provides for the beneficiary to serve as a co-trustee for a number of years, essentially an apprenticeship before becoming sole trustee. This educational component of a trust becomes that much more crucial when passing an interest in a family business to the next generation.

The Business Skills Trust

When an interest in the family business passes to the next generation, the ability of the business to grow and thrive can be threatened — less than one-third of family businesses survive the transition from the first generation to the second and only 13 percent survive the transition to the third. The likelihood that the family business will survive these transitions is greatly enhanced if a trustee with proper qualifications manages the interest in the family business until the beneficiary has both the desire and the skills to become trustee. Properly drafted and administered, a Business Skills Trust (BST) can minimize the risks of family business failure when transitioned to the next generation by reducing the likelihood of disputes and preparing the younger generation to succeed when they ascend to ownership rights in the family business.

The Business Skills Trust: Helping the Younger Generation to Take a Leadership Role in the Family Business

The BST recognizes that there is a minimum requisite knowledge that an "owner" of a business should possess in order to properly evaluate business decisions that arise; because the trust owns the business, the trustee is charged with exercising the rights and responsibilities of an owner and should possess this minimum level of business knowledge. In addition, the trustee of a BST has the responsibility of educating beneficiaries who wish to become trustees. Rather than conditioning access to the trusteeship on, for example, attaining a certain age or graduation from college, each of which has no necessary correlation with the ability to properly exercise the Trustee's powers as an owner of a family business, a BST conditions ascension to the trusteeship with acquiring the requisite knowledge and skills to properly manage the trust's interest in the family business.

Business Skills Curriculum

Using a curriculum we developed in conjunction with the UCLA Anderson School of Management, we work closely with the trust creator — the settlor — to specifically identify the concrete skills that the beneficiary should demonstrate in order to assume the trusteeship. Examples of skills typically identified in a BST include (i) knowledge about the business's organizational structure, including the differences in the roles of owners, board members, officers and managers and key personnel, distinctions in classes of ownership and any rights of minority and non-voting owners; (ii) dividend or distribution policies compared with reinvestment models; (iii) the business's purpose, objectives and strategic plan in the context of its industry, size, geographic location and other marketplace conditions; and (iv) an ability to read and understand the business's financials, including P&L statements, cash flows and assets and liabilities. We refer to this bundle of knowledge as "business skills." While each skill has broad application to any business, as a current owner of the business, the settlor is in a unique position to define the skills in the context of the particular family business.

An additional key consideration in creating a BST is who will assume the trusteeship and exercise rights in the family business while the beneficiary acquires these business skills — is this role entrusted to another family member involved in the business or a non-family member advisor and do the governing documents of the business limit who may exercise such rights? Finally, in any trust arrangement, we believe a key component to minimizing disputes is to educate the beneficiaries and the trustee on the terms of the trust and the roles and responsibilities each plays in carrying out the terms of the trust surprisingly, we have found that many beneficiaries and trustees have never even read their trusts!

Because of the specialized skills, it is desirable for a trustee of a BST to possess, we often provide that non-family business assets are allocated to a separate trust, in which the criteria for trusteeship do not correlate with business skills but could instead correspond with whether the beneficiary who wishes to serve as trustee demonstrates an ability to manage wealth responsibly. In addition, where a trust's ownership interest in a business is a minority interest or a non-voting economic interest, the business skills are adjusted to reflect this difference, recognizing that the trust could subsequently acquire a majority interest or acquire voting interests, making the traditional business skills more desirable.

In utilizing a BST, the next generation of family business owners can be provided the time and curriculum to learn crucial skills for understanding and exercising ownership rights in a family business and reduce the frequency of disputes among co- owners that arises from lack of understanding and which disrupts (and often destroys) the business.

ABOUT THE AUTHORS

Jon J. Gallo has earned a national reputation for developing intergenerational wealth transfer strategies.

He and Stefanie J. Lipson are members of Greenberg Glusker's Private Client Services Group and can be reached at (310) 553-3610.

How to Win a "Bet-the-Company" Lawsuit

By Harvey Friedman, Esq.

Greenberg Glusker Fields Claman & Machtinger, LLP
1900 Avenue of the Stars, 21st Floor
Los Angeles, CA 90067
Tel: 310.553.3610
Fax: 310.553.0687

hfriedman@greenbergglusker.com
www.greenbergglusker.com

A number of years ago, I represented an insurance company which sued a law firm for breach of fiduciary duty. The case was tried by a jury. The defendant was represented by a well-known, highly regarded law firm. I thought that the defendant's lawyers did a professional, competent job at trial. After a short deliberation, the jury came in with a multi-million dollar verdict in favor of my client – despite the fact that it was an insurance company.

I had the opportunity to interview the jurors after the trial. I learned that the jurors had a difficult time relating to the defendant's lawyers. Some of the jurors' statements have greatly influenced the way I have tried bet-the-company cases since then. Those statements include: make the facts easy to understand, tell a story, talk to (not down to) jurors, avoid sarcasm or being overly aggressive, use non-legal terms (greedy instead of egregious, rip-off rather than unconscionable, stole instead of converted, doesn't make common sense instead of illogical, fair instead of equitable), and establish the theme that what your client seeks is fair, right and makes common sense.

In addition to how to communicate to a jury, the following is a list of tools a defendant should employ to enhance its chances of winning a bet-the-company case.

Choose the Best Forum

- First, avoid arbitration if possible. For many reasons, arbitrators often split the baby. Additionally, there are no meaningful rules of evidence, which allows either side to submit evidence whether it's relevant or not, and there is no meaningful right to appeal if you are unsatisfied with the arbitrator's decision.

- Second, if you are a defendant, you should attempt to have the case litigated in federal court, not state court. A unanimous verdict is required in federal court, whereas many state courts, including those in California, require only 9 of 12 juror votes for a verdict. Jurors are generally more conservative in awarding damages in federal court and it is easier to obtain summary judgment, a determination made by the court without a full trial. Lastly, the interest payable on a judgment is much higher in state court (10 percent per year) than in federal court (approximately .13 percent per year).

Be the Plaintiff

Even if you are the party against whom a claim has been asserted, make a peremptory strike; become the plaintiff by being the first party to file the lawsuit. Many jurors believe a plaintiff would not have filed suit unless the plaintiff had suffered damages. Filing suit first may enable you to choose federal court, instead of state court as the forum. Moreover, if the case needs to be filed in state court, you may be able to select the state if you file suit first. In addition, a plaintiff speaks first and last, both in presenting evidence and in the summation. This can be a significant advantage.

How to Handle the Lawsuit

- If you contact most of the known experts on a particular issue, and thereafter choose one, the experts not chosen may disqualify themselves if asked by the other side to provide expert services. As a result, contact witnesses immediately, particularly expert witnesses.
- Attack punitive damages at every stage in the litigation. You don't want a jury to decide the issue. Many judges don't like punitive damages and will grant a motion to strike them from the case.
- The defendant usually has the right to take the plaintiffs deposition first. It is important for a defendant to take the plaintiffs deposition and pin him down before he knows the particulars of the defendant's defenses.
- It is important to make a summary judgment motion because, even if it is denied, it is an excellent discovery tool. A defendant can learn about the evidence and witnesses the plaintiff intends to use at trial from the opposing papers the plaintiff files.

Hire a Good Jury Consultant

Experienced jury trial lawyers believe that 75 percent of the outcome of a jury trial case depends on jury selection and opening statement. Although an experienced trial lawyer can do a good job in picking a jury without the aid of a jury consultant, the use of one can improve the possibilities of a "good" outcome to an "exceptional" outcome.

In addition, two important aspects of a persuasive opening statement are themes a lawyer is going to develop during the trial and "buzzwords"- words that a jury may relate to. A good jury consultant can help develop themes and formulate buzzwords.

Hire the Best Lawyer

There is a tremendous difference between a bench trial and a jury trial. There are many lawyers who do an excellent job trying cases to a judge but do not do well trying cases to a jury. Lawyers who do well trying cases to a jury have exceptional people skills.

The usual procedure is to make a decision on the basis of references and an interview with the lawyer. The references often come from friends or clients of the lawyer and can be unreliable. At the interview, the lawyer typically will toot his horn and tell you about the successes he has had-which are often exaggerated.

The best way to choose between lawyers you are considering is to have your general counsel make contact with judges -sitting and retired- to discuss the trial attorneys you have identified and with lawyers who have opposed the trial attorney you are considering. Judges and opposing counsel have no axe to grind and will provide opinions which are unbiased and more reliable than a lawyer who has tooted his own horn.

It is almost certain that a bet-the-company lawsuit will be tried by a jury. For the best possible outcome, you need to choose a lawyer who knows how to relate to the jurors and can persuade them that your cause is fair, right and makes common sense.

About the Author

Harvey Friedman is a trial lawyer at Greenberg Glusker Fields Claman & Machtinger LLP. He has tried more than 100 cases to conclusion, and for many years has been recognized by Best Lawyers in America in the Bet the Company and Commercial Litigation categories. Reach him at HFriedman@greenbergglusker.com.

Limit Your Company's Legal Risk by Negotiating Form Contracts

By Lee Dresie, Esq.

Greenberg Glusker Fields Claman & Machtinger, LLP
1900 Avenue of the Stars, 21st Floor
Los Angeles, CA 90067
Tel: 310. 556.3610
Fax: 310.553.0687

ldresie@greenbergglusker.com
www.greenbergglusker.com

Form contracts account for more than 80 percent of all agreements used to complete business transactions today. That percentage maybe even higher when it comes to commercial real estate transactions like the ones companies sign to acquire a corporate headquarters or satellite offices.

Unfortunately, many executives do not carefully review the specifics of a form contract before signing. Instead, they assume the form contract will be equitable to both parties. However, unless the form is an industry-neutral form such as one from the AIR Commercial Real Estate Association or Commercial Association of Realtors, terms in a standard form contract are generally designed to favor the party that presents it.

To limit a company's risk, it is vitally important to be able to recognize and negotiate unfavorable provisions out of form contracts. This may necessitate a call to in-house or outside counsel with expertise in the area.

By negotiating the form contract presented to him, a savvy building owner in Los Angeles was able to collect 15 years of rent from an outdoor sign company even though the law prevented the sign company from ever constructing a sign on the building.

The building owner had been approached by a well-known outdoor sign company about leasing the roof of his building for a large billboard. After reaching an agreement on the rent amount and term of the lease, which totaled $750,000 over 15 years, the sign company presented the building owner with its "standard" form lease. The form lease provided that if the sign company could not obtain a building permit to erect the billboard, or if applicable building codes changed, the sign company could terminate the lease with no penalty of payment. The form lease thus placed all risk on the building owner.

The sign company was an expert in the field and familiar with the building permit process. The sign company was aware of a movement by the

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Limit Your Company's Legal Risk by Negotiating Form Contracts

Los Angeles City Council to ban all new signs. Since the possible ban did not affect existing signs, the sign company wanted to get this deal done quickly so it could construct the billboard before any ban occurred. Once the ban went into effect, existing signs would become that much more valuable.

The building owner did not immediately agree to the sign company's form lease. Instead, the building owner (through his attorney) requested a different provision stating that the sign company had done all necessary investigation concerning city regulations and the availability of building permits. Because the sign company was anxious to acquire this site and complete construction of the billboard, the sign company agreed to replace its form provision with the building owner's provision.

Immediately after the parties signed the lease, the sign company's engineer re-measured the distance from the proposed sign location to the nearest competing sign. The sign company's preliminary measurements had been inaccurate. The sign company learned, after signing the lease, that the proposed sign location in the lease violated city codes providing minimum distances between billboard signs. The sign company therefore informed the building owner that the lease was terminated because the sign company could not construct its sign.
Believing that the sign company assumed the risk of any inability to construct its sign, the building owner filed suit in order to enforce the lease. The sign company vigorously protested, asserting that no court would require it to pay 15 years of rent for a location on which it could not construct a sign.

At trial, I argued (1) the sign company had knowingly assumed a foreseeable risk, and (2) the parties had re-allocated this risk to the sign company and away from the building owner.
The trial judge agreed with my position and ruled in favor of the building owner. The owner then recovered $750,000 for the entire 15-year term, despite the fact that no sign could ever be constructed. Additionally, the court awarded the building owner the attorney fees incurred enforcing the lease.

This example highlights the importance of carefully negotiating all contracts, especially those presented as the other party's "form contract." Such form contracts extend beyond real estate transactions, and could include executive employment contracts, lending transactions, and confidentiality or non-disclosure agreements.

You can be sure that the other party in a transaction will take the time and make the effort to carefully construct each provision in such an agreement to shift as much risk away from him or herself as possible. Unless you are willing to assume all of that risk, you should spend the same time and make the same effort to re-allocate the risk back to the other side.

Lee Dresie is a partner specializing in real estate litigation with the Los Angeles based firm of Greenberg Glusker Fields Claman & Machtinger, LLP. He can be reached at (310) 201-7466 or at LDresie@greenbergglusker.com.

Common Mistakes Made by Small Business Owners

By Eric Cruz, Esq.

Bivins & Hemenway, P. A.
1060 Bloomingdale Avenue
Valrico, FL 33596
Tel: 813.643.4900
Fax: 813.643.4904

ecruz@bhpalaw.com
www.bhpalaw.com

From the time they formulate their first business idea, and often all the way through dissolution, small business owners throughout the United States often find themselves in situations that they are not familiar or comfortable with. Specifically, throughout the life of their businesses, business owners are faced with a number of situations in which their knowledge of the rules, laws, and regulations affecting their day-to-day business operations and decisions is put to the test. The prudent small business owner seeks legal advice when such situations arise, in order to avoid putting their corporate liability protection at risk. Loss of corporate liability protection can result from a business owner's failure to follow what are often simple rules and corporate formalities. However, whether it is because of a lack of funds, time-constraint issues, or a misplaced I-can-do-it-myself attitude, many small business owners fail to seek the advice and answers they need, thus opening themselves up to potential personal liability and the piercing of the corporate veil.

This article focuses on common mistakes made by small business owners that are often caused by their failure to understand the legal rules and formalities affecting their business and legal entity of choosing, and is based on first-hand observations made by a business law attorney. When representing or doing business with small businesses, caution is recommended and advised in ensuring that both the owners and the officers or managers of such business entities are not making these simple mistakes that can result in much larger issues down the line.

I. Not forming a separate legal entity

One of the most common mistakes made by small business owners is not forming a separate legal entity at all, and operating as a sole proprietor. Many sole proprietors fail to understand that there is no legal distinction between them and the business – and that they have unlimited personal liability for all business

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debts and losses. This is especially concerning for businesses in which the owner can be exposed to a high level of liability, especially in those where the personal injury of another person may occur.

A number of sole proprietors legally file for and obtain a fictitious name to operate under, and then open bank accounts under their fictitious name. This may create a false sense of protection because business debts are being paid from the business account; however, the business owner may not understand their personal responsibility for business debts and liabilities, and the fact that they may have to be paid from the personal accounts and assets of the owner.

II. Not understanding the separation between a legal entity and the individual person – "I incorporated myself"

Many small business owners take the first step – after coming up with their business idea, they form a corporation, limited liability company, or other business entity existing within the laws of their state, which they are then able to operate under. But many business owners stop at this first step and do not understand the concept of their corporation or company existing as a separate legal entity or "person" that exists on its own, with its own assets, debts, and ability to enter into contracts, and sue and be sued, among other things. Such misunderstanding can result in the small business owner's failure to put into effect one of the key advantages they sought out by forming the business entity – corporate protection from personal liability for business debts and liabilities.

A phrase commonly heard from such a business owner is "I incorporated myself" - often uttered when the business owner is telling the tale of their business formation and the reasons why they decided to legally incorporate their business. Frequently, the business owner who uses this phrase has also formed a corporation named after their own name (i.e., "John Doe, Inc."), which doesn't own any actual assets or bank accounts, but at the same time incurs debt and opens itself up to liability. This typically occurs because the business owner in this situation attempts to create what they believe to be a "legal shield" from personal liability by "incorporating themselves," with an incorrect belief that all debts and liabilities incurred under the corporate name cannot become their personal responsibility for any reason. On the other hand, often they may deposit business revenues in the owner's personal bank account, and pay personal expenses from the business funds and bank accounts as well. Such intermingling of funds and assets of the business entity with those of the owner, and treatment of corporate assets as the business owner's own, while at the same time failing to keep corporate records and maintain corporate formalities (as discussed in more detail below), can lead to piercing of the corporate veil and potential loss of corporate liability protection, resulting in personal liability for the business owner.

III. Failure to organize and maintain corporate formalities

After legally forming a new business entity by filing their articles of incorporation or articles of organization with the respective and appropriate department in their state, many small business owners believe that they have completed all the steps necessary to operate under their new business entity, and completely ignore many corporate formalities required by statute or other applicable law. Many owners fail to realize that they have yet to name any officers, directors, or managers to manage the day-to-day operations of their new business entity, and sometimes that they have even failed to issue any actual shares or membership interests to themselves and other owners of their business entity. Therefore, such business owners have no evidence of ownership of their entity, and are thrown into panic when asked for the same by a potential lender, insurance agent, or other party doing business with the business owner. Moreover, by failing to name officers or managers, business owners fail to provide for any person with authority to act or make decisions on behalf of the business entity. This can cause issues when the company enters into a contract it is later trying to enforce.

In addition, there are a plethora of additional corporate formalities that often remain ignored by business owners, including, but not limited to: (a) adopting bylaws or an operating agreement setting forth, among other things, rules and guidelines for the operations of the entity, and the authority of officers or managers to act on behalf of the entity; (b) making sure officers and managers are abiding by such by-laws or the operating agreement; (c) holding annual meetings of directors and shareholders or members and recording the decisions made during such meetings (or preparing a written consent in lieu of the same, as authorized by local law); (d) keeping minutes of important decisions made during annual or special meetings of the shareholders and directors or members (or preparing a written consent in lieu of the same, as authorized by local law); (e) preparing and updating a readily-available corporate book with accurate, detailed minutes and other records of the business entity, including evidence of shares or membership interests issued and/or transferred, as well as records of other major actions taken and completed by the business entity (such as shareholder dividends and distributions, issuance of stock, recapitalization, etc.), whether evidenced through meeting minutes or by written consent.

A systematic failure to abide by the corporate formalities referenced above is one of the factors a court may consider when deciding whether or not a creditor may pierce the corporate veil and hold shareholders or members personally liable for business debts entered into by the company. Small business entities are especially vulnerable because the failure to meet such basic corporate formalities gives the appearance of the corporation simply being an "alter ego" of its owner created only to avoid the claims of potential creditors.

IV. Failure to file annual report

Most states require business owners to file annual reports with their respective department of corporations setting forth a summary of information regarding the current status of the business entity. This information often includes the mailing and principal business address of the business entity, the name and address of its resident agent within the entity's home state, and sometimes, a list of its officer, managers, and/or directors. An annual report also informs the state that the entity is still operating and in business. Entities registered to do business in other states as foreign corporations or companies may also have to file an annual report in such states to comply with foreign entity registration requirements.

After filing their initial articles of incorporation or organization, many business owners forget to file the required annual report in future years. Special attention must be given to each state's specific annual report requirements, as each state has different, and often very specific, requirements. For instance, some states only require a report to be filed every other year, many have different deadlines and due dates, and the information required to be provided may vary depending on the state. As some business owners may own separate business entities which have incorporated in different states, they can also fail to correctly or timely file their annual report in one of the states because they assume the rules are parallel throughout the entire United States.

Failure to timely and/or correctly file an annual report can lead to harsh penalties against the business entity. Typically, a late fee will be applied towards a late filing (in addition to the original filing fee), and in some states the business entity can be administratively suspended or dissolved by state. Such dissolution may result in the personal liability of officers or managers purporting to act on behalf of the business entity after its dissolution. In addition, reinstatement fees may apply if the business wants to be reinstated and regain good standing with the state.

V. Erroneously signing contracts on behalf of the business entity

The first common mistake made by business owners when entering into business contracts is incorrectly identifying the contracting party. Many small business owners fail to understand the importance of clearly identifying their business entity as the party to all business contracts entered into on behalf of the entity. Otherwise, such contracts may have the appearance of being personal, rather than business, contracts. Business owners sometimes fill in an abbreviated or incomplete name for their entity in the opening of the contract, or even worse, fill in their own personal name as the contracting party.

More commonly, even when correctly naming their company as the party to the contract in the opening section, many business owners will sign just their name with no designation of their title or capacity for the company at the end of the contract. This can create an issue as it becomes unclear whether the business owner signed the contract on behalf of the entity, individually (as a direct party), or perhaps guaranteeing the obligations of the business entity. The issues compound if at the same time the parties were also not clearly identified at the opening, or if the contract refers to "the undersigned," because then it could appear as if the individual business owner entered into the contract, rather than the entity, and then, in the event of a default under the contract, the business owner would lose his or her corporate liability protection and be subject to personal liability. The name and signature of the small business owner should always be accompanied by the title of the signatory and the name of the company in order to avoid personal liability.

This mistake may often occur in conjunction with another common mistake made by small business owners – when the business owner obtains a fictitious name registration for his or her business entity or operation, but lists him or herself as the owner of the fictitious name, resulting in the fictitious name simply becoming an alias for the owner, individually. This essentially creates a sole proprietorship, which should be avoided in most situations, as explained above. If the business owner enters into any contracts under the fictitious name owned individually, he or she has then entered into each contract personally and individually, without any corporate liability protection.

VI. Fail to plan for company succession

When starting a new business, the last thing a new business owner wants to think about is his or her death or disability, a dispute with a business partner or co-owner, their exit from the business, or other kinds of separation from or the transfer of their business, both voluntary (sale of ownership interest, resignation) and involuntary (judgments, bankruptcy, divorce). These are all common occurrences of events that can cause sudden changes to the ownership structure of a small business which can send it into a whirlwind when a person with no knowledge of the business suddenly finds him or herself in control because of one of the occurrences mentioned above.

Entities without bylaws, operating agreements, or separate shareholder agreements often don't have a structure in place for dealing with such unplanned or unexpected succession and changes of the ownership of the business, such as stock/membership unit transfer restrictions, rights of first refusal, and/or required approval of new members or shareholders. This is especially important when the business entity is owned by more than one person. In a classic example, when a business owner dies, his or her ownership stake in the business would likely be inherited by their spouse. If the deceased owner has not properly disposed of his ownership interest in the business under his will and/or made no separate agreement with the company as to what would happen with his shares after death, a spouse can immediately step into an ownership and management position within a business, but often the spouse lacks the knowledge, experience, and skills to run the business. Sooner than later, many businesses in this situation fail and are forced to dissolve.

