

BUSINESS LAW NEWSLETTER

BUSINESS AUDITS ALLOW BUSINESS AS USUAL

By James V. Irving, Esq.

Preventive law is a prime component of Bean Kinney's business law philosophy. As with doctors who prescribe preventive steps to avoid illness, we counsel our business clients to insure compliance with corporate formalities and to adopt and follow sound business practices designed to avoid unnecessary legal issues, thus minimizing both the cost and likelihood of expensive legal problems.

Many businesses achieve this goal through the companion devices of periodic, low cost legal audits, and through a checklist of common legal pitfalls, many of which are easily addressed, but may cause significant headaches if they are ignored. Among these issues are compliance with the basic corporate formalities and the maintenance of certain optional corporate documents that provide templates for the resolution of unanticipated problems.

ANNUAL CORPORATE DOCUMENTS

Failure to observe corporate formalities - including conducting and memorializing annual meetings, and recording the process by which key decisions are made - may lead to questions of validity, and, in some cases, can undermine the limited liability afforded shareholders by the statute. Annual minutes can be produced with little difficulty if their maintenance is a matter of practice; likewise other director, shareholder, or member decisions should be properly memorialized. An audit can identify recent transactions subject to recordation, and provide a tickler system to minimize the chance that meetings are missed or not memorialized in the future.

BUY-SELL AGREEMENTS

When times are good, the need to plan for a bleak or rainy day may seem superfluous. However, it is easier to decide objectively how the business will be transferred and acquired in difficult straits if it is addressed when the sun is shining. Restrictions on the sale of stock membership to outsiders and provisions governing buy-out on the death of an owner allow the corporation to maintain control of its fate, and ease the burden in case of the death or disability of an owner.

PUSH-SHOVE OR DISPUTE RESOLUTION

Similarly, a dispute resolution provision, whether contained in the By-laws or Operating Agreement, or in a stand-alone document, permits owners to identify and resolve substantive disputes in accordance with a pre-established protocol, lessening the chance that a difficult dispute leads to stalemate.

REGISTERED AGENT

Every business entity recognized by the State Corporation Commission must, as a condition of good standing, maintain a Registered Agent ("RA"). Under Virginia law, the RA must be either a resident of Virginia and an officer or director of the entity, or a law firm or lawyer. The office of the RA may be best understood as the designated recipient of formal notices, including notifications from the SCC, and service of lawsuits directed against the business. The RA is required to maintain his or her current business address with the SCC, and legal notice may be considered effective absent actual notice if an address change is not registered. The effect of an RA leaving the business, or a business relocating without notifying the SCC, can be devastating. An audit will determine whether you are in compliance with statutory obligations related to maintaining an RA.

... continued on page 3

IN THIS ISSUE:

- ◆ Business Audits Allow Business as Usual page 1
- ◆ Marital Property – What is It? page 2
- ◆ Changes in Jurisdictional Limits page 2
- ◆ Meet Our Lawyers – James W. Korman page 3

MARITAL PROPERTY - WHAT IS IT?

By Carol Schrier-Polak, Esq.

When dividing property as part of a divorce in Virginia, the Courts are mandated to equitably distribute "marital property".

With more and more spouses bringing assets to a marriage, the definition of "marital property" has been the subject of increasing dispute.

Virginia's statute states that all property acquired during the marriage is presumed to be marital. We know that "during the marriage" begins with the marriage date. But, for purposes of defining marital property, when does "during the marriage" end? The statute says that the ending date is the date the parties have separated with the intent that the separation be permanent. In other words, the ending date occurs when one spouse leaves, never comes back, and either the husband or wife or both intend that their separation will be permanent. In contrast, if there is a temporary or trial separation, there is no intent to separate permanently and marital assets continue to be acquired.

Another way of looking at the definition of "Marital Property" is to say what it isn't. Property that is "Separate" is not subject to distribution by a Court. Virginia's statute defines "Separate Property" as that property owned prior to the marriage, or property acquired during the marriage that is acquired by gift or inheritance from someone other than one's spouse, provided it is kept separate. Under this definition, a gift of IBM stock from one's parents would remain separate if the stock was kept in an account in the spouse's name only and not added to during the marriage (except for exchanges or passive appreciation).

The problem occurs when marital and separate property is commingled. For example, if one of the spouses owned a house prior to the marriage but earnings during the marriage paid for the mortgage payments, or, if one of the spouses used monies gifted to him or her (and not to both spouses) to pay part of the down payment to purchase the home or pay for a deck addition while marital funds and earnings were used to pay the mortgage or make additional improvements to the house, apportioning the commingled assets can be difficult. Other problem areas can

include retirement plans owned prior to the marriage, but to which the employer and/or employee made contributions during the marriage.

Fortunately, Virginia law provides for a fair division of part-marital and part-separate property. Virginia's statute specifically states that when marital and separate property are commingled, the Court shall give credit for the separate portion, provided the separate portion was not a gift to the spouse (a topic for another article) and provided one can trace the separate property contributions.

Once a tracing of assets is accomplished, real estate that was acquired from commingled or hybrid property will be divided according to the "Brandenburg Formula". This format was, in most cases, adopted from a Kentucky case of the same name and has been followed in almost all cases. Under this formula, the Court uses a