Small business owners need to think through these potential change of ownership events and come up with a plan for the succession of the business should they face them in the future. Some of these situations, such as death, are a certainty. Corporate documents should be amended as necessary, or additional shareholder/buy-sell agreements entered into, to make sure it is clear what processes the remaining owners of the business entity must follow when such situations arise.

VII. Failure to properly dissolve

Last, but certainly not least, when a business has run its course and the business owner makes the decision to formally dissolve it, the owner then simply stops filing annual reports with the division of corporations (or other state specific equivalent) and just allows the business entity to be automatically and administratively dissolved. As previously mentioned, when an entity is administratively dissolved for this reason, there is potential for continuing liability - shareholders, officers, directors, and managers may bear personal liability for acts they take on behalf of the corporation while they know the corporation to be administratively dissolved.

Business owners should pay attention to the dissolution provisions provided by law of their state and also within their corporate documents (such as bylaws or operating agreements) in order to avoid losing their corporate liability protection. If proper procedures are met, and the entity is then formally and legally dissolved according to such procedures, the owners may then avoid potential personal liability for claims against the entity that are not able to be paid from the remaining assets of the business entity at the time of dissolution. Such procedures and requirements often include guidelines regarding the kind of notice that must be given to creditors to let them know of the company's dissolution and whether or not assets are available for distribution as payment for claims. Therefore, dissolution procedures typically create an opportunity (and sometimes mandatory requirements) for dealing with the remaining creditors of the business entity at the time of its dissolution.

While this brief summary lists some of the most commonly encountered mistakes made by small business owners, it is in no way a comprehensive list of all the potential mishaps, actions, or omissions that could lead to a small business owner's exposure to personal liability and other business-related issues. When presented with one or more of these mistakes, it is important to understand how the local, applicable laws of the jurisdiction where the business entity was incorporated affect the situation, and what the result and consequences of the same might be, so that the small business owner can understand their current position and what they can do to potentially resolve them. Most importantly, however, is to be vigilant and help small business owners avoid these mistakes before they make them.

Eric A. Cruz is an associate attorney with Bivins & Hemenway, P.A., a full service commercial and real estate law firm located in Valrico, Florida. Eric's practice focuses on business law, real estate transactions, and estate planning.

Technology in the Debt Collection Industry. . . A Dangerous New Frontier?

By Jason G. Wehrle, Esq.

Grogan Graffam, P.C.
Four Gateway Center, 12th Floor
Pittsburgh, PA 15222
Tel: 412.553.6300
Fax: 412.642.2601

jwehrle@grogangraffam.com
www.grogangraffam.com

With the almost daily advent of new technologies in the way people communicate, it has never been easier to contact consumers or obtain personal information for social or business purposes. This ease of access has created a whole new horizon for companies in the debt collection and data collection industries. In addition to traditional mail and landline telephone contact, debt collectors are now able to contact debtors through email, text messaging, websites, and the messaging services available on websites such as Facebook, Twitter, Google+ and Linkedin.

When the Fair Debt Collection Practices Act (15 U.S.C. §1692 et seq. ("FDCPA")) was written in 1977, email, social networks and text messaging were the dreams of science fiction writers. With these new technologies, debt collectors and data collectors have begun to utilize alternative means of communication to contact debtors and to obtain personal financial information in an effort to collect debt more efficiently.

The use of these new technologies by the debt collection industry will likely lead to increased enforcement of the FDCPA because,unlike telephone conversations which are inconvenient or in some states illegal for the consumer to record, newer technologies create a record of communication between the debtor and collector.

While the FDCPA has not kept up with the times by specifically addressing the proper use of these advances, federal regulators and the court system have.

In 2010 the Dodd-Frank Act provided the Consumer Financial Protection Bureau ("CFPB ") with broad new powers to supervise debt collectors, and, if necessary, take enforcement action for violations of the FDCPA and other consumer protection statutes. The CFPB shares jurisdiction over the FDCPA with the Federal Trade Commission. ("FTC"). The CFPB has begun accepting complaints from consumers and continues to codify the rules and regulations applicable to the debt collection industry.

The FTC has stated that even though the FDCPA is somewhat antiquated, it is written in such a way that it governs debt collection practices regardless of medium. Therefore, barring future amendment of the Act, it remains the rule book for the collection industry governing all forms of communication and data collection.

This article will examine some of the new technologies available to the debt collection industry and will also discuss the hazards associated with their use.

Social Networking Websites

Social Networking sites like Facebook, Google+, Twitter and Linkedln provide creditors and collectors with the opportunity to obtain a wealth of information regarding debtors that might not normally be available through traditional directory and skip-tracing methods. Not only can information regarding a debtor's location be obtained, often consumers openly provide information relating to their finances on their personal profiles or status updates. For example, a debtor is much more likely to show off their new car or vacation on these sites, which indicates an ability to pay.

With this wealth of new information comes risk management and liability concerns for the collection industry. In the context of Facebook, the FTC has provided guidance as to how social networking contacts may violate the FDCPA. If a debt collector sends a "friend request" on Facebook to a debtor or a "friend" of a debtor, the FTC requires the debt collector at the same time to provide the "mini-Miranda" warning that the message is from a debt collector and that the purpose of the request is to obtain information to be utilized in the collection of a debt. Although the FTC did not specifically mention other social networking sites, it should be assumed that similar requirements will apply.

Even though the playing field may be ever evolving, the following are basic tenets that should always be followed by collectors when utilizing social media:

- Do not communicate with debtors through social media under false pretenses. 15 U.S.C. §l692(e).
- Do not use social media to harass, threaten or shame debtors, i.e. debt collectors cannot post on a debtor's wall that they owe a debt because this embarrasses and shames the debtor, which violates the FDCPA. 15 U.S.C. §1692(d).
- Do not mislead a debtor as to the source of the contact, i.e. the collector cannot use a false screen name to solicit a friend request, then inform the debtor that he or she is a debt collector after the request is accepted. 15 U.S.C. §1692(o).
- Do not publish a list of the names of debtors, other than providing the names to credit reporting companies. 15 U.S.C. §1692(d).
- Do not disclose the existence of the debt or the fact that collection activities have begun to any third-parties. This is especially problematic when considering postings on social media websites, which depending upon the debtor's privacy settings, may be viewed by hundreds of people. 15 U.S.C. §1692(c).

The court system has not been as responsive to the use of social networking websites as federal regulators have, but we are beginning to see lawsuits arising out of the use of social media to Collect debt. For example, on March 9, 2011, a Florida judge in the case of *Beachum v. MarkOne*

Financial, LLC, No. 10-12883CI-15 (Fla. Pinellas County August 26, 2010), ordered the debt collection agency to stop using Facebook, or any other social media site, in its attempts to contact a woman over an unpaid car loan. The court also ordered the debt collector not to contact the debtor's friends and family on Facebook. MarkOne had a corporate policy to use Facebook to not only contact the debtor, but to also contact her friends and family regarding the debt. MarkOne Financial unsuccessfully argued that it used social media to contact the debtor when the debtor did not respond to its other attempts to collect the debt through other mediums. This was the first ruling in the country banning a debt collector from using social media.

With all of the above warnings in mind, debt collectors are still able to utilize social media to their advantage for the limited purpose of obtaining information regarding a debtor. See, 15 U.S.C. §1692(b). What a debtor posts for public consumption is fair game for the collection industry. As long as the debt collector does not attempt to contact the debtor using false pretenses, the simple act of collecting public information posted by a debtor is unlikely to be actionable.

Electronic Mail

Although it is not a new technology, the use of electronic mail to contact debtors is gaining ground within the industry. The main reason for this increase in use by debt collectors is that email is still the preferred method of communication by most consumers.

The use of electronic mail by debt collectors is not a foolproof method. Among problems associated with this form of debt collection are:

- There is no way of verifying a debtor's identity when responding to an email.

- There is often no expectation of privacy when using email. This is especially true if a collector sends an email to a debtor's work email address, which may be monitored by the employer.

- There is a risk of unlawful third-party communications.

To limit the potential for violations of the FDCPA, some collection firms use a private email server where the debtor has to confirm his or her identity and give consent to communicate through this medium. Again, this is not a foolproof measure, but it may limit the collector's potential liability, because the debtor is identifying his or herself and consenting to the communication. Of course, the debt collector must also provide the FDCPA mandated "mini- Miranda" warning in its initial electronic message to comply with FDCPA requirements.

Prior to contacting a consumer via e-mail, a debt collector should consider adopting policies and procedures that ensure the use of e-mail is proper and authorized, which may minimize potential violations. To aid in such policies and procedures, a debt collector should take into account the following three factors: (1) an e-mail should be considered as a "writing"; (2) an e-mail should benefit from the "Mailbox Rule"; and (3) an e-mail should comply with the E-Sign Act.

Cell Phones

The prevalence of cell phones has also prompted action from the debt collection industry. Many consumers no longer maintain a landline in their homes, instead utilizing their cell phone for all telephone communication. Therefore, the only way to speak with these consumers is to contact them on their cellular telephones.

Contacting debtors on cell phones can become a complicated exercise for debt collectors trying to avoid running afoul of the FDCPA. For example:

- There is a higher possibility of violating the FDCPA's prohibition on phone calls at inconvenient times. Since consumers are able to take their phone with them on vacations and business trips, there is always the risk that what may appear to be a safe time to call the debtor becomes unreasonable when they are in a different time zone. 15 U.S.C. §1692(c).

- There is a higher possibility of violating the FDCPA's third-party communication provision. Since many consumers lend their phones to friends and family members, there is the risk of unintended third party disclosure of the voicemail message. 15 U.S.C. §1692(c).

- There is a higher possibility of violating the FDCPA's prohibition against causing a debtor to incur additional charges. See, 15 U.S.C. §1692(f). Some cellular plans charge per call or by minutes used, thereby causing the debtor to incur an additional fee for the debt collector's call, which is prohibited by the FDCPA.

In order to minimize the risk of a violation of the FDCPA, debt collectors must provide meaningful disclosure of their identities, as well as the true purpose of the communication when speaking to the debtor. Furthermore, since the use of a cellular phone often carries a per minute usage charge, it is advisable for a debt collector to obtain prior permission from the consumer before calling the consumer's cell phone.

Text Messaging

As discussed above, in today's world, people are becoming more and more dependent upon their cellular telephones, and not surprisingly, the use of text messaging by consumers has grown exponentially. The debt collection industry has taken notice of this trend.

Many of the same concerns mentioned with regard to making telephone calls to cell phones also apply to text messaging. The risk of third party disclosure is likely the most significant liability issue facing a collector that utilizes text messaging. With many businesses providing cell phones to their employees, there is a risk that the employer may monitor incoming messages. Also, people lend their cell phones to friends and family, thereby creating the chance of a text message popping up on the consumer's phone while in the possession of a third party. The safest way for a collector to reduce its risk of liability is to obtain express prior consent from the debtor.

An equally important concern when using text messaging is that the FDCPA mandated mini-Miranda warning must be included in any message to a debtor. Since most text messages have a limit to the amount of characters that any message may contain, it may be challenging to provide the required disclosures in a text message.

Finally, as with calls to cell phones, consumers may incur a fee for receiving the message. This may lead to a claim for a violation of the FDCPA. See, 15 U.S.C. §1692(f). One way for the debt collector to minimize this risk is to use "Free to End User" services. This service allows the collector to incur the charge for the text instead of the debtor.

Websites

Some debt collectors have created websites for debt collection purposes, the idea being that the debtor may be more inclined to pay the debt online instead of remitting a check or paying over the phone. For collectors utilizing websites to further their collection activities, extra precautions must be taken to insure compliance with FDCPA requirements. The courts have consistently concluded that a debt collector's website is nothing more than an extension of a collection notice sent to a debtor. Therefore, every piece of content on the website must meet the standards set by the FDCPA. Collectors must take every precaution to ensure that there is no false or misleading information on the website.

There are also state requirements that may be impacted by the use of websites for debt collection. Several states have licensing requirements for debt collectors seeking to solicit business within the state. For these states, communications with debtors through the website may expose the collector to licensing liability from the state. The prudent debt collector should make sure that it is properly licensed in any state within which it seeks to operate before it launches a debt collection website.

Conclusion

Although new technology makes it easier than ever to connect with people, it has also created a minefield of potential problems for the debt collector who wants to make use of these new ways to communicate, obtain information, and collect debts. The prudent collector should take the time to craft clear policies and procedures for the use of technology by their employees to insure that all applicable FDCPA guidelines are followed. In time it is hoped that the FDCPA will be amended in a way that will further clarify how debt collectors may operate in the virtual world. Until then, collectors are cautioned to utilize technology ethically and reasonably in their efforts to conduct business profitably.

This information is not to be construed as legal advice. Legal advice must be tailored to the specific circumstances of each case. Every effort has been made to ensure that this information is up-to-date as of the date of publication. It is not intended to be a full and exhaustive explanation of the law in any area. This information is not intended as legal advice and may not be used as legal advice. It should not be used to replace the advice of your own legal counsel.

Distribution Contracts
Formulating and Terminating the Agreement

By Stephen T. Sigler, Esq.

Neil, Dymott, Frank, McFall & Trexler APLC
1010 Second Avenue, Suite 2500
San Diego, CA 92101
Tel: 619.238.1712
Fax: 619.238.1562

ssigler@neildymott.com
www.neildymott.com

Too often the quality of a contract is defined by the problems that later arise as a result of poor drafting. Even the best laid plans, contractually, can devolve into a morass of litigation when unforeseen issues arise or relationships breakdown. The formation of distribution contracts requires not only foresight and experience with possible problems, but needs a healthy relationship between the parent or supplier and distributor. Legal guidance can help the parties avoid these pitfalls. Developing a framework for addressing common contractual issues specific to distribution contracts is both possible and necessary.

The Distribution Contract

A distribution contract is contractual arrangement wherein a manufacturer or supplier permits an outside party to sell/distribute their products to consumers within a specific geographic area. We see the results of distribution contracts on a daily basis with brand-name products being sold in any number of locations despite the manufacturer or supplier maintaining a small centralized operation. The distributed products can range from high-tech electronics to high fashion merchandise to simple home goods. The actual distribution contract serves as the "behind the scenes" agreement between the supplier and the distributor who then contract with retail establishments or organizations who deal with the public at large. The distribution contract is generally defined by the overall supply agreement and timeframes, wherein the actual terms of the distribution arrangement and exclusivity or non-exclusivity are built into the contract.

The foundation for a healthy contractual relationship often mirrors the relationship between the individuals controlling the contracting parties. The nature of relations can become very strained if the distribution contract does not go as planned. Unfortunately, many of the aspects requiring the most scrutiny prior to establishing a distribution agreement are those which can only be properly assessed by the parties as they pertain to industry standards, projected sales and the ability to meet sales goals. An experienced attorney acting as an advisor and counselor can provide some support, but areas of business expertise require direct attention and feedback from the players.

Identifying Basic Concerns for the Supplier And Distributor

When a supplier or distributor seeks legal advice about the formation of a new distribution agreement, initial considerations focus on client specific issues. Will a general boilerplate contract suffice or does the client want/need a specially drafted contract tailor-made to their industry or business relationship? When considering a distribution agreement, the parties need to have done their homework. Is this a situation where the other side has shown an ability to play well with others? Has an attorney asked to step in to draft the contract? Do you know if either side has an established history/reputation with regard to their prior distributors or prior distribution contracts? You may have the best product in the world, but if the supplier's history is one of scorched earth litigation at the conclusion of each distribution contract you might want to pass on the distribution. Is the supplier willing to share some 'control' with the distributor or will this be "their way or the highway".

Specific issues that must be included in the contract include the term of the agreement, the required performance, exclusivity or non-exclusivity, defining the territorial restrictions, establishing transfer of materials and specific definition of the conditions relating to sales. Additionally, these contracts should contain specific terms for allowable or required marketing and advertising, required reporting of activities and sales, consideration of what is considered competition regardless of the exclusivity decisions, concerns about trade marks and intellectual property concerns and the classic choice of law provisions for both interpretation and application of the contract. Remember these contracts are designed to be mutually beneficial for both parties, so be sure to ensure considerations and obligations are shared between the parties. Avoid situations where one party maintains total control over the other – too much control can color the relationship. Finally, there needs to be specific clauses regarding the grounds for termination, the impact as to existing orders and return of merchandise, customers, contacts as well as numerous catch-all contractual terms for contingencies (integration, *force majeure*, waivers, surviving obligations, antitrust considerations and others).

For the distributor, does your client want exclusivity and have they considered whether this will impact other potential lines or products they sell? Distributors need to lockdown sales terms and terms regarding the procurement of the product line. Also, distributors need to know the level of support they can expect to receive in areas like advertising and how quantity and pricing match reasonable expectations in the new market. Finally, additional concerns related to the effect of restrictions with the contract and whether they trigger problems with foreign jurisdictional provisions against vertical restraints or passive sales bans.[1]

For the supplier, have your client consider how strict they want the distributor's reporting requirements to be in order to maintain the pulse of the distribution arrangement without crowding the distributor. Oftentimes the supplier wants to establish a structure that ensures sufficient

[1] See the Consolidated Version of the Treaty on the Functioning of the European Union, Mar. 30, 2010, 2010 O.J. (C 83) 47, and Commission Regulation (EU) No. 330/2010 of April 20, 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, 2010, OJEU L 102/1 or the similar Chinese competition law, Anti-Monopoly Law (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 30, 2007, effective Aug. 1, 2008), art. 1 (China).

performance and grants them the right to end the relationship. Additional contractual considerations a supplier or supplier's counsel should consider include:

- how will the payment process work?
- what set of rules will be applied to establish when the legal responsibility for goods shifts from the supplier to the distributor?
- what happens with regard to the expanded customer base or goods should the contract be terminated?

Specific supplier expectations regarding promotion, advertising or intellectual property should also be defined.

Termination Concerns

In cases of termination or expiration of the distribution contract, the provisions set up at formation become the primary focus. Is the termination process spelled out, does it avoid any legal entanglements regarding anti-trust litigation? These issues can be handled well in advance -provided of course, they are discussed at the outset of the business relationship.

A common area of concern at termination is the status of the expanded customer base or client lists and how such information is handled when no specific clauses govern the issue. Clearly, both sides have vested interests in maintaining control or financial relationships with the end-of-distribution chain entities. The supplier wants to maintain the expanded market obtained through the distribution contract and distributors often want to limit supplier use of customer information. It is important to account for what each party learns by reason of its relationship with the other.

When such issues are left to chance, the question can hinge on the discretionary power attributed to a specific party within the contract. In California controlled contracts, arguments can be made by both sides about such data based upon rights spelled out or conferred under the initial contract or through California's implied covenant of good faith and fair dealing. Attempting to make these determinations at the conclusion of the contractual relationship is both costly and frustrating.

It is not unusual to want to seek compensation for such information under a termination arrangement. This can be accounted for in a carefully drafted liquidated damages clause, which is allowed under California law - provided the clauses can show a reasonable estimate for the valuation of the information. (Cal. Civ. Code § 1671(b).) Clearly, the need for carefully developed clauses and the foresight to consider how they will play out with such valued information as client lists is imperative to the success of the contract and distribution relationship.

As you can see, there are a lot of factors to consider when crafting a well-tailored distribution contract. You must consider and deal with a multitude of facts, contingencies, regulations, statutes, business practices, and many times the parties' egos. More times than not, provisions initially considered to be minor or axiomatic become huge problems down the road. This can be avoided with transparency and planning in the initial stage of contract negotiations. As an attorney you must take the time to work closely with your client to ensure their needs are met, but their backs are covered as well. In doing so you will curry favor with your client and allow them to get back to what they do best without worrying if they made a "bad deal".

Stephen T. Sigler is a shareholder and trial lawyer at Neil Dymott. He specializes in civil litigation with emphasis in general and professional liability. Mr. Sigler may be reached at (619)238-1712 or ssigler@neildymott.com.

The Real Estate Sector in Colombia

By Santiago Concha, Esq.

Pinilla Gonzalez & Prieto Abogados
Av calle 72 no - 6-30 piso 14
Bogota, Colombia
Tel. +57 1 210 10 00

sconcha@pgplegal.com
www.pgplegal.com

Colombia is a democratic Nation that bases its real estate sector activity under the principle of respect for property rights and justly acquired rights, which are limited in accordance with the Constitution and the law, only by the so-called social and ecological purpose of Property and the prevalence of the general interest or the common good.

This statement is particularly important since Colombian legislative development for real estate, has had enormous development from the Constitution of 1991, giving birth during the 90s and the beginning of this century to revolutionary real estate rules.

In implementation of this legal premise, Colombia has developed local powers and responsibilities to regulate land use and its development, under the premise of political centralization and administrative decentralization. In this sense, the Nation, through the Congress, has the authority to issue general laws for the management and use of land, for the rights and environmental obligations, the organization of cities, the legal conditions of rural development, as well as the rules on administrative procedures for licensing and sanctions, legal proceedings, land taxes and duties, etc.

The national government has the legislative authority to regulate of the law, especially for this sector, developing all necessary rules to establish policies on the management of the Territory, sustainable development, natural resource utilization, rules on supply and demand for housing and other destinations, distributions of burdens and benefits for development, land appraisals, etc.

And municipalities have the legislative authority to issue regulations within their territories of the special rules on land use and development through the Land Management Plans (POT, from its acronym in Spanish) and rules that develop and complement it, as well as

the ability to establish municipal taxes for uses and land use, all in accordance with the law. Additionally, municipalities have the authority through its agencies to issue zoning permits.
Another fundamental player in the sector due to its regulatory delegations is the environmental authorities with specific responsibilities divided between the Ministry of Environment, the Regional Autonomous Agencies, Metropolitan Areas and the municipalities themselves.
Based on the above, it is possible to note that Colombia has developed a wide series of regulations for real estate which is now-a-days the basis of legal certainty, which allows a sufficient level of information for making investment decisions in this field.

Under these conditions, whatever the direction of a real estate investor, particularly for one who purchases land with any soil use for general real estate investment, or one who acquires land for enabling it for urban use, or that investing in rural development land, or the one who intends to acquire urban land for urban development or purely architectural, or simply the investor of institutional or social activities that must acquire property for its purpose, they all find sufficient regulations that may apply to the good and sought to establish the legal conditions, in order to decide on investment.

But due to the amount of relevant legislation, that of course also requires close due diligence for the investment decision and therefore the investor should be highly careful in the analysis of all levels of regulation, which involves a complex and specialized work requiring the participation various specialties of law, in such a way, for example, that property taxes studies should include analysis of the transfer titles of the land, not only on limitations and encumbrances registered in the public registry, but the status of the piece of real estate from its origins, in order to have legal certainty about its private property status. Another example of the close scrutiny is that it should contain studies on the actual existence of the area and boundaries, terrain adjacent and related, but not only physically in the field but through research before to the competent authorities, as well as research on soil environmental conditions, existence of environmental liabilities or penalties for these causes; verification of environmental licenses required for the performance of an activity in the soil, review of rules on land use and development together with the complementary technical and legal assessment of the conditions for enabling urban soil use; study of the conditions necessary for obtaining planning and zoning permits, assessment of agricultural and environmental legal possibility of rural development or rural ownership restrictions, etc.

Moreover, it should be noted that there may be contradictions in the different fields, ie., environmental vs. zoning and therefore collision of competencies between different governmental authorities, representing legal and technical challenges on these properties and the required expertise for predicting the risks and legal means of conflict settlement, in order to achieve adequately and safely over time the development of the investment.

Finally, on this regulatory topic, it is important to note that especially at the Municipal level, there are frequent changes, which require extreme care in handling administrative legal terms to translate regulatory expectations into acquired rights, so that due diligence cannot finish with the aforementioned analysis before the investment decision, but the monitoring of activities necessary to strengthen the rights of the investor on the property to avoid the change of laws risk.

In economic terms, Colombia is going through a great investment moment and particularly in real estate development, and in this sense it is possible to call it <u>the country and the sector of opportunities.</u>

The Real Estate Sector in Colombia

The sector is so important that the National Government, has placed special focus on real estate as one of the pillars for growth ("locomotive of the economy"), with the impact on proactive government decisions, such as issuing rules that allow investors certainty over acquired rights as per granted licenses and permits, subsidies to promote housing demand for the less favored, important investments in the sector of water and sanitation, significant investments in subsidies for the development of social housing projects; rules allowing quick and efficient management of soil uses to enable supply of housing and other uses; taxation rules that allow efficient property investment, investment benefits for technical agricultural development, etc.

On a final note, we have perceived that most authorities appreciate the need to generate high quality cities in Colombia and this means, to apply all the methodologies necessary to provide quality spaces, with good roads, adequate public space, massive transportation systems and adequate institutional uses.

No doubt Colombia is the land of opportunity to invest in all these developments for which we are politically, legally and culturally ready.

Document prepared by Santiago Concha (sconcha@pgplegal.com), partner at Pinilla, Gonzalez & Prieto Abogados in Colombia.

Doing Business in Ontario

Houser Henry & Syron LLP
2000 - 145 King Street West
Toronto, Canada M5H 2B6
Tel: 416.362.3411
Fax: 416.362.3757

www.houserhenry.com

About Ontario

Ontario is Canada's most populous province with about 13 million people. It is home to Canada's federal capital, Ottawa. Ontario's provincial capital is Toronto, Canada's most populous city and its financial centre.

Economically, Canada has outperformed most other countries in recent years and Ontario has traditionally been its engine. Companies are often attracted by Ontario's well-educated and skilled workforce, its environment of innovation, and its central location within North America. Several studies have found that Ontario is a great place to do business. KPMG's 2012 "Competitive Alternatives" study of international business costs confirmed Canadian business costs are among the lowest in the G7, and Forbes.com recently named Ontario a top destination for foreign direct investment in North America. Other advantages which Ontario offers to foreign investors or businesses seeking to expand include a sound banking sector, large and active capital markets, a simple and inexpensive process of incorporation, few import restrictions, and easy access to other North American markets. There are also government incentive programs which involve financial assistance and/or tax incentives, such as competitive corporate income tax rates, tax-free inter-corporate dividends, and reduced withholding tax rates for treaty countries.[1]

About Our Firm

Our firm is centrally located in the heart of downtown Toronto. Our business lawyers have been helping entrepreneurs and companies grow their businesses since 1934.

Simply put, we help businesses thrive, from incorporation onwards. Our services are tailored to

[1] For information on tax credits, please visit: www.sse.gov.on.ca/medt/investinontario/en/pages/government_programs_tax.aspx (for provincial tax credits), and www.canadabusiness.ca/eng/page/2738/ (for federal tax credits)

an organization's business goals. This includes assistance with corporate and real estate transactions, commercial agreements, employment law, and a myriad of other issues that owners and entrepreneurs face every day.

We have gained extensive experience advising foreign companies looking to do business in Ontario. We have worked with clients in a wide range of industries setting up Ontario-based operations for manufacturing, distribution and sales of their products in Canada.

Our business clients are based both in Canada, as well as across Europe, the US and Asia. Our experienced team works seamlessly with all key stakeholders to navigate through both regulatory and cross-cultural business environments.

Creating a truly exceptional experience for our clients is the cornerstone of our service philosophy. Every client, regardless of their size or the complexity of their transaction, receives a high level of personal care, responsive service and expert legal advice delivered by an experienced lawyer, at a reasonable price.

ESTABLISHING A BUSINESS IN CANADA: BUSINESS PRESENCE AND FORM

Expansion Methods

There are numerous methods available to foreign businesses looking to expand into Canada. Before committing to any one method, it is important to discuss the ramifications with both legal and tax counsel. As opportunities and obligations evolve, the foreign entity can be adapted from one form to another to meet changing business needs. The methods of expansion include:

Licensing

Licensing is the simplest method of expanding into Canada. A company can avoid establishing a physical presence in a geographical area in which it wants to conduct business by way of license agreement. A license is a business arrangement where one party (the licensor) gives specific rights in some or all of its property, usually intellectual property (**IP**), such as its trade-mark, patent or industrial design, to another party (the licensee). The licensee is then allowed to use the IP or other property in exchange for a fee or royalty. License agreements protect the business interests and intentions of each of the parties. Some of the more important factors that should be considered in the negotiation of a license agreement are:

1. the term or length of the agreement, as well as any rights or options to renew the agreement, and rights to terminate the agreement;

2. the territorial or geographical boundaries that are covered by the agreement;

3. the specific IP or other property being licensed;

4. how payment will be made, including the amounts to be paid, as well as payment dates and bonuses and/or penalties;

5. whether the license is to be exclusive or non-exclusive, the permitted uses and any limitations or exclusions with respect to how the IP or other property is used;

6. any support or training provided by the licensor;

7. whether the licensee is required to provide a warranty on the licensed goods, and any limitations on the licensor's responsibility;

8. how the licensed goods are to be marketed and sold, as well as how much money is to be spent in doing so;

9. the requirement for non-disclosure of confidential information, as well as non-compete conditions;

10. who is responsible for defending potential IP infringement claims;

11. what happens when the agreement is terminated; and

12. how and where disputes will be resolved.

Distributor and Agency Agreements

If a foreign company wants to sell goods in Canada, but wants to avoid establishing a physical presence, then a distributor or agency agreement may work. In an agency relationship, an agent acts on behalf of the principal (the foreign company). Agents may or may not have the ability to legally bind the principal for which they are acting.

Agency differs from a distribution relationship. A distributor is an independent party that typically buys the goods and then offers them for re-sale. Normally distributors cannot bind their suppliers. If engaging a distributor, the foreign company should enter into a written agreement with the distributor that sets out the parties respective rights and obligations, including how the agreement can be terminated and what notice is required. For more information on supplier-distributor agreements, please see our article on *Supplier and Distributorships – Common Problems Can Be Avoided.*

Foreign Branch

A foreign company that wishes to establish a physical presence in Canada, but avoid creating a separate legal entity may want to consider opening one or more foreign branch offices. The foreign branch will likely need a license in Ontario in order to carry on business in the province (an extra-provincial license), and may need to register its business name (discussed later).

This form of expansion can have tax advantages, as Canadian losses can be claimed by the parent company in its home jurisdiction. However, it also means the foreign company will be subject to Canadian income tax on its Canadian branch income and all the liabilities of the Canadian branch.

Canadian Subsidiary

Another option is to incorporate a Canadian subsidiary. Unlike a foreign branch, liabilities incurred would be limited within the subsidiary, and not imposed on the parent foreign company (except in the case of ULCs which are discussed below).

In Canada, companies can be incorporated at either the provincial or federal level. For most purposes, federal and provincial business corporations are able to conduct business anywhere within Canada and abroad. When choosing to incorporate provincially or federally, it is important to be aware of the differing rights and obligations that exist. These include requirements involving the location of the head office, Canadian residency requirements for directors, and shareholders rights. You should discuss your particular situation with legal counsel to ensure you choose the appropriate jurisdiction for incorporation.

An unlimited liability corporation (ULC) is a special type of corporation that currently only exists in three of Canada's provinces: Alberta, British Columbia and Nova Scotia (not Ontario). Unlike limited liability corporations (LLCs), the shareholders of a ULC can be liable for any liabilities of the company. However, ULCs also allow some flow-through tax benefits to shareholders, in some cases.

Partnerships

A partnership involves two or more persons carrying on a business in common with a view to profit. Partnerships are either general partnerships or limited partnerships.

In a **general partnership**, each partner is entitled to participate in the ownership and management of the organization. Each partner also assumes unlimited liability for the debts and obligations of the partnership. This relationship can arise without a formal written agreement; however, it should be set out in a written partnership agreement. A **limited partnership** requires at least one general partner. The general partner is subject to unlimited liability for the debts of the partnership, and manages the partnership's business. General partners can be, and usually are, corporations with no other purpose or assets. Limited partners, however, are only liable to the extent of their capital contribution and are not permitted to take part in the management of the business (or they risk losing their limited liability).

All forms of partnership can offer some flow-through tax benefits to partners which are not available to shareholders of corporations.

Buying a Canadian Business

Finally, another option is to buy an existing Canadian business. Buyers interested in acquiring a business in Ontario will need to complete due diligence on the potential acquisition, plan the financing required to complete the purchase, and determine how the business will be integrated with the buyer's other business or assets. For more information, please see our guide on *Buying or Selling a Business.*

Business Registrations

Extra-Provincial License (EXPL)

A corporation that was incorporated in a jurisdiction outside of Canada must obtain an EXPL to carry on business in Ontario.[2] "Carrying on business" is defined broadly and covers most business/commercial activities. It includes, but is not limited to, having an agent, representative, warehouse, office, and/or an interest in real property (such as a land mortgage) in Ontario. For more information on obtaining an EXPL, please see our FAQ and worksheet on *Extra-Provincial Registration in Ontario.*

Canadian non-Ontario companies seeking to carry on business in Ontario do not need an EXPL, but will need to file information with the Ministry of Government Services.

LLCs (familiar to many US businesses) cannot be created under Ontario law. They are a hybrid between a corporation (in that they offer limited liability to stakeholders) and a partnership (for some tax benefits). Foreign LLCs are able to carry on business in Ontario, but the requirements for them are different than for foreign corporations. While an LLC is usually regarded as an "unincorporated organization" for corporate purposes in Ontario, it may still be treated like a corporation for tax purposes.

Business Number (BN)

All businesses need to apply for a BN with the Canada Revenue Agency (**CRA**) if the business needs one or more of these CRA program accounts: (1) goods and services tax/harmonized sales tax (**GST/HST**); (2) payroll; (3) import/export; or (4) corporation income tax (discussed later). The BN acts as the business's single account number for dealing with the federal government.

Trade-marks

Registration under the federal *Trade-marks Act* is optional. However, registration will help a

[2] s. 4(2), *Extra-Provincial Corporations Act* (EPCA)

business protect its trade-name(s) and/or business name(s).

Business Name

Under the Ontario *Business Names Act* (***BNA***), if a business uses a business name that differs from the individual's name (in the case of a sole proprietorship), the names of the partners (in the case of a partnership), or from its corporate name (if a corporation), it must register that business name in Ontario.

Before deciding on a business name, you should make sure that the name is not already used by, or could be confused with the name of, another entity. The *BNA* does not grant any rights to the registered name in Ontario. However, a business may be able to protect a trade name by registering a trade-mark under the federal *Trade-marks Act*. The *BNA* also does not prohibit the registration of identical names. However, if a business decides to use a name that is the same as or confusingly similar to that of an existing business, it can result in a lawsuit.

Ontario Employer Health Tax (EHT)

Ontario's employers are required to pay tax on remuneration paid to its employees, known as the EHT.[3] Some employers are exempt from EHT on the first $400,000 of their annual Ontario payroll. Currently, the EHT tax rates range from 0.98% on total remuneration less than $200,000 to 1.95% for total remuneration over $400,000. This tax is intended to fund the Ontario Health Insurance Plan (OHIP).

Ontario Workplace Safety and Insurance Board (WSIB)

Most employers in Ontario have to report the earnings of employees working in Ontario and pay SIB[4] insurance premiums on those earnings. The WSIB provides insurance for injuries and illnesses incurred in workplaces and supports early and safe return to work for injured workers. WSIB coverage also protects employers from lawsuits related to work injuries and from the direct cost of these injuries. Workers injured on the job cannot sue their employer but they can be paid by the WSIB to replace lost earnings and health care costs resulting from work-related injuries and illnesses.

If a business employs people and does not register with the WSIB, it will face financial and legal penalties. This includes fines up to $100,000 and/or imprisonment. Workers are covered even if the employer is not registered, in this situation the employer will also have to pay the full costs of any workplace injury or illness claim. Some employers are exempt from WSIB premiums. Their employees are not entitled to WSIB benefits.

ESTABLISHING A BUSINESS IN CANADA: TAX

Tax Liability: Income Tax on Canadian Activity

Residents and non-residents with income from a taxable source in Canada are required to file a Canadian tax return and pay income tax.

A corporation will generally be considered a resident of Canada if (1) it was incorporated and carried on business within Canada; or (2) the "central management and control" of the corporation occurs in Canada (even if the business was incorporated in and/or has major operations in

3 Ministry of Finance. *Employer Health Tax – Guide for Employers.* Pg. 4 ["**EHT book**"]

4 WSIB. *Register with Us.* Accessed at: http://www.wsib.on.ca/en/community/WSIB; click on Employers; then click on Registration under the Employers tab. Or click here.

a foreign country).[5] Countries may enter into a bilateral tax treaty with the goal of reducing or eliminating double taxation and promoting international trade. Canada has entered into bilateral tax treaties with 90 different countries.[6]

Income Tax

Canada has a progressive tax system. Sole proprietors and partners in a partnership are taxed at the individual level. The rates of tax increase as the income of the individual increases. In 2012, the federal individual income tax rates ranged from 15% for the first $42,707 of income to 29% for income over $132,406. The 2012 Ontario individual income tax rates were 5.05% on the first $39,020 of taxable income to 11.16% on taxable income over $78,043.[7]

Canadian corporations pay a flat rate of income tax. The current federal corporate tax rate is 15% and the Ontario corporate tax rate is 11%. The combined rate for incorporated businesses operating in Ontario is therefore currently at 26%.[8]

Capital Gains/Losses

A capital gain is the profit from the sale of an asset like real estate or securities such as stocks and bonds. This profit is taxable upon the sale or 'disposition' of the asset. In Canada, the buying and selling of property is given favourable tax treatment as only half of the capital gain is taxable at the taxpayer's marginal income tax rate. Where a taxpayer sells an asset at a price lower than the original purchase price, the resulting capital loss may be set off against taxable capital gains for the current year. Where capital losses exceed capital gains in the year, a net capital loss is generated which may be carried backwards to any of the three previous years or forward indefinitely. The application of such losses reduces the amount of capital gains tax payable.[9]

Foreign investors are obliged to obtain a clearance certificate (under Section 116 of the *Income Tax Act*) from the Canadian taxing authorities when disposing of taxable Canadian property. Unless the foreign vendor has obtained a clearance certificate, purchasers have a duty to withhold and remit a portion of the purchase price to the Canadian taxing authority.[10] If the property is not treaty-protected, the non-resident vendor must generally forward an amount equal to 25% of the capital gain plus applicable tax to obtain the clearance certificate. If the property is treaty-protected, the clearance certificate will generally be issued without the prepayment of tax.

Other Types of Taxes

Land Taxes

In Ontario, if you buy land or an interest in land, you must pay provincial land transfer tax ranging from 0.5% to 2% depending on the type of land and its purchase price. Certain municipalities, such as Toronto, also levy a land transfer tax in addition to the provincial land transfer tax.
Municipalities charge annual property taxes on the assessed value of real estate. Assessments are made based on the current or average current value of similar properties. The applicable property tax rates are set by the municipality

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[5] For more information on determining the residency of a corporation, please visit the following website from the Canada Revenue Agency: www.cra-arc.gc.ca/tx/nnrsdnts/bsnss/bs-rs-eng.html

[6] For more information on countries with which Canada has tax treaties, please visit: www.fin.gc.ca/treaties-conventions/in_force--eng.asp

[7] Ibid

[8] Canada Revenue Agency. Corporation Tax Rates. <URL: http://www.cra-arc.gc.ca/tx/bsnss/tpcs/crprtns/rts-eng.html>

[9] Canada Revenue Agency. Capital Gains 2011. <URL: http://www.cra-arc.gc.ca/E/pub/tg/t4037/t4037-11e.pdf>

[10] Canada Revenue Agency. Information Circular. IC72-17R6. <URL: www.cra-arc.gc.ca/E/pub/tp/ic72-17r6/ic72-17r6-11e.pdf>

annually and vary depending on the class of property.

Payroll and Other Employment Taxes

Businesses which have employees have a number of payroll-related expenditures. Federally, employers are obliged to make contributions for income tax, Employment Insurance (**EI**) and Canada Pension Plan (**CPP**). Provincially, all employers in Ontario must pay the Employer Health Tax and, if applicable, make contributions to the WSIB to provide for workers who are unable to work due to an accident arising out of a work-related injury or disease.

Withholding Tax

Non-residents may be subject to Canadian withholding taxes on certain types of passive income. Income paid out to non-residents in the form of interest, rent, royalties, dividends and other specified amounts is subject to a default 25% withholding tax.[11] This amount may be varied by tax treaty. For example, under the tax convention between Canada and the United States, US residents pay a reduced tax on dividends issued from a Canadian business and are not required to pay any tax on interest generated from Canada unless it is tied to a permanent establishment.[12]

Non-residents who are paid a "fee, commission or other amount in respect of services rendered in Canada" (i.e. 'actively' earned income) are subject to a default 15% withholding tax.[13] Tax treaties do not exempt non-residents from having to pay this 15% withholding tax. However, Canadian tax authorities may nevertheless grant a waiver of withholding taxes upon application.

Branch Tax

Non-resident foreign corporations that carry on business in Canada through a branch rather than through a Canadian subsidiary are subject to a 25% branch tax.[14] This tax is in addition to income tax payable on all Canadian-source income. The branch tax serves as a stand-in for the withholding tax that would otherwise have been levied on dividends issued to the non-resident parent had the business instead been carried on through an incorporated Canadian subsidiary.[15] The branch tax may be reduced by reinvesting branch profits in Canadian business assets or according to the terms of a tax treaty.[16]

CRA Program Accounts

Opening CRA program accounts is the first step for a business to meet its tax obligations. There are four major CRA program accounts:

GST/HST

The federal government and the Province of Ontario impose a sales tax on the consumption of goods and services in Canada. This tax is known as the **GST/HST** and is 13%. While the burden of paying this tax is borne by the consumer, businesses are obligated to collect and remit this tax to the Canadian taxing authorities.

Businesses that provide taxable goods and services must charge their clients GST/HST. Businesses can also claim input tax credits to recover the GST/HST they pay on goods and services consumed, used, or supplied in their commercial activities.[17]

[11] *Supra* note 15 at s. 212

[12] *Supra* note 31 at Article XI.

[13] Canada Revenue Agency. International and Non-resident taxes: Common Topics – Rendering Services in Canada. <URL: www.cra-arc.gc.ca/tx/nnrsdnts/cmmn/rndr/pyr-eng.html>

[14] Canada. Natural Resources Canada. Canadian International Income Tax Rules. "Taxation of Foreign Investment in Canada: Branches." <URL: www.nrcan.gc.ca/minerals-metals/business-market/3854#b>

[15] *Ibid*

[16] *Ibid*

[17] Pg. 10 BN CRA

A business must register for a GST/HST account if it (resident or non-resident) provides taxable goods or services in Canada and its revenues **exceed $30,000 a year.**

Payroll

Most employers need to register for a payroll account to deduct and remit the income tax of its employees. An employer must open the payroll account before the first remittance date, which falls on the 15th day of the month following the month one becomes an employer.[18]

Import/Export

If a business will be importing commercial shipments from a foreign country into Canada, or exporting commercial goods to other countries, it must register for an import/export account. The CRA will use the import/export account number to process customs documents.[19]

Corporation Income Tax

All corporations operating in Canada have to file a corporation income tax return within six months of the end of each tax year (its fiscal year).

When a business incorporates in Ontario or federally, the business will automatically be registered for a BN and a corporate income tax program account. Non-resident corporations will also be registered with a corporation income tax account when they apply for a BN with the CRA.[20]

[18] Pg. 20 BN CRA

[19] Pg. 18 BN CRA

[20] Canada Revenue Agency. *Corporation income tax program account.* Accessed at: www.cra-arc.gc.ca/tx/bsnss/tpcs/bn-ne/ndn/crprtns-eng.html

ESTABLISHING A BUSINESS IN CANADA: EMPLOYMENT

The information in this section relates to non-unionized employees and their employers in Ontario. The rights and duties of unionized employees and their employers are governed by the agreement between the parties and Ontario's labour laws.[21] The relationship between employees who work for "federal undertakings or businesses" (which include banks, telecommunication companies, and transportation companies) and their employers is governed by federal laws. The fact that a company is federally incorporated does *not* necessarily mean that its employees will be governed by federal employment or regulatory laws.[22]

This section also does not apply to independent contractors, which differ from employees. Many people try to classify themselves as independent contractors so they can deduct expenses for tax purposes, when they are in fact employees. Employers may also try to classify employees as independent contractors so that they are not obligated to provide termination pay or severance. These obligators will be discussed below in further detail. For information relating to an independent contractor, see our FAQ on *Employees and Independent Contractors in Ontario.*

***The Employment Standards Act* (the ESA) – Minimum Standards**

The ESA and its regulations provide standards for employee wages, hours of work, overtime entitlement, and vacation entitlement, among other things. Some employees may be exempt

[21] If you would like more information about Ontario's labour laws, please visit the Ontario Ministry of Labour's website at: www.labour.gov.on.ca/english/lr/

[22] If you would like more information about federal employment and labour laws, please visit the federal Ministry of Labour's website at: www.hrsdc.gc.ca/eng/labour/employment_standards/index.shtml

from particular standards, and employers should discuss this issue with Ontario legal counsel.

The ESA also provides employees with certain protected leave of absence entitlements. An employee cannot be penalized by an employer for taking a protected leave of absence. These include pregnancy, parental, personal emergency, family medical, organ donor, declared emergencies (for emergency personnel), and reservist leaves (for members of the Canadian military). If employers have any questions as to whether an employee is entitled to a leave of absence, they should discuss this with Ontario legal counsel.

Employers should have a written employment agreement with their employees and make signing of the agreement a condition of any job offer.

Occupational Health and Safety and Workers' Compensation

Employers must comply with Ontario's *Occupational Health and Safety Act* (**OHSA**). The OHSA seeks to keep workplaces healthy and safe for Ontario's workers. Ontario's Ministry of Labour will investigate when there is an accident involving workers, or if a complaint is made. As previously mentioned, most Ontario employers are required to obtain WSIB coverage for its employees. Employers who violate the OHSA can face severe penalties.

Depending on the size and nature of an employer's workforce, the employer may be required to have a "joint health and safety committee" or "health and safety representatives" which include employees. Employers must co-operate with the committee and/or representatives on health and safety matters.

The OHSA also imposes regulations regarding toxic substances and other dangerous work conditions. If a worker reasonably feels unsafe at work, he or she can stop working or refuse to work.

Importantly, the OHSA also addresses workplace violence and workplace harassment. Employers must have a written violence and harassment policy in place which clearly outlines unacceptable behavior, how a complaint can be made and investigated, and how violence or harassment will be dealt with by the employer.[23] If an employer fails to appropriately deal with violence or harassment in the workplace, the employer could be liable.

Human Rights Law and Pay Equity

Employers must also comply with the *Ontario Human Rights Code*, which stipulates that employers cannot discriminate against employees (or prospective employees) on any of the following grounds: race; ancestry; place of origin; skin colour; ethnic origin; citizenship; creed (religion); sex (includes gender identity and pregnancy); sexual orientation; age; marital status; family status; disability (includes perceived disability); or record of offences. If an employer discriminates against an employee (or prospective employee) on any of these grounds, that person could bring a complaint against the employer at the Ontario Human Rights Tribunal and the employer could be ordered to pay compensation. In addition to the *Human Rights Code*, Ontario has pay equity legislation to address gender-based wage discrimination.

Disability and the Duty to Accommodate

Disability is defined very broadly under the *Human Rights Code*. A disability is not always obvious and must be handled with sensitivity. Employers are strongly encouraged to consult with Ontario legal counsel when dealing with an employee who has, or claims to have, a disability.

Employers in Ontario must accommodate employees with disability. Accommodation

[23] Section 32.0.1(1)(a) and (c) of OHSA.

involves arranging the employee's workplace or duties to enable the employee to do his or her work, if this can be done without undue hardship to the employer.

Termination of Employment

The concept of "at will" employment does not exist in Canada. Employees are either employed for a specific period of time or for an indefinite period. If individuals are employed on an indefinite basis, they must generally be given notice (or pay in lieu of notice) if their employment is terminated without cause.

Whether or not an employee is entitled to receive notice of termination and/or other compensation depends on how and why their employment is being terminated.

Termination without Cause

Most terminations are done "without cause." This means that the termination is not because of any specific charge or problem in the employee's performance or behaviour. Compensation for this type of termination is established by the written employment agreement between the employee and the employer; if there is no such agreement, then by the common law and the ESA.

Under the ESA, an employee whose employment is terminated without cause is entitled to receive a minimum prescribed amount of notice of termination or, alternatively, pay in lieu of notice if the employer wishes to terminate the employee's employment immediately. The maximum ESA termination pay is eight weeks. This is generally a lump sum payment equivalent to what the employee would have been paid if he or she had worked for the employer during the notice period. The longer the employee has served, the longer the notice period will be.

Where a person's employment is terminated without cause, and the employee has served for five or more years, the employer may also be required to pay severance in addition to termination pay if one of the following applies:

- the employer has an annual payroll of $2.5 million dollars (CAD) or more; or
- the termination is in connection with the permanent discontinuance of all or part of the employer's business at an establishment, and 50 or more employees are terminated within a six month period.

The ESA provides a formula for calculating severance pay. The maximum ESA severance pay is 26 weeks.

In addition to notice of termination (and severance pay, if applicable), the ESA also requires that employees be paid accrued and unpaid vacation pay. Vacation pay will vary depending on how much annual vacation the employee receives.

The minimum standards in the ESA are absolute minimums and cannot be lowered by employment agreements. Ontario courts typically award longer notice periods than those provided for under the ESA. Under Ontario common law, an employer must give an employee "reasonable notice" of termination (or pay in lieu of reasonable notice), unless the employee is terminated for just cause. The amount of notice required depends on various factors, which usually include:

- the character or nature of the employment (e.g. was the employee a management or non-management employee?);
- the length of the employee's service;
- the employee's age;
- the availability of similar employment, having regard to the experience, training, qualifications and the responsibilities of the employee;
- the circumstances surrounding the hiring of the employee; and
- any written employment agreement between the employee and employer.
- Employers should consult with Ontario legal counsel to ascertain what reasonable notice

would be in each particular circumstance. For more information, please see our FAQ on Employee *Terminations*.

Termination for Cause

In a termination for cause, an employee must be guilty of significant misconduct. Where that exists, there is no entitlement to notice or compensation and the employee can be terminated without notice. Employers are advised to seek legal counsel before terminating someone's employment when they believe there is cause for termination.

Constructive Dismissal

An employer cannot unilaterally change a material term of a person's employment unless the employee agrees to the change, or the change is specifically permitted by a written employment agreement. The law treats the employer's implementation of a material change as a "constructive dismissal" of the employee. Constructive dismissal usually occurs when an employer significantly reduces an employee's salary or changes the employee's work location, hours, authority, position or benefits (e.g. extended health insurance) in a negative way. It may also occur if an employer harasses an employee or condones such conduct by other employees. Constructively dismissed employees are entitled to the same notice (or pay in lieu of notice) and other compensation as if their employment was terminated without cause.

Fixed Term Employees

If an employee is hired for a fixed period of time, but let go before the end of that term, the employer must pay the employee for the balance of the term, unless an employment agreement provides otherwise or unless the person's employment is terminated as a result of a breach of the agreement. An employee who agrees to a fixed employment period is not entitled to notice (or pay in lieu of notice) or other compensation which extends beyond that term. However, if an employee continues to be employed after the fixed term has expired without a new or extended agreement, he or she can become an employee for an indefinite term of employment, and be entitled to notice (or pay in lieu of notice) if his or her employment is later terminated without cause.

Mandatory Retirement

There is no mandatory retirement age in Ontario. An employer cannot force an employee to retire or quit at a particular age. Employers cannot discriminate against employees on the basis of age. If they do so, they could face allegations that they have violated the *Human Rights Code*.

Non-Competition and Non-Solicitation Agreements

Non-solicitation agreements and non-competition agreements contain "restrictive covenants" that restrict what a person may do. A restrictive covenant must meet certain criteria in order to be enforceable. It must be reasonable between the employer and employee, and reasonable with reference to the public interest in having a free and competitive marketplace.

Non-Solicitation Agreements

Non-solicitation agreements should only serve to prevent a former employee from attempting to "hire away" other employees, and from attempting to "take business" from his or her former employer by approaching existing (or recent) customers of the employer with offers of similar goods or services. A non-solicitation agreement should have time and/or geographic limits (e.g. valid for a two year period after employee's employment ends, valid within the Province of Ontario). If a non-solicitation agreement is too broad, then it may be deemed to be a "non-competition agreement."

Non-competition Agreements

Non-competition agreements can severely limit an employee's ability to find similar work after his or her employment ends. In Ontario, courts are generally very reluctant to enforce non-competition agreements, because they often lessen competition generally. A non-competition agreement will generally only be upheld if there are exceptional circumstances. For example, if there is a sale of a business, the key person(s) involved in that business can be prevented from starting a competitive business for a certain period of time after closing. Further, if someone is a manager or otherwise very senior in an organization, then a non-competition agreement may be upheld against that person.

Courts have made it clear that they will only enforce restrictive covenants when they are reasonable in their entirety. Courts will not sever overreaching terms or interpret ambiguous terms. For this reason, it is very important for employers to review their proposed restrictive covenants with Ontario legal counsel.

For more information, please see our article on *Confidentiality Clauses and Restrictive Covenants – Be Careful What You Include in an Employment Agreement.*

ESTABLISHING A BUSINESS IN CANADA: REAL ESTATE AND LEASING

Foreign businesses looking to set up a physical location in Ontario will either purchase or lease commercial property. Any person purchasing commercial property in Ontario will be required to pay land transfer tax on the purchase price of the property (as discussed in the "Other Types of Taxes" section). The purchase will also be subject to GST/HST.

In our experience, initially, most new businesses choose to lease space. For that reason, we have limited the information in this section to commercial leasing. If your business decides to purchase property in Ontario, please consult with us and we will guide you through the process.

***Commercial Tenancies Act* (Ontario)**

Commercial leases are governed by the *Commercial Tenancies Act* (Ontario), the common law and the lease agreement. The application of the *Commercial Tenancies Act* (Ontario) is somewhat limited because landlords and tenants in Ontario are treated as sophisticated commercial parties. As sophisticated commercial parties, landlords and tenants are free to negotiate most of their own terms. A written lease agreement signed by the parties can take precedence over the *Commercial Tenancies Act*.

Offers to Lease

Landlords will usually require tenants to enter into an offer to lease to secure the location. Such offers to lease will set out the main terms of the lease agreement – the location, the term, the rent, the extra costs, the options to renew, the use of the space, whether a security deposit is required, insurance requirements, assignment and subletting rights. It will also usually provide that the tenant will sign the landlord's standard form lease so long as the terms set out in the offer to lease are incorporated into the lease. Therefore, it is important that any offer to lease be reviewed by legal counsel and negotiated thoroughly before it is signed. If a tenant does not negotiate specific requirements at the offer to lease stage, it will have a difficult time negotiating changes to the landlord's standard form of lease.

Real Cost of the Lease

To determine the total cost of a lease, tenants need to know whether the lease is a gross lease or a net lease. A **gross lease** is one in which the tenant pays a single amount which covers both rental of the tenant's leased premises and all other costs associated with the leased premises and the tenant's portion of the common elements. With a gross lease, a tenant has certainty and knows what the total rent of the lease will be.

A **net lease** is one in which the tenant pays a predetermined amount for rental of the tenant's leased unit (usually called "base rent") and another variable amount for all other costs associated with the leased unit and the tenant's portion of the common elements (usually called "additional rent"). Base rent is usually based on the square footage of the leased unit. Additional rent, however, fluctuates and such fluctuations can be substantial, particularly if property taxes increase or if the common elements undergo a major upgrade (e.g. a parking lot is re-paved). Because landlords want to be fully reimbursed for the costs associated with the property, most commercial lease agreements are net leases. In net leases, "rent" is generally defined as base rent and additional rent. Net leases do not provide tenants with certainty regarding the total cost of the lease. The rent will change as the costs incurred by the landlord change.

GST/HST is charged on rent for all commercial properties. As discussed earlier, GST/HST is charged at a rate of 13%. This cost should be budgeted by tenants.

Landlord's Remedies in Ontario

If a tenant fails to pay rent, Ontario landlords have a number of options. These options are:

1. Do nothing to alter or terminate the lease, but insist on performance of the lease and make a claim for outstanding rent or damages on the basis that the lease remains in force;
2. Terminate the lease, and make a claim for outstanding rent or damages incurred to the date of termination;
3. On proper notice to the tenant, re-enter the unit(s) in order to re-let the unit(s) on the tenant's behalf; or
4. On proper notice to the tenant, terminate the lease and claim damages for the breach of the lease, including for future losses.[24]

If the Landlord chooses not to terminate the lease, landlords have the right under Ontario law to distress seize against the assets of the tenants. This means that they can seize and sell the tenant's assets and set off the profit from the sale against the rent owed.

If a foreign business is entering into a lease in Ontario, it is important that the business fully understand its obligations under the lease and know the consequences of failing to meet those obligations. As a result, a foreign business negotiating a lease in Ontario would benefit from the counsel of an Ontario lawyer experienced in Ontario commercial leasing law.

For more information, please see our article titled "*Renting the Space that's Right for Your Business: Things for Tenants to Consider in a Commercial Lease.*"

Conclusion

If you have made the decision to establish a business in Ontario or to expand your existing business into Ontario, we congratulate you on embarking on this exciting journey. We hope the topics discussed in this guide on methods of carrying on business, tax considerations, employment law and real estate, have provided you with a basic understanding of some of the key legal issues to be considered when operating a business in Ontario.

We invite you to access related articles on the topics we have covered in this guide, available on our website, www.houserhenry.com.

[24] *Highway Properties Ltd.* v. *Kelly, Douglas and Co. Ltd.* [1971] S.C.R. 562.

Doing Business in Ontario

To see this article as it was originally published, go to: http://houserhenryandsyron.uberflip.com/i/142770

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Your business grows. You expand into new markets, hire new people, move into larger facilities, launch new products or services – and face new legal issues and challenges.

Since 1934, Houser Henry & Syron LLP has provided legal services to private businesses, helping them deal with the complexity that comes with growth and success. We understand the needs of mid-sized businesses and their owners and managers and we have the breadth of expertise and the depth of experience necessary to meet those needs.

We offer this booklet as a handy reference and as an overview of some of the questions you may face when considering taking security in personal property in Ontario.

For more information, please contact one of the lawyers with our firm. You may also wish to visit our website, www.houserhenry.com, for an overview of our team and our services.

Contact Us

If you would like more information about this or any area of corporate law, please contact us:

Houser Henry & Syron LLP
Suite 2000
145 King St. West
Toronto, Ontario
Canada M5H 2B6
t: 416.362.3411
f: 416.362.3757
e: info@houserhenry.com

This publication provides an outline of issues for business professionals to consider. The content should not be taken as legal advice. It is not exhaustive and is subject to change. Please consult with an HHS lawyer for information or advice specific to your situation.

Doing Business in Panama

By Marcela Virzi Martinelli

Quijano & Associates
Salduba Building, 3rd Floor
East 53rd Street, Urbanizacion Marbella
Panama City, Panama

Tel: 507.269.2641
Fax: 507.263.8079

quijano@quijano.com
www.quijano.com

Facts about Panama

Area: 75,517 km2

Population: 3,395,000

Currency: Dollar / Balboa

Business Hours: 8 am - 5 pm

Official Languages: Spanish

Public/National Holidays:
- Jan. 1: New Year's Day
- Jan. 9: Day of National Mourning
- Flexible (Feb.): Mardi Gras./.Carnival
- Flexible: Good Friday
- May 1: Labor Day
- Nov. 3, 5, 10, 28: National Holidays
- Dec. 8: Mothers' Day
- Dec. 25: Christmas Day

1. Why Panama

As a country, Panama is blessed with several advantages:

1. A geographical position that ensures ease of access for visitors from all over the world, whether traveling on commercial flights or by cruise ship.

2. The Panama Canal, which, since it opened in 1914, has been of enormous service to trade and cultural exchange all over the world. The current work to enlarge the canal is likely to lead to increased traffic since larger ships will be able to pass through this vital waterway. The country also has ports endowed with technology and infrastructure to make them competitive with ports anywhere else in the world.

3. A stable economy thanks to the use of the dollar.

4. Tax incentives to encourage trade and investment.

5. The country is one of the most highly valued destinations for world-class residential tourism.

6. The use of English as a second language among Panamanians. There are a number of business incentive areas such as the Panama-Pacific area which borders the canal and is close to Panama City, where major multinational companies have established operational headquarters to benefit from the nearby Tocumen International Airport, railway and port of Balboa. Modern business facilities, apartment buildings and residential 'gated community' type complexes have made the country a highly desirable place in which to take up permanent or temporary residence.

2. Legal Framework

The legal system is based on the civil law system and has three branches: the executive, which consists of the President and Vice-President of the Republic; the Legislature, a body of deputies representing each province, and the Judiciary, with judges sitting in courts of various types.

3. Banking

Panama's Banking Centre is the biggest in Latin America, with approximately one hundred (100) banks of which some 50% are licensed to provide general services, with the remainder split between banks with international licenses and representative licenses. There are two state banks: the Banco Nacional de Panamá and the Caja de Ahorros (savings bank). The use of the US dollar as legal tender, tax benefits and other advantages all provide incentives to encourage banks from other countries to set up offices in Panama. The Banking Centre is one of the pillars of the Panamanian economy and is characterized by economic stability and growth, low inflation, low exchange rate risk and interest rates that are comparable with global rates. Furthermore, Panama has first-class legislation which is continually being updated and has made strenuous efforts to combat and prevent unauthorized use of banking services for money laundering and for financing terrorist activity. This has earned it recognition from the main International Rating Agencies and multilateral credit institutions.

4. Financial Regulatory Authority

The Panama Bank Superintendency (*Superintendencia de Bancos de Panamá*) is the authority that issues licenses and authorizes banks to engage in any banking activities permitted by law. The Superintendency is an autonomous state body whose essential functions are to ensure the robustness and efficiency of the banking system, create conditions favourable to the development of Panama as an International Financial Centre, help to strengthen public confidence in the national banking system, monitor the strength, liquidity, control systems and procedures of the banking system and the professional conduct of bankers, and punish any violation of banking law.

5. Taxation

5.1. Corporate Tax

Panamanian companies are subject to a territorially-based tax system, which means that tax is only payable on activities undertaken, or deemed to be undertaken, within the territory of the Republic of Panama. Under Panamanian Tax Law business transactions that are agreed, are executed or have effect outside Panama are treated as offshore and are not liable for tax, even where the transactions are managed or administered from an office in Panama. Panamanian companies of the 'sociedad anónima' type are required to pay an annual company tax of USD 300.00. For all companies registered between January and June, the payment deadline

for the annual company tax is June 30 each year, and for companies registered between July and December, the payment deadline is December 31 each year. The registration date for this purpose is the date on which the company was registered in the public registry and is shown on a stamped seal on the last page of the Deed of Incorporation.
Non-payment of the annual company tax means a penalty of USD 50.00 for each year for which the tax remains unpaid and a fine of USD 300.00 if two or more single payments are in arrears. In addition to a Deed of Incorporation, companies are required to keep company share registers and minute books which, when created, should preferably be authenticated by a Notary.

5.2 Personal Tax Rates

In Panama the personal income tax is based on a variable scale: no tax is payable if the net annual income is less than USD 11,000; tax is charged at 15% on all income between USD 11,000.00 and USD 50,000.00; and 25% on all income above that figure. Income tax only applies to income from Panamanian sources regardless of whether the taxpayer is a Panamanian citizen or a temporary resident. Income liable for tax includes pay for fulltime employment, pay for temporary employment, the profits of any business, pensions and bonuses.

5.3. Transfer Tax

Transfer of real property is subject to tax at a rate of 2% of the greater of the value in the deed of transfer.

5.4. Social Security

Employers and employees pay contributions into the Panamanian social security system. The employer pays 12.25% of the total wage and salary amount, plus 1.5% by way of an education tax. The employer deducts social security taxes from his income taxes. The employee pays 9.75% (the social security tax) plus 1.25% (education tax).

5.5. Customs & Excise Duties

Tariff rates on foreign goods coming in to the customs area of the Republic (import tariffs) are regulated by special customs rules.

5.6. V.A.T.

From July 2010 onwards the tax on moveable property and services (Spanish abbreviation: ITBMS) is due to increase from 5.0% to 7.0%. This is the value added tax (VAT) in other countries. The tax applies to restaurant, home telephone and other services.

5.7. Tax Incentives

Along with a tax system which is itself supportive of business start-ups and ship registrations in applying only to activities which are formally agreed, are executed or have effect on Panamanian soil, Panama has over the years offered numerous tax advantages for certain types of activity. Some of these are: (i) the Colón tax-free zone, where imported and re-exported goods are exempt from all taxes; (ii) areas for the processing of goods for export, where companies engaging in the production and transfer of goods and services for export are exempt from tax; (iii) call centers, which are subject to a special regime in relation to business start-ups, business operations, and migratory and hiring arrangements for employees; (iv) the special tax regime applicable to operations in the Panama Pacific Business Area, which offers tax advantages on imports of goods and on services offered by companies established in the area, including special migratory and employment arrangements; (v) foreign investment in the tourist industry, including an exemption form income tax, property tax, import tax, and other taxes depending on the amount of investment and location; (vi) investment and financing for reforestation; (vii) the exporting and production of hydrocarbons; (viii) the establishment of multi-national companies, which are exempted from tax on all services delivered outside Panama and on transfers of goods for export, and benefit from favorable migratory and employment arrangements (ix) cruise ship or homeport operators, whose income is not liable for tax.

6. Main Types of Corporate Forms

The corporation (*Sociedad Anónima*) and the Private Interest Foundation (*Fundación de Interés Privado*). Limited Liability Companies (LLC) maybe incorporate as well, however, the corporations represent most of the incorporations.

7. Company Incorporation

- Minimum Number of Shareholders/Members: One
- Minimum Number of directors: Three
- Bearer shares: Yes*
- Can Corporate Directors/Managers be appointed? Yes
- Administrators: Yes
- Standard authorized share capital: US$ 10,000
- Company office/local agent: Yes
- Must a local director be appointed?: No
- Must directors be local?: No
- Official meetings in the jurisdiction?: No
- Official registration of directors: Yes
- Official registration of shareholders/members: No

* In order to comply with international demands concerning transparency and, at the same time, continue offering the regulations required to satisfy legal entities and natural persons who choose our jurisdiction, the National Assembly of the Republic of Panama has approved Law No. 47 of the 6th of August 2013 creating a system to immobilize bearer shares in the near future, without impairing the authority to issue them.

The provisions of this law shall not be in force and effect until the 6th of August 2015. The law provides a period of three (3) additional years for all those certificates of shares issued to the bearer before that date. Therefore, it will not be until the 6th of August 2018 when such certificates will have to be deposited with an Authorized Custodian contemplated by said legislation in order to comply with the new regulations.

On the other hand, the certificates of bearer shares issued as from the 6th of August 2015 will have to comply with the provisions of the law, and be delivered to an Authorized Custodian within a period of twenty (20) days after the date of issue. Thus, when Law comes into force, Panamanian corporations may either issue only registered shares; or Deliver the certificates representing issued bearer shares to an Authorized Custodian as the law provides.

8. Reporting & Auditing

Panamanian Corporations are not required to present tax returns or any other reports provided that they do not earn any taxable income in the Republic of Panama, that is, if they do not engage in transactions that are formally concluded, or are executed or have effect within Panamanian territory. They may also keep their accounting records outside the Republic and are not subject to Panamanian accounting or turnover regulations.

Private Interest Foundations are statutorily prohibited from engaging in trading activities but are also not required to file reports of any kind.
Corporations have to pay an annual company tax or single annual charge of USD 300.00. Similarly, Private Interest Foundations are subject to pay an annual maintenance tax of USD 400.00. Both taxes respectively must be paid punctually in order to ensure that documents are able to be recorded in the Panama Public Registry and/or that the company or foundation is not removed from the registry.

9. Taxation Advantages of Panamanian Corporations

As we mentioned before, Panamanian corporations are under a territorial system of taxation, which means that no income arising from activities or transactions conducted or property held outside of the territory of the Republic of Panama is subject to income tax.
This "offshore" feature of Panamanian corporations has been in force and effect since 1927, as the following exemptions show:

- There is no income tax applicable to income from sources outside of the territory of the Republic of Panama.
- No capital gains tax applicable to capital gains through sources outside of the territory of the Republic of Panama.
- No taxation applicable to interests derived by saving accounts or certificates of deposit within or outside of the Panamanian territory.
- No taxation applicable to dividends received from sources outside of the territory of the Republic of Panama.
- Exemption from any obligation to prepare or publish or submit financial statements and full freedom to carry its accounting as and where the corporation may decide when its income arises from sources outside of the territory of the Republic of Panama.
- Any Panamanian corporation whose income arises only from sources outside of the territory of the Republic of Panama does not have to make or submit any tax return, and may conduct its accounting as and where it pleases.

CCN Mexico Report™ (September 2013):

Real Estate Law - The Purchase and Sale of Real Property and the Anti-Money Laundering Act

By Jorge Ojeda, Esq.

Cacheaux Cavazos & Newton
Torre Metrocorp, Avenida Tecamachalco No. 14-502
Colonia Lomas de Chapultepec
Mexico City, Mexico C.P. 11010
Tel: 011 52 55 5093 9700
Fax: 011 52 55 5093 9701

Website: www.ccn-law.com

On July 18, 2013, the Federal Law for the Prevention and Identification of Operations with Illicit Resources (the "Anti-Money Laundering Act") went into effect, the same which was issued by the Mexican Congress for the purpose of serving as an information hub in the government's fight against money laundering. Similarly, (i) on August 16, 2013, the Regulations to the Anti-Money Laundering Act (the "Regulations") were published; (ii) on August 23, 2013, the General Rules (the "General Rules") were published; and (iii) on August 30, 2013, the formats for registration and notification in terms of the Anti-Money Laundering Act were published (the "Formats").

The Anti-Money Laundering Act contains a list of at-risk activities and requires those who conduct such activities to file certain notices with the Mexican Department of Finance and Public Credit (Secretaría de Hacienda y Crédito Público). Unfortunately, the Anti-Money Laundering Act and the rules deriving from such contain various inconsistencies resulting from drafting issues. These inconsistencies are generating confusion and include issues such as whether the purchase and sale of real property is considered an at-risk activity, as well as who is required to present the corresponding notice as to such transactions.

In this regard, it is important to note that while various activities in the real estate sector are considered at-risk activities subject to the law's required notice, the Anti-Money Laundering Act does not establish an obligation on the seller and/or buyer of real property to give notice as to such given that activities considered to be at-risk and subject to presentation of the respective notices are the following:

(i) Real estate brokerage in the purchase and sale of real property, with the real estate broker being required to give notice when the price of the transaction is for an amount equal to or greater than 8,025 times the Minimum Salary in Effect in the Federal District (Salario Mínimo Vigente en el

Distrito Federal ["SMVDF"]), meaning MX$519,699.00;

(ii) The rendering of professional independent services, without the existence of an employment relationship, when a service provider, on behalf of and in representation of his client, carries out a financial transaction related to the purchase and sale of real property or a related trust;

(iii) The participation of a notary public in the purchase and sale of real property, the same who must give notice when the value of the transaction or the property is greater than 16,000 times the SMVDFD, meaning MX$1,036,160.00; and

(iv) The participation of a notary public in the formation of a trust transferring ownership of real property, the same who must give notice when the value of the transaction is greater than 8,025 times the SMVDFD, meaning MX$519,699.00.

It is important to note that the Anti-Money Laundering Act prohibits the payment and receipt of all or part of the purchase price for real property in cash when the value of the transaction is greater than 8,025 times the SMVDFD, meaning MX$519,699.00. As a result, it is necessary to provide the notary public who supervises the closing of the transaction with detailed information regarding the form of payment of the purchase price, date, legal currency and respective amounts, without there being an obligation upon notaries public to include such references in the actual notarial instrument or deed. Therefore, the notary public's certification that he or she has received the corresponding information is deemed to be sufficient.

CCN is an international law firm with offices throughout Mexico. At CCN they are dedicated to serving clients engaged in business transactions within the NAFTA region and throughout Latin America. The firm is comprised of both Mexico-licensed and U.S.-licensed attorneys who work in an integrated, bilingual environment. CCN represents U.S. and other foreign investors doing business in Mexico, as well as Mexican and other international investors doing business in the U.S.

CCN Mexico Report™ (September 2013):

IP Notes - Recommendations for the Use and Preservation of Registered Trademarks

By Antonio Campero, Esq.

Cacheaux Cavazos & Newton
Torre Metrocorp, Avenida Tecamachalco No. 14-502
Colonia Lomas de Chapultepec
Mexico City, Mexico C.P. 11010
Tel: 011 52 55 5093 9700
Fax: 011 52 55 5093 9701

Website: www.ccn-law.com

In Mexico, as in the rest of the world, trademarks that are duly registered may be enforced against third parties who attempt to utilize or copy them. Nonetheless, it is advisable to take certain measures with respect to their use and proper maintenance, including the following recommendations:

- Ensure that the marks are always used in the manner in which they were registered. Many times the design of a trademark evolves over time, which means that while the mark continues to maintain similar elements, it has been modernized in such a manner that it can no longer be considered the same trademark that was previously registered. In this case, the rights pertaining to such trademark may be lost for failure to use the mark in the manner in which it was registered. In any event, it is advisable to verify any changes from time to time in order to make decisions regarding the same or to register the new image of the mark.

- The ® symbol is universally known and accepted to indicate that a trademark is registered. Although some designers may not like the presence of this symbol on the image of the mark, it is very convenient to accompany the mark with such symbol to give third parties notice as to the exclusivity of such mark. Similarly, it is highly recommended that the mark occupy a central space (noticeable) on the labels, packaging or printings of products that display the mark.

- Naturally, with the passage of time, trademarks gain notoriety through their use in commerce, and, in some cases, such notoriety reaches a level where the name of the mark is used as if it were a "generic" term to identify similar products (even competitors' products are called by the same name). Mexican legislation provides that when a trademark is used as a generic term and its owner "provoked or tolerated" such, then the trademark can be cancelled. Therefore, it is necessary to always include the ® symbol, since it openly demonstrates the exclusivity of the name and makes the generic name of the product known to the public. Unquestionably, in the event third parties imitate or copy the mark, the owner should take necessary actions to avoid creating an impression that the owner tolerated the conversion of the mark to a generic term.

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CCN Mexico Report™ (September 2013):

Privacy in Mexico, New Risks and Requirements

By Francisco Peña, Esq.

Cacheaux Cavazos & Newton
Torre Metrocorp, Avenida Tecamachalco No. 14-502
Colonia Lomas de Chapultepec
Mexico City, Mexico C.P. 11010
Tel: 011 52 55 5093 9700
Fax: 011 52 55 5093 9701

Website: www.ccn-law.com

Mexico ardently protects the privacy of its individual citizens' personal data and sensitive personal information (Information). This protection is enforced though the Federal Personal Information Protection Law (Law) and its regulations (Regulations). The Federal Institute for Access to Public Information and Protection of Information (IFAI) is the agency in charge of enforcing the Law and its Regulations. The Law has the following eight main principles:

i) Lawfulness, which requires using the Information in compliance with the Law;

ii) Consent, meaning that consent should be obtained before handling the Information;

iii) Information, prescribing instructions as to how Information should be handled;

iv) Quality, seeking to maintain current and correct Information ;

v) Purpose, tending to limit handling of the Information to the sole purpose described in the privacy notice (Notice);

vi) Loyalty, which is the obligation to respect the terms in which the Information was issued to the responsible party;

vii) Application, referring to the application of the Information solely for the strict purpose for which it was collected; and

viii) Responsibility, adopting only those measures that are necessary in order to comply with the Law.

Additionally, there are two duties that the responsible party should observe:

a) Duty of Confidentiality, maintaining confidentiality of the Information; and

b) Duty of Safeguarding, implementing the security measures of an administrative, physical and technical nature that guarantee the confidentiality and integrity of the Information.

Among other things, the Law defines what constitutes Information and how such should be handled. As a result, companies should review and identify which types of Information they handle or will handle. Once the type of Information is identified, companies can take required measures and necessary actions to safeguard the integrity of the Information, being that the collection and protection of such varies according to the nature of the Information itself. Under the Law, companies must write, publish and issue the corresponding privacy notice, guidelines for which were briefly discussed in the February 2013 edition of this report.

It is important that each person or company comply with the Law because any breach of such may result in an Information protection proceeding or in a verification procedure and, if applicable, fines of between 100,000 to 320,000 days of minimum salary in effect for the Federal District may be levied, with the possibility of being doubled in the event of a reoccurrence. For violations related to the handling of sensitive Information, fines can increase and even double, apart from applicable civil and/or criminal liability (including jail time), depending on the severity of the violation.

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Discrimination Claims Made at the Workplace

By Alan B. Graves, Esq.

Neil, Dymott, Frank, McFall & Trexler, APLC
1010 Second Avenue, Suite 2500
San Diego, CA 92101
Tel: 619.238-1712
Fax: 619.238.1562

agraves@neildymott.com
www.neildymott.com

Employee Cooperation will be Expected in the Employer's Investigation

An employee makes a claim to his or her employer of discrimination. The employer as rule of thumb needs to investigate the claim in order to address the claim and take appropriate action. However, what happens during the employer's investigation when other employees do not want to participate or refuse to cooperate. This question was recently addressed by the California Court of Appeal in McGrory v. Applied Signal Technology, Inc. (2013) 212 Cal. App. 4th 1510.

The plaintiff, John McGrory, sued his employer for wrongful termination following an investigation into whether he had sexual harassed another employee who he supervised and was openly gay. The employee made a claim to human resources that her supervisor, Mr. McGory, criticized her work performance because she was gay, told off color jokes, and demonstrated an overall lack of good judgment and sensitivity to those of other cultures.

The employer, Applied Signal Technology, Inc., hired a third party attorney to do an investigation into claims made by the employee against Mr. McGory alleging discrimination and harassment. At the completion of the investigation, the findings exonerated Mr. McGory of discrimination, but provided Mr. McGory had certain performance issues, which included making jokes based on race and sex in the workplace. Further, the attorney who did the investigation provided Mr. McGory had been uncooperative and untruthful during the investigation. The attorney made a recommendation to the employer that Mr. McGory should be terminated because his conduct was unacceptable for a manager and he appeared unwilling to acknowledge or reform his behavior.

The employer subsequently fired Mr. McGory. He turned around and sued his employer for wrongful termination and defamation. He alleged his termination violated public policy because he was fired as a result of participating in an employer's internal investigation.

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During the course of the lawsuit employer (defendant) filed a motion for summary judgment. The employer provided Mr. McGory was terminated because he had violated the employer's policies on sexual harassment, business, and personal ethics. Further, he was untruthful and uncooperative with the investigator and there was a concern his behavior might create a future legal liability for the employer. During the course of the lawsuit employer (defendant) filed a motion for summary judgment. The employer provided Mr. McGory was terminated because he had violated the employer's policies on sexual harassment, business, and personal ethics. Further, he was untruthful and uncooperative with the investigator and there was a concern his behavior might create a future legal liability for the employer.

Mr. McGory argued he was not terminated because of violating any policy, but primarily for being uncooperative during the internal investigation. Mr. McGory then cited to the Fair Employment Housing Act (FEHA), Government Code section 12940 where it provides it is unlawful employment practice "For any employer . . . to discharge, expel, or otherwise discriminate against any person because that person has opposed any practices forbidden under this part or because the person has filed a complaint, testified, or assisted in a proceeding under this part." (California Government Code section 12940 subdivision (h))
Mr. McGory assumes the employer's internal investigation was a "proceeding" as defined in Government Code section 12940 and therefore his participation in the investigation is a protected activity for which the employer could not take any retaliatory action, including termination against him. The trial court disagreed and granted the employer's Motion for Summary Judgment. Mr. McGory appealed.

The Court of Appeal upheld the trial court's ruling and further provided an employer's internal investigation is not a "proceeding". More specifically the Court of Appeal provided: "We conclude the Government Code section 12940, subdivision (h) does not shield an employee against termination or lesser discipline for either lying or withholding information during an employer's internal investigation of a discrimination claim. In other words, public policy does not protect deceptive activity during an internal investigation. Such conduct is a legitimate reason to terminate an at-will employee." (McGory v. Applied Signal Technology, Inc. at 1528).

The onus on the employer in California can be stringent when it comes to an employer's duty to address claims of discrimination in the workplace. These matters never should be taken lightly and advice from an experienced employment law attorney is helpful to avoid pitfalls. The ruling by the Court of Appeal in McGory v. Applied Signal Technology, Inc. does not ease the duty of the employer, but does provide support, putting employees on notice they have an obligation to be truthful and cooperative with an employer's internal investigation into discrimination claims.

There's No Such Thing as a Free . . . Intern

How to Distinguish Interns from Employees in California

By Robert J. Olson, Esq.

Neil, Dymott, Frank, McFall & Trexler, APLC
1010 Second Avenue, Suite 2500
San Diego, CA 92101
Tel: 619.238.1712
Fax: 619.238.1562

rolson@neildymott.com
www.neildymott.com

A New York District Court recently held employers cannot use an internship program in order to avoid paying wages or paying less than minimum wage. The court separated and defined interns and employees and adopted the Department of Labor's (DOL) guidelines. If your company employs an internship program now would be a good time to review it. Complicating matters, since the passage of the Patient Protection and Affordable Care Act, the court's ruling may reach further then just unpaid internships. Finally, it is highly likely a California Court will follow the same reasoning the NY court used.

Patient Protection Affordable Care Act (Obamacare)

The court defined when an intern becomes an employee. This is especially noteworthy because of the implications of the Patient Protection Affordable Care Act (ACA). The ACA does not differentiate interns from employees, so DOL and Courts are left to make the definitions. Under the ACA if an individual is an employee they are either a full time employee, part time employee, or a seasonal worker. As the ACA currently stands, unless your intern meets the six factor test they are classified as an employee under the ACA.

Intern vs. Employee

There is no reason to cancel or decide against an internship program just yet. Perhaps your internship program simply needs a few tweaks.

California generally follows Federal Labor Laws

The U.S. Department of Labor essentially followed a US Supreme Court holding which created a six factor test distinguishing an employee from a trainee. (Walling v. Portland Terminal Co.; DOL Fact Sheet #71 [April 2010].) In the recent New York case, the court used both the Walling decision and the DOL's Fact Sheet to hold a company cannot use an "intern" classification to get around paying wages.

There's No Such Thing as a Free . . . Intern

How to Distinguish Interns from Employees in California

California's Division of Labor Standards Enforcement (DLSE) prepared its' own opinion letter regarding interns in 2010 (2010.04.07). California's DLSE aligned California's internship classification with the FLSA and adopted the same six factors. As well, California's labor laws are generally compared and associated with the FLSA. Furthermore, California and Federal laws share similar definitions of "employee" and "employ," therefore it is reasonable to assume a California Court would adopt the same rationale the NY court.

The six criteria are:

1. Even though an intern is involved in the operations of a for-profit business, the interns are more involved in training (like the training given in an educational environment);

2. The internship experience is for the benefit of the intern;

3. The intern does not displace regular employees, but works under close supervision of the existing staff;

4. The employer providing the training derives no immediate advantages from the activities, in fact training the intern may actually impede its operations

5. Intern is not entitled to a job at the conclusion of the internship; and

6. Both the employer and employee understand the intern is not entitled to wages while acting as an intern.

Evaluating the Six Factors in your Company

A factor test means you do not need to achieve every factor. The more factors you meet the better you are. Courts often give more weight to certain factors; therefore you should try to meet those factors. This paper will outline where courts typically place more emphasis in their analysis.

1. Training is similar to an educational environment.

There must be some training beyond "on-the-job training." Even paid employees receive on-the-job training. An internship should involve teaching "fungible" skills useful in the industry and not just skills and techniques unique to your company. The training interns receive should be something more or different from training paid employees receives.

Perhaps the best way to develop an unpaid internship program is to incorporate your program with the intern's academic program. Another way to create an educational system is cycling interns through the various communities of your company (e.g. few weeks in operations, marketing, accounting, sales, etc.).

2. The internship experience is for the benefit of the intern.

This factor is similar to (1), but the focus is defining "skills" the program intends to use to each the intern. Since learning is subjective, the courts analyze this factor objectively. The courts will evaluate how the program was designed and how well it meets its objectives to train interns. The court evaluates whether your company expends resources to train the interns in matters relating to the industry and if the intern obtains skills valuable to more than just your company.

Note: It is insufficient to claim the intern benefited by getting experience on his resume. A paid employee also receives this benefit.

3. The intern does not displace regular employees, but works under close supervision of the existing staff;

The key question to ask is: if your intern leaves would you need to hire someone else to do the work? Past cases have placed more weight on this factor than others. In other words, was an unpaid intern doing a job a paid employee could perform?

Courts will consider: how closely the interns work with the employees in your business? Are your employees giving up their time to train and discuss work with the interns? Do the interns go to a work station every day and sit there working or are they following employees around and going to higher level meetings and functions?

4. The employer derives no immediate advantages from the interns work, in fact training the intern may actually impede its operations

This factor closely relates to (3) and the courts give it more weight as a factor. Is your company providing its interns company time and resources? Is your company taking the intern to meetings or business functions? Are you taking time away from your job to provide training to the interns?

The benefits of the intern's work should not produce an immediate profit nor provide improvements in efficiency. However, gaining future advantages from an internship program is still encouraged and usually the main purpose of the internship program.

These last two factors are the least important, but are the easiest factors to comply with.

5. The intern is not entitled to a job at the conclusion of the internship; and

If the intern was entitled to a job at the conclusion of the internship the program is actually considered training. You can easily adjust your program by informing interns they are not guaranteed employment and when they are finished with the internship and they will need to apply to the position if one is open.

6. Both the employer and employee understand the intern is not entitled to wages while acting as an intern.

This is perhaps the least important factor and also begs the question of an intern. Under the FLSA an employee cannot contract around his rights under the law. The FLSA sets the minimum wage. However, if it's considered an internship under these factors the intern must also understand they will not receive wages for their work.

Conclusion

Factor tests can be tricky and after the publicity of the New York case it could potentially open the door to lawsuits for lost wages, back pay, interest, and attorney fees. If you have an unpaid internship program, or if you are looking to start one, it might be wise to consult your attorney to evaluate your program.

President Obama recently delayed the employment piece of the Affordable Care Act until 2014. It would be wise to stay alert to the changes and updates especially regarding how ACA will define employees. Beware, if interns are classified as employees, it will open a whole new set of concerns under the ACA.

If you have a paid or unpaid internship program, it would be wise to review your program and see how many of the factors your program meets. As you evaluate your program, consult with your attorney. Remember it's cheaper to evaluate the program now before you get stuck in a class action lawsuit and cheaper to prevent ACA fines from being levied against your company.

Lucrative Government Program Funds Hospital Training of New Physicians

By Kathleen Hatfield, Esq.

Stewart and Stewart
2100 M Street, N.W., Suite 200
Washington, DC 20037
Tel: 202.315.0765
Fax: 202.466.1286

khatfield@stewartlaw.com
www.stewartlaw.com

The United States faces a looming shortage of primary care physicians that will only be exacerbated next year when, under the Affordable Care Act (ACA), 32 million additional Americans gain access to health insurance.[1] To help alleviate this crisis, the ACA in 2010 provided $230 million to fund an innovative proposal called the Teaching Health Center Graduate Medical Education (THCGME) residency training program. The program provides hospitals and community health centers with funds to train new primary care physicians each year in the amount of approximately $150,000 per resident. The funding is made available through a non-competitive grant, which means that all applicants who meet five eligibility requirements will be funded. The opportunity will be posted by the government later this fall, with applications due approximately 60 days thereafter.

[1] Association of American Medical Colleges, *Physician Shortages to Worsen Without Increases in Residency Training*, 1 *available at* https://www.aamc.org/download/286592/data/ and https://www.aamc.org/advocacy/campaigns_and_coalitions/fixdocshortage/

Background

Traditionally, resident physicians in hospitals received their training primarily with Medicare dollars administered by the U.S. Centers for Medicare and Medicaid Services (CMS). CMS funded the resident training, also known as "graduate" medical education (GME), after the medical students received their Doctorate of Medicine (M.D.) or Doctor of Osteopathic Medicine (D.O.) degrees in the United States. GME still supports residencies and leads to state licensure and board certification. Because CMS administers GME, it was long assumed that unless redirected by Congress, CMS would largely determine the future size and character of the physician workforce in America -- a system rooted in legislation which preceded the ACA, namely the Balanced Budget Act of 1997. The 1997 Act sought to reduce Medicare spending on GME by placing a "cap" on the number of residents that could be trained at each hospital. These and other spending reductions were imposed in 1997 across facilities nationwide, with payments for resident training, home health services, skilled nursing care, and hospital outpatient services all reduced via a new prospective payment system.[2] Indirect Medical Education Reimbursement (IME) payments, used to subsidize hospital expenses associated with running resident training programs, were also reduced.[3] [4]

The 1997 Act evoked a negative response when rapid population growth in particular areas of the United States placed considerable burdens on hospitals and medical schools.[5] Physician residency training programs struggled to produce enough physicians to provide adequate care in geographic areas where primary care physician (PCP) training was most needed.[6] This was because community hospitals experiencing Medicare cutbacks had to decrease residency training, even though family physicians were always considered more likely than general internists or pediatricians to be trained in community hospitals and locate their practices in rural underserved areas.[7]

According to the Center for Workforce Studies in Washington, D.C., the number of physician residents and fellows changed little between academic year 1997 (98,143) and 2002 (98,258), but increased to 106,012 in academic year 2007, a net increase of only 8.0% over the decade. While the annual number of new GME entrants increased by 7.6%, this was due to an influx of international, rather than U.S., medical graduates. From 2002 to 2007, American doctors training in primary care decreased by 2,641, while international medical graduates increased by 3,286. Increased specialization rates also led fewer doctors to enter primary care practice post-residency.[8]

Thus, Medicare's support for physician training was effectively "frozen" in 1997, which led to concerns that unless the number of residency training slots was increased in America's teaching hospitals, the nation would continue to confront a declining number of physicians per capita -- just as baby boomers joined Medicare rolls. The U.S. now faces a shortage of more than 45,000 primary care physicians by 2020.[9]

Solution

Recognizing that something must be done to address the shortage, pursuant to the ACA and consistent with congressional directive, the U.S. Department of Health and Human Service's Health Resources and Services Administration (HRSA) for three years has provided grant funding for hospitals in partnership with community-based ambulatory care centers and/or

[2] "Ronald Schneeweiss, MBChB; Roger A. Rosenblatt, MD, MPH; Susan Dovey, PhD; L. Gary Hart, PhD; Frederick M. Chen, MD, MPH; Susan Casey, PhD; George E. Fryer, Jr., PhD, *The Effects of the 1997 Balanced Budget Act on Family Practice Residency Training Programs*, Family Medicine 93, 94 (February 2003), *available at* http://www.stfm.org/fmhub/fm2003/feb03/re1.pdf

[3] Association of American Medical Colleges, *Medicare Indirect Medical Education (IME) Payments, available at* https://www.aamc.org/advocacy/gme/71150/gme_gme0002.html

[4] Health Affairs, *Health Policy Brief on Graduate Medical Education* (August 31, 2012), *available at*: http://www.healthaffairs.org/healthpolicybriefs/brief.php?brief_id=73

[5] "Ronald Schneeweiss, MBChB; Roger A. Rosenblatt, MD, MPH; Susan Dovey, PhD; L. Gary Hart, PhD; Frederick M. Chen, MD, MPH; Susan Casey, PhD; George E. Fryer, Jr., PhD, *The Effects of the 1997 Balanced Budget Act on Family Practice Residency Training Programs*, Family Medicine 94 (February 2003), *available at* http://www.stfm.org/fmhub/fm2003/feb03/re1.pdf

[6] *Id*.

[7] *Ibid*.

[8] Edward Salsberg, MPA; Paul H. Rockey, MD, MPH; Kerri L. Rivers, MS; Sarah. E. Brotherton, PhD; and Gregory R. Jackson, BS, Center for Workforce Studies, Association of American Medical Colleges, *U.S. Residency Training Before and After the 1997 Balanced Budget Act*, 1 (September 10, 2008), *available at* http://www.ncbi.nlm.nih.gov/pubmed/18780846

[9] Association of American Medical Colleges, *Physician Shortages to Worsen Without Increases in Residency Training*, 1 *available at* https://www.aamc.org/download/286592/data/ and https://www.aamc.org/advocacy/campaigns_and_coalitions/fixdocshortage/

medical schools to train new residents in the following practice areas:

- Family medicine;
- Internal medicine;
- Pediatrics;
- Internal medicine-pediatrics;
- Obstetrics and gynecology;
- Psychiatry;
- General dentistry;
- Pediatric dentistry; or
- Geriatrics.

Under the THCGME grant program, approximately $150,000 is provided per new resident, each year, to increase the supply of primary care physicians. Today, HRSA-funded teaching health centers exist in: Alaska, Arkansas, California, Connecticut, Iowa, Idaho, Illinois, Kentucky, Maine, Massachusetts, Michigan, Missouri, Montana, North Carolina, New Mexico, New York, Oklahoma, Pennsylvania, Texas, Washington and West Virginia.

HRSA intends to post a notice announcing the fourth round of this funding sometime this fall, with applications due approximately 60 days thereafter. The goal of the THCGME program is to move primary care physicians into traditionally underserved areas, whether urban or rural. Government payments will cover direct expenses (*i.e.*, salaries) associated with the residency training programs, as well as indirect expenses associated with training the new residents.

Specific examples of eligible community-based ambulatory patient care facilities with which hospitals can partner to obtain this funding include: federally-qualified health centers; community mental health centers; rural health clinics; health centers operated by the Indian Health Service, an Indian tribe or tribal organization, or an urban Indian organization; and entities receiving funds under title X of the Public Health Service Act.

Whichever of these eligible entities partners with a hospital in the application, they must be listed as the institutional sponsor of the proposed Teaching Health Center by the relevant accrediting body, meaning either the Association of Osteopathic Medicine (AOA) or the Accreditation Council for Graduate Medical Education (ACGME). A hospital can partner with the accredited FQHC/CHC, or create an entirely new consortium also eligible for funding by collaborating with a health center and/or a medical school in operating one or more residency programs. In its grant guidance, HRSA finds teaching hospitals and academic institutions have proven to be successful members of many established GME consortia. In these cases, the consortium itself may serve as both the applicant and the institutional sponsor of the residency program. In all cases, the health center must be an essential and key partner in the project.

Federal funding provided under the grant may be used to pay the costs of training new residents either in a newly-established teaching health center, or it may support an expanded number of new residents to be trained in an existing teaching health center.

The teaching health center model has a long history with several successful teaching health centers dating back to the 1980s. However, past growth of these facilities has been limited due to the difficulty of bringing together the dual missions of training and service; administrative complexities; and a lack of financial resources.[10]

What really influenced the U.S. government to undertake this program were studies which demonstrated that family medicine residents who

[10] Affordable Care Act – Teaching Health Center Graduate Medical Education (THCGME) Program Funding Opportunity Announcement Number: HRSA 13-144 (August 3, 2012).

train in teaching health center settings are nearly three times more likely to practice in underserved settings after graduation compared to residents who did not train in such settings. Further, the government describes successful teaching health centers as having these common elements: an institutional commitment to the dual mission of medical or dental education and *service to an underserved patient population, including underrepresented minority and other high risk populations.*[11]

In sum, the THCGME program represents one way in which the nation's graduate medical education program is moving beyond limits in the 1997 Balanced Budget Act. In underserved areas, primary care physicians and community hospitals remain invaluable, and their high caliber can be credited specifically to the health facilities that undertake exactly these types of residency training programs.

Future

In this time of worsening physician shortages, the provision of funding for these training programs will go a long way to improve quality of care and expand services. Today's health care environment is far different from that of 1997. Residency programs need to be expanded rather than capped. To counter imminent provider shortages and provide all-encompassing quality care, America simply needs more well-trained doctors. The THCGME program helps accomplish this goal.

Currently, there exist 32 federally-funded teaching health centers. This summer, Health and Human Services Secretary Kathleen Sibelius announced another $12 million in additional ACA funding to support the program. She stated the money would help train more than 300 residents during the 2013-2014 academic year -- doubling the number of residents trained in the prior one.

"Teaching Health Centers help attract students who are committed to serving communities of need and prepare them to practice in these communities," Secretary Sebelius said in her statement. She noted that teaching health centers are in urban, rural, and Tribal communities, and serve populations including veterans, minorities, older adults, and children.

"This program not only provides training to primary care medical and dental residents, but galvanizes communities," said HRSA Administrator Mary K. Wakefield. "It brings hospitals, academic centers, health centers, and community organizations together to provide top-notch medical education and services in areas of the country that need them most."

Because traditional CMS-funded residency training continues to produce an inordinate proportion of specialists under fixed "caps" -- largely at the expense of primary care -- it is anticipated that the THCGME program will be extended by Congress for another five years beyond its current expiration date in 2015. This is because the continued funding and expansion of the THCGME program will:

- provide more than 700,000 primary care visits in needy rural and urban settings; and
- guarantee that every dollar expended by the government for this project will be used exclusively for primary care training.

To ensure that the THCGME program will be extended, an organization called the American Association of Teaching Health Centers was established in Washington, D.C., in June to lobby the U.S. Congress for the reauthorization and expansion of the THCGME program. The group is requesting an additional $800 million to fund the program through the end of fiscal year 2021, and Senators Kay Hagan (D-NC) and Bernie Sanders (D-VT), supported by Senator Joe Manchin (D-

[11] *Id.*

WV), have drafted legislation that will obtain this goal.

Once funded, the extended THCGME program is expected to double the number of teaching health centers in the United States and support the training of over 1,000 residents each year. The teaching health centers will "graduate" more than 350 new primary care providers annually, who will serve an additional 700,000 new patients every year through nearly 1.5 million patient visits.

If you and your clients would like to discuss this federal funding opportunity and obtain ongoing support for your application from your Members of Congress, please contact Kathleen Hatfield in the Law Offices of Stewart and Stewart at 202-466-1274 or e-mail her at: KHatfield@stewartlaw.com.

Frequently Asked Questions Regarding Workplace Accommodations Requested by Pregnant Employees

By Carol Schuler Harding, Esq.

Earp Cohn P.C.
20 Brace Road, 4th Floor
Cherry Hill, NJ 08034
(856) 354-7700
(856) 354-0766

csharding@earpcohn.com
www.earpcohn.com

1. Is pregnancy deemed to be a disability under the original ADA?

No. Neither pregnancy itself, nor common restrictions thereof, including avoidance of repetitive heavy lifting and of exposure to hazardous chemicals, have been deemed to be a disability requiring accommodation under the original ADA.[1] In rare circumstances, however, serious complications of pregnancy have been deemed to meet the definition of disability under the original ADA.[2]

[1] *See, e.g., Young v. United Parcel Service, Inc.,* 707 F.3d 437, 445 (4th Cir. 2013) (noting that "[g]iven the relatively manageable weight restriction – twenty pounds – and the short duration of the restriction, there is no evidence that Young's pregnancy or her attendant lifting limitation constituted a disability within the meaning of the ADA."); *Spees v. James Marine, Inc.,* 617 F.3d 380, 396 (6th Cir. 2010) (stating "because pregnancy is not the result of a physiological disorder," it is "not an impairment."); *Farrell v. Time Serv., Inc*., 178 F. Supp. 2d 1295, 1298-99 (N.D. Ga. 2001)(noting "[a]t most, courts have held that pregnancy may rise to the level of a disability if there are severe complications.); *Minott v. Port Auth. of N.Y. & N.J.*, 116 F.Supp.2d 513, 525 (S.D.N.Y. 2000) (noting that pregnancy related conditions have been found to constitute a disability under the ADA "only in extremely rare circumstances."); 29 C.F.R. pt. 1630 app §1630.2(h) ("conditions, such as pregnancy, that are not the result of a physiological disorder are . . . not impairments."); EEOC Compliance Manual § 902.2(c)(3)("Because pregnancy is not the result of a physiological disorder…it is not an impairment and therefore cannot be a disability.")

[2] *See, e.g., Cerrato v. Durham*, 941 F.Supp 388, 393-94 (S.D.N.Y. 1996) (finding that Plaintiff's pregnancy-related condition of spotting, leaking, cramping, dizziness and nausea was sufficient to survive motion to dismiss ADA claim); *Patterson v. Xerox Corp*., 901 F.Supp. 274, 278 (N.D.Ill., 1995) (finding that Plaintiff's pregnancy-related severe back pain was sufficient to survive a motion to dismiss ADA claim.)

Frequently Asked Questions Regarding Accommodations Requested by Pregnant Employees

2. Is pregnancy deemed to be a disability under the ADA Amendments Act (ADAAA)?[3]

While pregnancy is not considered to be a disability under the ADAA[4], the amended act significantly lowers the bar with regard to what may be considered to be a disabling limitation, restriction, or complication of pregnancy. The amended act broadens the definition of disability, and contains a rule of construction requiring courts to interpret the definition of disability broadly.[5] The stated primary purpose of the ADAAA was to make it easier for people with disabilities to obtain protection under the ADA.[6] While the EEOC has not stated that limitations which commonly accompany pregnancy should be considered to be disabling, in the Appendix to the regulations under the amended act, the EEOC refers to an employee who has an impairment resulting in a "20 pound lifting restriction that lasts or is expected to last for several months," which is not an uncommon restriction during pregnancy, as meeting the definition of an ADA disability.[7] It should also be noted that in the EEOC's strategic enforcement plan adopted in December of 2012, the EEOC identified accommodating pregnancy-related limitations under the ADAAA and the Pregnancy Discrimination Act ("PDA") (discussed below) as a priority for enforcement because such accommodations are an "emerging and developing issue."[8]

[3] The original ADA applies to instances of alleged discrimination occurring before January 1, 2009. The ADAAA applies to instances of alleged discrimination occurring on or after January 1, 2009.

[4] 29 C.F.R. pt. 1630 app. 1630.2(h).

[5] 42 U.S.C. § 12102(4)(1)(A).

[6] 29 C.F.R. pt. 1630, app § 1630.1(c), *citing*, Joint Hoyer-Sensenbrenner Statement on the Origins of the ADA Restoration Act of 2008 H.R. 3195.

[7] 29 C.F.R. pt. 1630, app § 1630.2(i)(1)(ix)

[8] EEOC Strategic Enforcement Plan, FY 2013-2016, at 10 (2012), available at http://www.eeoc.gov/eeoc/plan/upload/sep.pdf.

3. Does the Pregnancy Discrimination Act ("PDA") require that workplace accommodations be provided to pregnant employees?

It depends. The PDA is an amendment to Title VII that was passed in 1978. It requires that women affected by pregnancy, childbirth, or related medical conditions be treated in the same manner as other employees with similar abilities or limitations. Accordingly, under the PDA, workplace accommodations must be provided to pregnant employees with some related restrictions or limitations only if such accommodations are provided to non-pregnant employees with similar restrictions or limitations.[9]

4. What should an employer do when a pregnant employee indicates a need for a workplace accommodation?

If an employee, formally or informally, informs her employer that she has a pregnancy-related restriction, the employer must first consider whether the restriction may qualify as an ADAAA disability. As stated above, under the

[9] A frequently cited discussion of the limited nature of the requirements of the PDA appears in *Troupe v. May Dep't Stores*, 20 F.3d. 734, 738 (7th Cir. 1994) (Judge Posner), where the court noted that "[t]he Pregnancy Discrimination Act does not … require employers to offer maternity leave or take other steps to make it easier for pregnant women to work. Employers can treat pregnant women as badly as they treat similarly affected but nonpregnant employees." It should be noted that the Pregnant Workers Fairness Act (PWFA), H.R. 1975 proposed in Congress would, essentially, combine the requirements of the ADA and the PDA to require employers to make reasonable accommodations to employees who have limitations stemming from pregnancy, childbirth, or related medical conditions, unless the accommodation would impose an undue hardship on the employer.

Amended Act, the bar is set quite low.[10] If it is determined that the restriction may qualify, the employer is required to start an interactive process with the employee to determine how the restriction might impair her ability to do her job, and whether a reasonable accommodation may be made.[11] The employer should determine the demands of the particular job by analyzing the actual job duties and determining the true purpose or object of the job.[12] The employer should next consult with the employee regarding her restriction and ask for documentation from her health care provider with regard to restriction and the need for a reasonable accommodation. Together with the employee, the employer should identify possible reasonable accommodations (such as light duty, unpaid leave, access to a chair or stool, job restructuring, modified workplace policies, periodic breaks, etc.) and determine which, if any, is the most appropriate for the employee and employer that does not cause undue hardship to the employer.[13] The employer should document the process and be sure to provide appropriate training to any supervisory employees who will be implementing the process. It may be helpful to centralize the process by directing that all such inquiries be referred to certain Human Resource personnel, who are well-trained, who will work with both the employee and her direct supervisors to determine how to proceed.

10 While the bar is low, there is still a bar. 29 C.F.R. § 1630.2(i)(1)(ii) states that an "impairment is a disability within the meaning of this section if it substantially limits the ability of an individual to perform a major life activity as compared to most people in the general population. An impairment need not prevent, or significantly restrict, the individual from performing a major life activity in order to be considered substantially limiting. Nonetheless, not every impairment will constitute a 'disability' within this section."

11 The EEOC recognizes that in some circumstances the necessary accommodation may be so apparent to the employer and employee that no interactive process would be necessary. The example given is an employee who uses a wheelchair requests that his desk be put on blocks to allow the chair to pass under the desk. 29 C.F.R. pt. 1630, app § 1630.9.

12 29 C.F.R. pt. 1630, app. § 1630.9.

13 *Id.*

5. What is a "reasonable accommodation"?

Measures that would be deemed to be reasonable accommodations vary on a case by case basis. Generally, a reasonable accommodation is any change in the work environment or in the way things are customarily done,[14] and may include job restructuring, part-time or modified work schedules, reassignment to a vacant position, job-protected leave, acquisition or modification of equipment, modifications of policies, and other similar accommodations.[15] An employer need not implement a reasonable accommodation for its pregnant employee if it would cause undue hardship to the employer. "Undue hardship" means significant difficulty or expense and focuses on the resources and circumstances of the particular employer in relationship to the cost or difficulty of providing a specific accommodation. Undue hardship refers not only to financial difficulty, but to reasonable accommodations that are unduly extensive, substantial, or disruptive, or those that would fundamentally alter the nature or operation of the business.[16]

6. What is the total amount of leave that must be provided to a pregnant employee?

The total amount of leave that must be provided varies on a case by case basis. An employer must consider its obligations under not only the ADAAA and the PDA, but also the Family and Medical Leave Act (FMLA).[17] The PDA applies only to the pre-natal period. The FMLA, and possibly the ADAAA, applies to both the pre-natal and post-natal periods. The FMLA provides the employee with certain leave rights for both her serious health condition that makes her unable to perform the functions of her position,

14 29 C.F.R. pt. 1630 app. § 1630.2(o).

15 42 U.S.C. § 12111(9).

16 See 42 U.S.C. § 12111(10).

17 It should be noted that both the ADAAA and the PDA apply to private employers with 15 or more employees, but that the FMLA will not apply unless a private employers has 50 or more employees.

and for the birth and care of her child.[18] Under the PDA, the employer must provide leave to the pregnant employee during the course of a pregnancy if such leave would be provided to a non-pregnant employee with similar restrictions or limitations. Where an employee may be entitled to leave under both the ADAAA and the FMLA, the employer should consider her leave rights under both statutes separately and then determine where the two may overlap. Take, for example, a pregnant employee who advises her employer that she has been placed on bed rest with six weeks remaining in her pregnancy. Further, the employee advises that she will give birth by C-Section and will require eight weeks leave following the birth. Twelve weeks of leave are guaranteed under the FMLA. This would cover the time after the birth of the baby and four of the six weeks of bed rest. The remaining two weeks of bed rest may be deemed to be a reasonable accommodation under the ADAAA. If it presents an undue hardship to provide the leave however, the employer is not required to provide the leave. If this is the case, the employer should anticipate having to respond to a complaint and must be prepared to prove that the additional leave actually would cause it undue hardship. If the additional leave would be provided to a non-pregnant employee with a similar restriction, the provision of the additional leave likely would fail to meet the burden to prove undue hardship to the employer, and would be a required accommodation under the PDA.

[18] 29 U.S.C. § 2612(a).

Hot Topics In Colorado Employment Law Rocky Mountain High: What the Legalization of Marijuana Means for Employers

By Muliha Khan, Esq.

Zupkus & Angell, P.C.
555 East 8th Avenue
Denver, CO 80203
Tel: 303.357.0202
Fax: 303.894.0104

mkhan@zalaw.com
www.zalaw.com

Background: Legalizing Marijuana in Colorado

Was John Denver's "Rocky Mountain High" an innocent tribute to the beauty of the Colorado mountains or a premonition regarding the state's future legalization of marijuana? While some believe the tune was about nature and only nature[i], Colorado's recent legalization of marijuana gives a whole new meaning to the 1973 song, now ironically one of the two official state songs.[ii]

Arguably, Colorado's legalization of recreational marijuana was merely a continued progression of past laws of the state. In 1932 Colorado was the first state to repeal the nation's prohibition on alcohol.[iii] Fast-forward to the millennium and medical marijuana was decriminalized in the state. Technically speaking, Colorado created insulation from criminal prosecution for those using marijuana for medical purposes.[iv] In 2012, twelve years later, Colorado voters approved an amendment to the state constitution extending the "use of marijuana . . . legal for persons twenty-one years of age or older."[v] In other words, marijuana, even if not used for medical purposes, had become legal in Colorado.

Inevitably, the legalization of marijuana has in many ways led to more questions than answers. For example, how does this recent legalization impact employers? The constitutional amendment clearly states that employers are not required "to permit or accommodate the use, consumption, possession, transfer, display, transportation, sale or growing of marijuana in the workplace . . ."[vi] Easy enough: what this means is that employers can clearly prohibit employees from using marijuana in the workplace. But, what about off the job? The constitutional amendment does state that employers can still "have policies restricting the use of marijuana by employees."[vii] So is it permissible for an employer to terminate an employee simply for testing positive for marijuana even if the employee was ***not*** under the influence of the drug at work? Applying Colorado case law

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regarding medical marijuana in the workplace, the short answer is most likely yes. However, employers should not assume automatic insulation from liability. As discussed later, the regulation of marijuana in the workplace is largely a policy question. Therefore, there could be future opportunity and basis to challenge a termination stemming from an employee's off duty use of marijuana. In light of this, employers must continue to take precaution and adopt a best practices approach with respect to drug policies and procedures in the workplace.

Case Law: Medical Marijuana in the Workplace

In 2000 Colorado voters approved an amendment to the constitution which established affirmative defenses to the state's criminal laws against marijuana for those who used the drug for medical purposes ("Medical Marijuana Amendment").[viii] Inevitably, the Medical Marijuana Amendment has collided with the drug-free policies adopted by many businesses, as evidenced in the cases discussed below.

In *Beinor v. Indus. Claim Appeals Office*, Jason Beinor was discharged by his employer after testing positive for marijuana.[ix] Beinor obtained and used marijuana for severe headaches, as recommended by a physician.[x] However, the employer's zero-tolerance drug policy was very clear: "[I]f a current employee is substance tested for any reason . . . and the results of the screening are positive for . . . illegal drugs, the employee will be terminated."[xi] Ultimately, Beinor was denied unemployment benefits following his discharge. The Colorado Court of Appeals upheld the denial relying on Colorado law which disqualifies employees "from receiving unemployment compensation benefits if a separation from employment occurs because of '[t]he presence in an individual's system, during working hours, of ***not medically prescribed controlled substances*** . . .'"[xii] The court ruled that medical marijuana, even though decriminalized pursuant to the Medical Marijuana Amendment, did not qualify as a medically- controlled substance.[xiii] Therefore, denial of Beinor's unemployment benefits was upheld.

There is no doubt that *Beinor* is a pro-employer case. In addressing the interplay between Colorado's drug laws and the workplace, the court emphasized that the Medical Marijuana Amendment does not "require any employer to accommodate the medical use of marijuana in any work place."[xiv] Furthermore, the court pointed out that "the Colorado Constitution does not give medical marijuana users the unfettered right to violate employers' policies and practices regarding use of controlled substances."[xv]

The court in *Beinor* made it very clear that its focus was denial of unemployment benefits and "not deciding whether the amendment limits an employer from discharging an employee for using medical marijuana."[xvi] The court in *Coats v. Dish Network, L.L.C.*, considered the larger issue of discharge.[xvii]

In *Coats*, ex-employee of Dish Network, Brandon Coats, was fired after he tested positive for marijuana. Coats, a quadriplegic, used marijuana for medical purposes in compliance with the Medical Marijuana Amendment which provides immunity from criminal prosecution of marijuana use.[xviii]. Coats challenged his termination arguing that his use of marijuana qualified as lawful off duty conduct.[xix]. The Court of Appeals disagreed reasoning that because marijuana was prohibited by federal law such activity could not be categorized as lawful off duty conduct.[xx] Thus, the court found that the employer was justified in discharging Coats after he failed a drug test.[xxi]. Coats' claims that he "never used marijuana on defendant's premises, and was never under the influence of marijuana at work" played no role in the court's analysis.[xxii]

Off Duty Use of Marijuana

Extending *Beinor and Coats* to the 2012 amendment legalizing recreational marijuana ("Recreational Marijuana Amendment"), could an employee be legitimately fired for off duty use of recreational marijuana? The answer is most likely yes. The fact that the ex-employees in both cases used marijuana, even though only for medical purposes, was enough to render pro-employer outcomes. However, no consideration was given to whether the ex-employees were actually under the influence of marijuana **at work**.[xxiii] Recreational marijuana would probably be treated in the same manner, particularly as the Recreational Marijuana Amendment, like the Medical Marijuana Amendment, does not "require an employer to permit or accommodate the use, consumption, possession, transfer, display, transportation, sale or growing of marijuana in the workplace or to affect the ability of employers to have policies restricting the use of marijuana by employees."[xxiv]

However, the dissents in both *Beinor and Coats* raise valid points, suggesting that employers may not always be justified in discharging an employee for off duty use of marijuana. The dissent in *Beinor* argues that "many patients who are eligible to use medical marijuana would likely abandon their right to do so because even lawful use at home would put their benefits, and perhaps even their jobs, at risk."[xxv]. So, isn't the question of whether an employee can be fired for off duty use of marijuana really a question of policy? Even though recreational marijuana is legal in Colorado, any person who uses it, even if in compliance with the law, risks the possibility of termination regardless of whether or not they use the drug on the job. Doesn't such a policy defeat the very purpose of the Recreational Marijuana Amendment? And, doesn't such a policy infringe on an employee's off duty autonomy? The *Coats*' dissent points out that the Colorado off duty conduct statute is "to protect employees' autonomy in their off-the-job activities, such as smoking and eating patterns that lead to obesity." [xxvi] Even the majority in *Coats* admits that the purpose of the off duty conduct statute is to "is to keep an employer's proverbial nose out of an employee's off-site off-hours business."[xxvii]. However, when it comes to marijuana, Colorado courts will likely let employers keep their proverbial noses in the off duty conduct of their employees. Well, at least for now.

On August 29, 2013, the U.S. Department of Justice (DOJ) issued yet another Memorandum, the subject of which was: Guidance Regarding Marijuana Enforcement.[xxviii]. The purpose of the Memorandum was to provide "guidance in light of state ballot initiatives that legalize under state law the possession of small amounts of marijuana . . ."[xxix]. The Memorandum specifies the DOJ's enforcement efforts with respect to marijuana.[xxx]. Clearly, the Memorandum was directed at Colorado and Washington. If this Memorandum was in existence at the time of the *Beinor and Coats* decisions, arguably the rulings in those cases could have been different. To illustrate, the court in *Beinor* cited to the DOJ memorandum which was in existence at that time to further support its denial of benefits.[xxxi] However, the 2013 Memorandum may have prompted the court to rule differently. Additionally, in *Coats* the court's argument was premised on the unlawfulness of marijuana at the federal level.[xxxii] The 2013 Memorandum addresses this very issue and could have impacted or changed the court's ultimate ruling in *Coats* that off the job use of marijuana was not lawful off duty conduct.

The main lesson in light of *Beinor and Coats* is that the interpretation of the Recreational Marijuana Amendment, like the Medical Marijuana Amendment, will largely be driven by policy. Undoubtedly, policy is shaped by many factors, including the 2013 Memorandum referenced above, and thus is subject to continuous change. Therefore, employers should not assume blanket protection when terminating employees for off duty use of marijuana. Instead, employers should adopt the best practices and policies such as the ones listed below.

Learning from Beinor and Coats: Implementing Best Practices

The following are best practices for employers to implement for purposes of establishing and/or maintaining a drug-free workplace:

1. The drug-free policy should be in written form either in the handbook or as a separate policy. Regardless of where it appears, the employee should be required to show receipt of the policy either through signature or electronic verification.
   - Reasoning: This provides the employee with less of a basis to argue that they were unaware of the drug-free policy.

2. The drug-free policy should be as broad in scope as possible i.e. "If a current employee is substance tested for any reason and the results of the screening are positive for illegal drugs and/or marijuana, the employee will be terminated."
   - Reasoning: If you limit the prohibited drugs to just "illegal drugs," employees could now argue that marijuana is legal pursuant to the Recreational Marijuana Amendment. Therefore, if the policy only prohibited illegal drugs, use of marijuana would never be a violation. Also, as opposed to stating that drugs are not to be used in the workplace, the policy should state that those who test positive for drugs will be terminated because this encompasses any kind of drug use whether on or off the job. As we learned from *Coats*, an employee could be discharged for off duty drug use.

3. If the goal is to deny unemployment benefits, testing should be carried out during work hours.
   - Reasoning: Tests showing the presence of not medically controlled substances during work hours disqualify the employee from receiving unemployment benefits.[xxxiii]

4. If the goal is to deny unemployment benefits, testing should be administered by a medical facility or laboratory licensed or certified to conduct such tests.
   - Reasoning: Tests showing the presence of not medically controlled substances to deny unemployment benefits must be administered by licensed facilities or labs.[xxxiv]

5. If possible, document any and all evidence of on-the-job drug use or the effects of off duty drug use.
   - Reasoning: While *Coats* likely supports the discharge of an employee even for off duty use of recreational marijuana, any evidence showing on-the-job drug use or effects of off duty drug use will further justify the termination of the employee.

Conclusion: If You Choose to Use

Colorado voters approved the legalization of marijuana; it's what the people wanted. But, as Eleanor Roosevelt said, "With freedom comes responsibility."[xxxv] Thus, those who choose to use must comply with the law: they must be of age; they must pay the necessary tax (still a pending issue); they may not distribute to minors; and they must not violate their employer's drug policy.[xxxvi] With respect to the last point, policy at this time favors employers. However, watch this space, as this unchartered, emerging area of law will inevitably change.

[i] Rick Moore, *John Denver, "Rocky Mountain High,"* AMERICAN SONGWRITER (April 1, 2013, 6:07 AM), http://www.americansongwriter.com/2013/04/john-denver-rocky-mountain-high/,
[ii] Colorado Department of Personnel & Administration, http://www.colorado.gov/dpa/doit/archives/history/symbemb.htm (last visited Sept. 12, 2013).
[iii] Dick Kreek, High, Dry Times as Prohibition Era Sobered Denver, DENVER POST (July 5, 2009). http://www.denverpost.com/ci_12743857
[iv] Colo. Const. art. XVIII, § 14.
[v] Colo. Const. art. XVIII, § 16(1)(a).
[vi] Colo. Const. art. XVIII, § 16(6).
[vii] *Id*.
[viii] Colo. Const. art. XVIII, § 14.
[ix] *Beinor v. Indus. Claim Appeals Office*, 262 P.3d 970, 972 (Colo. App. 2011), *cert denied*, NO. 11SC676, 2012 WL 1940833 (Colo. May 29, 2012).
[x] *Id*.
[xi] *Id*.
[xii] *Id*. at 973 (citing C.R.S. § 8-73-108(5)(e)(IX.5)).
[xiii] *Beinor*, 262 P.3d at 974-975.
[xiv] *Id.* at 976 (citing Colo. Const. art. XVIII, § 14(10)(b)).
[xv] *Beinor*, 262 P.3d at 976.
[xvi] *Id*.
[xvii] *Coats v. Dish Network, L.L.C*., 303 P.3d 147 (Colo. App. 2013).
[xviii] *Id*. at 149.
[xix] *Id*.
[xx] *Id*. at 151-152.
[xxi] *Id*. at 152.
[xxii] *Id*. at 149.
[xxiii] *Beinor*, 262 P.3d at 978; *Coats*, 303 P.3d at 149.
[xxiv] Colo. Const. art. XVIII, § 16(6).
[xxv] *Beinor*, 262 P.3d at 980.
[xxvi] *Coats*, 303 P.3d at 156.
[xxvii] *Id*. at 151.
[xxviii] Memorandum from James M. Cole, Deputy Attorney General, for All United States Attorneys (August 29, 2013), *available at* http://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf.
[xxix] *Id*. at p. 1.
[xxx] *Id*.
[xxxi] *Beinor*, 262 P.3d at 974.
[xxxii] *Coats*, 303 P.3d at 152.
[xxxiii] C.R.S. § 8-73-108(5)(e)(IX.5) (2013).
[xxxiv] *Id*.
[xxxv] PEARLS OF WISDOM, *Quotations*, http://www.sapphyr.net/women/women-quotes-eleanorroosevelt.htm (last visited Sept. 12, 2013).
[xxxvi] Colo. Const. art. XVIII, § 16(1) & (6).

Arbitration of Employment Disputes? Let's Have Another Look!

By Dennis J. Alessi, Esq.

Mandelbaum Salsburg
155 Prospect Avenue West
Orange, NJ 07052
Tel: 973.736.4600
Fax: 973.325.7467

dalessi@msgld.com
www.msgld.com

Arbitration For All Employees

Since the early 1990s, many of the more sophisticated employers have required that all their employees sign arbitration agreements for any disputes regarding their employment and termination. In some instances these agreements are incorporated into the employment application; or as a separate document employees execute upon initiating employment, along with many other employment-related forms; or, in other situations, a policy on arbitration is included in the Employee Handbook. Regardless of the mechanisms the employer uses to establish this arbitration agreement, there are standard factors which all courts will consider in deciding whether to enforce it.

Federal and state supreme courts have enforced such agreements provided certain conditions are met; primarily that: (1) the employee has signed a document which in clear, simple, and straightforward language states the terms of the arbitration agreement; (2) the agreement contains this same type of language that the employee is waiving the right to a trial in court with a judge and jury; and (3) from the circumstances of the employee's signing the agreement, (e.g. having time to consider signing and an opportunity to ask management any questions), it is clear that they knew and understood what the agreement meant, particularly the waiver of a jury trial, and have voluntarily signed it as a condition of continued employment.[1] This last requirement can usually be met, to the court's satisfaction, if the employee has signed an acknowledgment for the arbitration agreement which includes such representations.

[1] Some states, particularly California, have imposed a number of additional conditions which an employer must meet before the courts will enforce an employee's arbitration agreement.

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Arbitration of Employment Disputes? Let's Have Another Look!

Advantages of Arbitration

There are many advantages for employers in arbitrating employment disputes as compared to a jury trial in court. These advantages have been written about extensively, so only a few of the most important ones will be summarized in this article.

The most obvious advantage to an employer is that arbitration avoids a jury trial where the jury pool will most assuredly be comprised almost totally of employees. If an owner or executive of a business does happen to be in the pool, the employee's attorney will certainly use a preemptory challenge to remove this person from the jury. For an employer there is no jury of its peers in a wrongful employment practices lawsuit. By far, eliminating this unfair advantage for the employee is the greatest benefit of arbitration for an employer.

A second, closely related advantage for an employer is that arbitrators are experienced jurists who "have heard and seen it all". They are much less likely to be swayed by the emotional appeals of the employee and their attorney. An arbitrator will usually decide a case on a cold, hard analysis of the facts.

Even when the arbitrator does find that the employer has violated some employment law, there are still advantages for employers. As compared to a jury, an arbitrator is far less likely to award large, or any, punitive damages against the employer for its violation. Similarly, arbitrators are not prone to large employee awards for what are usually very subjective claims of alleged pain and suffering.

A fourth advantage of arbitration is that it is a private means of settling a dispute with no court or other public filings, except in the rare instance of a court complaint to vacate or enforce the arbitrator's award. Even in these instances, such a filing is likely to generate far less media attention than the filing of an initial law suit alleging, for example, sexual harassment or whistleblowing. For a company that is concerned about its public image with women, or its compliance with government regulations, arbitration has a definite advantage over a law suit.

In sum, the advantages of arbitration are that for employers it is a far more level playing field than in court with a jury, and with a greater likelihood that the employer will prevail. Even when it does not, the damages awarded the employee in arbitration are nearly always far less than in a jury trial, and an arbitrator's award against the employer is a private matter.

Disadvantages of Arbitration

There are, however, many disadvantages to arbitration which are often overlooked by employers who obviously want to avoid jury trials of employment disputes. Most importantly, the arbitrator's decision is essentially final because it is subject to very limited review by the courts. If the arbitrator just "didn't get it", in terms of the employer's arguments; or incorrectly interpreted or applied the law; or erroneously excluded testimony or evidence helpful to the employer; the employer is essentially stuck with the arbitrator's decision.

The second most important disadvantage of arbitration is that unless the matter is settled, the employer will almost always have to proceed through the entire arbitration process. There are few procedures for the arbitrator to decide the matter, in whole or even partially, prior to the completion of the hearing process. And in this writer's experience, arbitrators are reluctant to use those arbitration procedures which do exist to decide the case on a summary basis. This is one aspect of arbitration which does not appear to be changing, even with retired judges now often being the arbitrators.

By comparison, as all attorneys know, there are many procedures and opportunities under the rules of all federal and state courts to have a judge decide multiple individual issues, and even the entire matter, before it proceeds to a trial. Besides the potential strategic advantages for employers of procedural moves in the actual litigation of the matter, they can often also result in an acceptable settlement prior to trial. Most of these procedural moves generally do not exist in arbitration.

In addition, there are the Rules of Evidence, particularly in Federal Courts where, in general, they are more stringently applied than in most state courts. These Rules afford an employer at least the potential that a judge will limit, or completely bar, testimony that is particularly damaging to the employer's case, which would be admissible in arbitration. A good example is that hearsay evidence is permissible in arbitration.

With the internet and social media, one of the great advantages of arbitration, privacy, can be totally undermined by a claimant who is bent on "telling their story". A good example is the allegedly sexually harassed secretary who posts a video on You Tube, involving her high profile boss, that goes viral. Unlike a judge, an arbitrator has no authority or ability to address such conduct. Consequently, one of the employer's main advantages in arbitration may be lost in the very situation where privacy is most important.

The Changing Nature of Arbitration & Arbitrators

The nature of the arbitration process, and the arbitrators themselves, have changed over the last two decades. Arbitration is supposed to be, and initially was, a more informal and faster process for adjudicating disputes. While many arbitrators were previously trained as lawyers, many others were not. They had backgrounds in human resource management or labor relations. Until the early 1990s, most of them spent their entire careers, or the greater part, as arbitrators.

Presently, many arbitrators are retired federal or state court judges. Because of this experience they have engrafted onto the arbitration process, either intentionally or unintentionally, many of the formalities and procedures of the Court Rules. This has eliminated many of the advantages of arbitration.

Added to these changes are the arbitrator's fees which can be six to eight hundred dollars an hour, and fees up to nine hundred dollars an hour are being charged by the most experienced retired judges, now arbitrators. With these arbitrators encumbering the process with many of the formalities and procedures adopted by the courts, the costs of arbitration can be burdensome, particularly for a small employer. (California, and perhaps other states, essentially require that the employer pay the entire cost for the arbitrator, before their courts will enforce an arbitration agreement against an employee.)

Another Way; Judges But No Juries

Considering the disadvantages of arbitration, its changing nature, and changes in the pool of available arbitrators, employers should consider another alternative; having agreements with their employees that all legal disputes will be submitted to court, but only before a judge without a jury (a "bench trial"). This alternative preserves the unquestionable employer advantage of not having the matter decided by a jury. It eliminates all the disadvantages of arbitration, and affords the employer all the advantages of being in court.

In addition, this alternative does preserve one of the major advantages of arbitration. Judges, like arbitrators, have also "heard and seen it all". They are less likely to be swayed by the employee's, and their attorney's, emotional appeals. Judges are also less likely to award punitive damages, or damages for alleged emotional pain and suffering. They are more likely to decide the matter on an objective analysis of the facts and the real damages, if any, to the employee.

Litigants often agree to waive the right to a jury trial even without a prior agreement. Judges are very familiar with this procedure, and they tend to be comfortable with it. By following the same steps outlined above, for having employees agree to arbitration, employers should not have any problems enforcing employee agreements to proceed in court with a bench trial.

Conclusion

In counseling their clients, in-house counsel should carefully consider the nature of the business and the composition of the workforce; their prior experiences with employee claims; and with litigation in court and/or in arbitration; before deciding which litigation process best suits their company. The "bottom-line" for in-house counsel is to ensure that one of these methods for avoiding jury trials is properly implemented for all the company's employees.

If in-house counsel wants to discuss how to properly adopt an enforceable agreement for either arbitration or a bench trial for all company employees, or to obtain sample documents, please contact:

Dennis J. Alessi, Esq.
Co-Chairman, Employment Law Department
Mandelbaum Salsburg Lazris & Discenza, P.C.
155 Prospect Avenue
West Orange, NJ 07052
direct dial: 973.243.7968
Cell phone: 201.306.6637
e-mail: dalessi@msgld.com

Enforcing Civility in an Uncivilized World

By Donald J. Winder, Esq.

Winder & Counsel, PC
460 South 400 East
Salt Lake City, UT 84111
Tel: 801.322.2222
Fax: 801.322.228

don@winderfirm.com
www.winderfirm.com

"That man is guilty! That man there is a slime! He is a slime! If he is allowed to go free, then something real wrong is goin' on here!"

"Mr. Kirkland, you're out of order."

"You're out of order, you're out of order! This whole trial is out of order!"

Al Pacino as Arthur Kirkland in *And Justice for All*[1]

We have all seen the entertainment industry's impressions of the legal profession. Fired up attorneys in court yelling at witnesses, belittling their opponents, and battling the judge hammer and tong over every perceived slight or unfavorable ruling. Despite the artistic license entertainment writers take in creating these characters for the screen, we know all too well the caricature of the uncivil attorney has a basis in reality and in many cases is not far off the mark. We live in an increasingly disrespectful and competitive world, and our profession is not immune from the general discourtesies that permeate society. The nature of our adversarial system of law can also foster an environment where it is often believed antisocial behavior can get you noticed and get results.

But does the adversarial system necessarily require incivility on the part of the participants? Does the fact that each party enters a matter with the intent to triumph over the other side require disrespect of one's opponent? Winston Churchill did not think so. After the Japanese bombing of Singapore and Hong Kong in 1941, Winston Churchill dispatched a letter to the Japanese Ambassador announcing that a state of war existed between England and Japan. After noting the acts of aggression, Churchill's letter ended with these words: "I have the honour to be, with high consideration, Sir, Your obedient servant, Winston S. Churchill." Churchill commented in his memoirs, "Some people did not like this ceremonial style. But after all when you

[1] AND JUSTICE FOR ALL (Columbia Pictures 1979).

have to kill a man it costs nothing to be polite."[2] Clearly, the ability to maintain civility can be accomplished, even under the most adversarial situations.

The efforts of ABOTA have long been at the forefront of promoting civility in the legal profession.[3] ABOTA's Principles of Civility provide the benchmark for establishing a framework for civility in all aspects of the legal profession. As a result of the efforts of ABOTA, members in state and local bar associations and courts throughout the country, a quiet revolution has been taking place as bar associations and courts seek to put a greater emphasis on civility in the legal profession. Rules of civility, often based upon ABOTA's Principles of Civility, have been adopted in a vast majority of states, as well as county bars and federal courts.[4] As of August 2012, forty-two out of fifty states have adopted professionalism codes.[5]

In the mid-1990s, the incivility in the profession that had come to bear from the quest for "zealous" representation began to be called into question. As noted in a law review article in 1994, "Zealous [a]dvocacy is the buzz word which is squeezing decency and civility out of the law profession. . . . [It is] the modern day plague which infects and weakens the truth-finding process and which makes a mockery of the lawyers' claim to officer-of-the-court status."[6] In response to the quest for more civilized dealings in the practice of law, in 2003 the Arizona Supreme Court eliminated the obligation of attorneys to be "zealous" advocates of their clients in favor of a duty to "act honorably" in furtherance of their client's interests.[7] Indiana, Louisiana, Montana, Nevada, New Jersey, Oregon and Washington have likewise omitted all references to zealousness in their rules, preambles, and commentaries.[8] Similarly, Canon 7 of the prior Model Code of Professional Responsibility included a charge to "represent a client zealously." This language was removed when the Model Rules were adopted.[9] The Preamble now provides in [9]: "These principles include the lawyer's obligation zealously to protect and pursue a client's legitimate interests, within the bounds of the law, while maintaining a professional, courteous and civil attitude toward all persons involved in the legal system."

A critical aspect of the move toward civility in the legal profession has been the inclusion of a civility requirement in the attorney oath. In 2003, the South Carolina Bar amended its lawyer's oath to include the following: "To opposing parties and their counsel, I pledge fairness, integrity, and civility, not only in court, but also in all written and oral communications."[10] In Utah, the attorney's oath

[2] WINSTON S. CHURCHILL, THE SECOND WORLD WAR, VOL. III, CH. 32 (1950).

[3] Along with our sponsors and contributors: JAMS Foundation, ABOTA Foundation, American Inns of Court, American Association for Justice, Association of Defense Trial Attorneys, Defense Research Institute, Federal Bar Association, Federation of Defense and Corporate Counsel, National Center for State Courts and International Society of Primerus Law Firms.

[4] *See* PROFESSIONALISM CODES, American Bar Association, August 2012, *available at* www.americanbar.org/groups/professional_responsibility/resources/professionalism/professionalism_codes.html.

[5] *See id.*

[6] Kathleen P. Browe, Comment, *A Critique of the Civility Movement: Why Rambo Will Not Go Away*, 77 Marq. L. Rev. 751, 767 (1994).

[7] *See* ARIZ. R. SUP. CT 42 PMBL. ¶ 9 ("These principles include the lawyer's obligation to protect and pursue a client's legitimate interests, within the bounds of the law, while acting honorably and maintaining a professional, courteous and civil attitude toward all persons involved in the legal system.").

[8] See INDIANA RULES OF PROF'L CONDUCT, *available at* http://www.in.gov/judiciary/rules/prof_conduct/; LOUISIANA RULES OF PROF'L CONDUCT, *available at* http://www.ladb.org/Publications/ropc.pdf; MONTANA RULES OF PROF'L CONDUCT, *available at* www.montanabar.org/associations/7121/files/ethicsrule comparison.pdf; NEVADA RULES OF PROF'L CONDUCT, *available at* http://www.leg.state.nv.us/courtrules/rpc.html; NEW JERSEY RULES OF PROF'L CONDUCT, *available at* http://www.judiciary.state.nj.us/rules/apprpc.htm; OREGON RULES OF PROF'L CONDUCT, *available at* www.osbar.org/_docs/rulesregs/orpc.pdf; WASHINGTON RULES OF PROF'L CONDUCT, *available at* http://www.courts.wa.gov/court_rules/?fa=court_rules.list&group=ga&set=RPC.

[9] *See* ABA MODEL RULES OF PROFESSIONAL CONDUCT (1983).

[10] *Available at* www.judicial.state.sc.us/courtReg/displayRule.cfm?ruleID=402&subRuleID=&ruleType=APP.

was modified to include promises to "discharge the duties of attorney . . . with honesty, and fidelity, professionalism, and civility" and to "faithfully observe . . . the Standards of Professionalism and Civility."[11] Several other states have also recently amended their attorney oaths to incorporate similar language, recognizing the need for civility in all aspects of the practice of law. These include New Mexico[12] ("I will maintain civility at all times"), as well as Florida,[13] Louisiana,[14] and Arkansas,[15] which all follow the South Carolina model ("To opposing parties and their counsel, I pledge fairness, integrity, and civility, not only in court but also in all written and oral communications."). ABOTA members actively participated in bringing about these results.

Efforts by the ABA have also contributed.[16] Other states with civility components in their oaths include Arizona,[17] which while not specifically referring to civility in its oath, does reference adherence to the state bar's "Lawyers Creed,"[18] which in turn instructs attorneys to advise clients regarding the need for civility ("I will advise my client that civility and courtesy are not to be equated with weakness") and to act courteously and civilly ("I will be courteous and civil, both in oral and in written communication"); and Ohio[19] ("I will conduct myself with dignity and civility and show respect toward judges, court staff, clients, fellow professionals, and all other persons"). Likewise, Hawaii[20] recognizes the need for civility in the practice of law, albeit with a slightly less broad scope ("I will conduct myself with dignity and civility towards judicial officers, court staff and my fellow professionals"). In all, nine states have now modified their attorney oaths to specifically include reference to the requirement of civility in the practice of law.

In addition to the specific references to civility in the attorney oaths, several other states have included reference to other definitional analogs to civility, such as courtesy and respect. The oaths of Alaska[21] ("I will be candid, fair and courteous before the court and other attorneys"), Colorado[22] ("I will treat all persons . . . with fairness, courtesy, respect, and honesty"), Minnesota[23] (attorneys shall conduct themselves "in an upright and courteous manner"), Delaware[24] ("with all good fidelity as well to the court as to the client"), and Virginia[25] (attorneys shall "courteously demean" themselves) all include specific references to being courteous, which, as any dictionary will confirm, is the touchstone of civility.[26] Thus, in addition to the nine states directly referencing civility in their oaths, these five "analogous" oath states make certain the modern trend of law is moving swiftly toward a standard of civility that is made clear to

[11] *See Preamble: A Lawyer's Responsibilities*, *in* UTAH RULES OF PROF'L CONDUCT.
[12] NEW MEXICO RULES GOVERNING ADMISSION TO THE BAR (N.M.R.A.) R. 15-304, *available at* http://www.nmcompcomm.us/nmrules/NMRules/15-304_3-30-2010.pdf.
[13] *Available at* www.floridabar.org/tfb/TFBProfess.nsf/basic+view/04E9EB58153 8255A85256B2F006CCD 7D?OpenDocument
[14] *Available at* http://www.lascba.org/lawyers_oath.asp
[15] AR R ADMIS Rule VII(G) (2012)
[16] *See ABA Recommends Creeds for Bar Associations*, ABA J., Jan. 1989, at 58, for a discussion of the model lawyer creeds proposed by the ABA's Young Lawyers Division and the ABA's TIPS section.
[17] *Available at* www.azbar.org/membership/admissions/oathofadmission
[18] *Available at* www.azbar.org/membership/admissions/lawyer'screedofprofessionalism
[19] *Available at* www.supremecourt.ohio.gov/LegalResources/Rules/govbar/govbar.pdf#Rule1
[20] *Available at* www.courts.state.hi.us/docs/court_rules/rules/rsch.htm#Rule_1.5
[21] *Available at* www.courts.alaska.gov/bar.htm#5
[22] *Available at* www.cobar.org/index.cfm/ID/1653/CLPE/Colorado-Attorney-Oath-of-Admission/
[23] *Available at* www.revisor.mn.gov/statutes/?id=358.07
[24] *See In re Abbott,* 925 A.2d 482 (Del. 2007).
[25] *See Zaug v. Virginia State Bar ex rel. Fifth Dist.-Section III Comm.*, 737 S.E.2d 914, 918 (Va. 2013).
[26] *See Civility Definition*, http://www.merriam-webster.com/dictionary/civility (last visited June 25, 2013) (defining "civility" as (2)(a) "civilized conduct; *especially* : courtesy, politeness"); BLACK'S LAW DICTIONARY (9th ed. 2009) (defining "legal etiquette" as "professional courtesy that lawyers have traditionally observed in their professional conduct, shown through civility and a strong sense of honor").

attorneys from the moment they take the oath of their respective jurisdictions.[27]

The next inevitable step in the progression toward more civility in our profession is a decision on how to enforce the civility provisions that have been enacted and to which lawyers are urged to follow. While there have always been professional sanctions available for violating rules of professional conduct, is there more that should or could be done to enforce civility in the profession?

Following up on the issue of enforcement of civility, the Utah Supreme Court has created what is believed to be the first program in the country of professionalism counseling for members of the Utah Bar.[28] Specifically, the program functions through a board of five counselors, appointed by the Utah Supreme Court, who generally counsel and educate members of the Bar concerning the Standards of Professionalism and Civility.[29] The Court intended the counselors to serve a four-fold purpose: 1) to counsel members of the Bar in response to complaints by other lawyers or referrals from judges, 2) to provide counseling to members of the Bar who request advice on their own obligations under the Standards of Professionalism and Civility, 3) to provide CLE on the Standards, and 4) to publish advice and information relating to the work of the counselors.[30] Of these functions, it is the counseling function that is most critical to the notion of enforcing civility in the profession.

The goal is to provide a method in which incidents of incivility or unprofessional conduct could be reported and addressed. The focus, however, would not be punitive in nature, but rather, educational. In responding to a complaint from a fellow attorney or judge, the counselors may issue a written advisory to the offending lawyer, or may simply counsel with the lawyer in a personal meeting, with the goal of educating the offending lawyer as to alternative modes of practice in harmony with the Standards. In conjunction with this direct contact with offending attorney, the counselors would publish an annual report concerning the Standards it has interpreted, as well as periodically publishing selected portions of its advisories in the Utah Bar Journal for the benefit of practicing lawyers.

Courts around the country have also entered the fray to find a way to enforce what were initially seen as non-binding suggestions on civility. For example, in the Fifth Circuit case, *In re First City Bancorp. of Texas, Inc.*,[31] a "zealous" lawyer referred to opposing counsel, which included an Assistant U.S. Attorney, as a "stooge," a "puppet," a "deadhead," and an "underling who graduated from a 29th tier law school."[32] The bankruptcy court in which the case was originally heard did not agree with the lawyer's tactics and slapped him with a $25,000 sanction.[33] When the lawyer appealed to the Fifth Circuit, he argued that his behavior was an appropriate trial tactic, allowing him to recover more money for his clients and giving him the upper hand in settlement negotiations.[34] The Fifth Circuit disagreed, affirming the lower court's decision that the lawyer's conduct was "egregious, obnoxious, and insulting."[35] The $25,000 sanction was deemed appropriate and upheld by the Court.[36] A quick search of case law will reveal numerous examples where courts

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[27] Michigan is a state that does not include civility in its oath. However, it enforces civility through rules of professional conduct. *See Grievance Adm'r v. Fieger*, 719 N.W.2d 123 (Mich. 2006) (attorney reprimanded for violating rules of professional conduct requiring civility. The Court further upheld a constitutional challenge involving MRPC 6.5(a), which provides that "[a] lawyer shall treat with courtesy and respect all persons involved in the legal process.").
[28] *See* Utah Supreme Court Standing Order No. 7, issued January 9, 2008, effective April 1, 2008, *available at* http://www.utcourts.gov/resources/rules/urap/Supctso.htm#7.
[29] *Id.*
[30] *Id.*
[31] 282 F.3d 864 (5th Cir. 2002).
[32] *Id.* at 866.
[33] *Id.*
[34] *Id.* at 865.
[35] *Id.* at 866-67.
[36] *Id.* at 867.

around the country have begun to draw lines regarding incivility in the practice of law.[37]

In the Utah Supreme Court case *Peters v. Pine Meadow Ranch Home Ass'n.*, the petitioners were appealing an appellate court affirmation of a trial court's grant of summary judgment to a homeowners' association regarding the enforceability of its covenants, conditions, and restrictions ("CCR's").[38] Rather than reach the issues raised in the appeal, the Utah Supreme Court focused on the petitioners' briefs and the uncivilized language and tone of the briefs to affirm the holding of the lower court.[39] Specifically, the court noted:

> petitioners' briefs . . . are replete with unfounded accusations impugning the integrity of the [court below]. These accusations include allegations, both direct and indirect, that the [court of appeals] panel intentionally fabricated evidence, intentionally misstated the holding of a case, and acted with improper motives. Further, petitioners' briefs are otherwise disrespectful of the judiciary.[40]

Instead of ruling on the merits of the petitions, the court dismissed the petition and ordered the offending attorney to pay the other side's attorney fees, which at the time had amounted to approximately $17,000. In sum, the court noted if attorneys continue to adopt the "scorched earth" approach to advocacy, they do so at their own peril.[41] In choosing to disregard the petitioners' briefs, the *Peters* court relied on Rule 24(k) of the Utah Rules of Appellate procedure, which provides:

> All briefs under this rule must be . . . free from burdensome, irrelevant, immaterial or scandalous matters. Briefs which are not in compliance may be disregarded or stricken . . . and the court may assess attorney fees against the offending lawyer.[42]

Further, in arriving at its decision, the court noted the Utah Standards of Professionalism and Civility[43] as well as Rule 8.2 of the Utah Rules of Professional Conduct. Rule 8.2 provides, "A lawyer shall not make a public statement that the lawyer knows to be false or with reckless disregard as to its truth or falsity concerning the qualifications of a judge."[44]

As case law develops in this area,[45] the inclusion of the requirement of civility in attorney oaths has also resulted in court imposed sanctions

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[37] *See, e.g., GMAC Bank v. HTFC Corp*, 248 F.R.D. 182, 193 (E.D. Penn. 2008) (fining attorney $13,026.00 for actions during deposition described as hostile, uncivil and vulgar); *Hagen v. Faherty*, 66 P.3d 974, 979-80 (N.M. Ct. App. 2003) (admonishing attorneys for uncivil behavior in briefs, bemoaning ""culture of belligerence"" that has taken root in legal system); Steven Kreytak, *Lewd Gesture Gets Lawyer 90 Days in Jail*, AUSTIN AMERICAN STATESMAN, Apr. 17, 2008.
[38] 151 P.3d 962 (Utah 2007).
[39] *Id.* at 962.
[40] *Id.*
[41] *Id.* at 967 (warning that inappropriate conduct could lead not only to sanctions, but also to ineffectiveness as an advocate).

[42] *Id.* at 964.
[43] Standard 3 of the Utah Standards of Professionalism and Civility ("USPC") provides, "Lawyers shall not, without an adequate factual basis, attribute to . . . the court improper motives, purpose or conduct." www.utcourts.gov/courts/sup/civility.htm. Standard 1 of the USPC provides, "[L]awyers shall treat all other counsel, parties, judges, witnesses, and other participants in all proceedings in a courteous and dignified manner." *Id.*
[44] *Peters*, 151 P.3d at 964 (quoting UTAH RULES OF PROF'L CONDUCT 8.2(a)).
[45] *See generally*, Judith D. Fischer, *Incivility in Lawyers Writing: Judicial Handling of Rambo Run Amok*, 50 Washburn L. J. 365 (2011) (detailing case law regarding incivility in written legal documents). Utah courts continue to address the need for civility in all areas of the practice of law, as recent case law makes clear. *See, e.g., Arbogast Family Trust v. River Crossings, LLC*, 238 P.3d 1035 (Utah 2010) ("[w]e encourage lawyers and litigants to follow [the Utah Standards of Professionalism and Civility]"); Featherstone v. Shaerrer, 34 P.3d 194 (Utah 2001) ("Courts are endowed with the inherent authority to regulate attorney misconduct"); *Robinson v. Baggett*, 263 P.3d 411 (Utah Ct. App. 2011) (citing the Utah Standards of Professionalism and Civility as authority); *State v. Doyle*, 245 P.3d 206 (Utah Ct. App. 2010) (stating conduct of all lawyers "should be characterized at all times by personal courtesy and professional integrity in the fullest sense of those terms"); *Superior Receivable Services v. Pett*, 191 P.3d 31 (Utah Ct. App. 2008) (reiterating *Peters* holding incivility may warrant sanctions and will often diminish a lawyer's effectiveness); *Advanced Restoration, LLC v. Priskos*, 126 P.3d 786 (Utah Ct. App. 2005) (noting "[d]erogatory references to others or inappropriate language of any kind has no place in an appellate brief").

for violations. In the case *In re Abbott*, the Delaware Supreme Court cites to the attorney oath ("with all good fidelity as well to the Court as to the client") as a basis for publicly reprimanding a lawyer who, among other things, accused fellow counsel of fabrication.[46] As a leader in the charge to add civility to its oath, so too are South Carolina Courts pushing hard against attorneys who violate their oath.[47] In 2011 alone, three South Carolina Supreme Court cases dealt with sanctions imposed against attorneys for uncivil actions in violation of the South Carolina Rules of Professional Conduct and the Attorney Oath.[48] These cases dealt with various instances of attorney incivility in both oral and written forms, but all indicate the South Carolina Court's intent to enforce sanctions for violations of the oath and the standards of civility attorneys have sworn to uphold.

In re Anonymous Member of South Carolina Bar provides a good example of this direct approach.[49] For the benefit of the bar, the Court took this opportunity to address the increasing complaints of incivility.[50] In upholding the disciplinary panel's decision regarding sanctions, the Court noted, "Respondent took the lawyer's oath which includes the following clause, 'To opposing parties and their counsel, I pledge fairness, integrity, and civility, not only in court, but also in written and oral communications . . . .'" It then commented, "[a]n e-mail such as the one sent by Respondent can only inflame the passions of everyone involved, make litigation more intense, and undermine a lawyer's ability to objectively represent his or her client."[51]

The Court went on to hold:

> In this case, there is no question that even a casual reading of the attorney's oath would put a person on notice that the type of language used in Respondent's "Drug Dealer" e-mail violates the civility clause. Casting aspersions on an opposing counsel's offspring and questioning the manner in which an opposing attorney was rearing his own children does not even near the margins of the civility clause. . . . Moreover, a person of common intelligence does not have to guess at the meaning of the civility oath.[52]

In overruling due process and First Amendment challenges, the Court stated:

> The interests protected by the civility oath are the administration of justice and integrity of the lawyer-client relationship. The State has an interest in ensuring a system of regulation that prohibits lawyers from attacking each other in the manner in which Respondent attacked [opposing counsel]. Such conduct not only compromises the integrity of the judicial process, it also undermines a lawyer's ability to objectively represent his or her client.[53]

Besides including civility in its lawyer's oath, South Carolina took a step further, and in 2004 amended Rule 7 of the Rules for Lawyer Disciplinary Enforcement to include that violation of the lawyer's oath is grounds for discipline.[54] Other states, like Kansas and Nebraska, although lacking a provision requiring

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46 925 A.2d 482 (Del. 2007).
47 *See* ABA J., Jan. 2013, at 32-40.
48 *See In re White III*, 707 S.E.2d 411 (So. Car. 2011) (attorney sanctioned for written correspondence suggesting opposing counsel had "no brains" and questioning if "he has a soul," among other derogatory remarks); *In re Anonymous Member of South Carolina Bar*, 709 S.E.2d 633 (So. Car. 2011) (attorney sanctioned for derogatory remarks regarding opposing counsel's family unrelated to the matter at hand), and, *In re Lovelace*, 716 S.E.2d 919 (So. Car. 2011) (attorney sanctioned for threatening and then slapping defendant during a deposition).
49 709 S.E.2d 633 (So. Car. 2011).
50 *Id.*at 635.
51 *Id.* at 637.
52 *Id.*
53 *Id.* at 638.
54 *See* http://www.sccourts.org/courtOrders/HTMLFiles/2004-09-22-01.htm.

civility in their oaths, do also include a provision that violating the oath is grounds for discipline under the rules of professional conduct.[55] Such an expressed provision is not necessarily a disciplinary requirement for acts of incivility. As noted above, the Delaware Supreme Court has enforced the lawyer's oath without such a corresponding rule of professional conduct.[56] And other courts have also disciplined attorneys for violation of their oath, without such a provision in the rules of professional conduct.[57]

In June 2013, the Florida Supreme Court adopted procedures for, among other things, enforcing principles of civility as set forth in the *Oath of Admission to The Florida Bar, The Florida Bar Creed of Professionalism*, and *The Florida Bar Ideals and Goals of Professionalism*. In so doing, the Florida Supreme Court rejected the prior passive academic approach to civility problems, stating further and more concrete actions are now required. Entitled a *Code for Resolving Professionalism Complaints*, 2013 WL 2435539 (Fla.), any person may initiate a complaint either telephonically or by written request. Depending on the severity of the complaint, resolution can be pursuant to a local professionalism panel or through the Florida Bar offices. Such a resolution may be informal or include diversion, admonition and even disciplinary action.

These developments in South Carolina, Delaware, Utah, and elsewhere indicate the sea change taking place within our profession, where civility in the practice of law is no longer tempered by notions of "zealous" or "aggressive" representation. By moving the civility requirement into the attorney oath, lawyers are now on notice that zealous representation must be accomplished within the context of civility.

Primerus should also continue to set an example of civility in all phases of our profession. Programs such as the Utah Supreme Court's professionalism counseling for members of the Utah Bar may also help enforce the expectations of civility to which we all must aspire. Primerus should urge all states to: 1) adopt enforceable principles of civility, 2) modify attorney's oaths to eliminate "zealous" advocacy and require adherence to principles of civility, 3) establish judicial precedence enforcing those principles, 4) create a counseling program and a panel or board to handle complaints, and 5) further the goal of civility education by devoting a part of any CLE requirement solely to those principles.[58] As recognized by the Utah Supreme Court, education is the key component to any successful effort to enforce civility. As attorneys learn what is expected in the practice of law, the "culture of belligerence,"[59] like the typewriter and carbon paper, will become a relic of a bygone era.

Don Winder is managing partner in the firm Winder & Counsel, PC, Salt Lake City, Utah. Mr. Winder has practiced for over 40 years and has a varied trial practice focusing on business litigation. He is a proud member of ABOTA. Mr. Winder has also been privileged to serve on the Utah Supreme Court Committee on Professionalism since its inception. This committee is tasked with developing the Utah Standards of Professionalism and Civility, modifying the Attorney's Oath and recommending the establishment of a program of professionalism counseling for members of the Utah Bar.

Enforcing Civility in an Uncivilized World, updated July 17, 2013.

[55] *See, e.g.*, http://www.ksd.uscourts.gov/rule-83-6-1-professional-responsibility/; *State ex rel. Counsel for Discipline v. Sipple*, 660 N.W.2d 502 (Neb. 2003) (attorney subject to discipline under both the rules of professional conduct and for violation of attorney's oath).
[56] *See In re Abbott*, 925 A.2d 482 (Del. 2007).
[57] *See, e.g., State ex rel. Counsel for Discipline v. Sipple*, supra @ fn. 53.

[58] *See, e.g.*, RULES GOVERNING THE UTAH STATE BAR 14-404 (requiring active attorneys to take three hours of ethics or professional responsibility CLE credits per reporting period, one credit of which must be in the area of professionalism and civility).
[59] *See Hagen v. Faherty*, 66 P.3d 974, 979-80 (N.M. Ct. App. 2003).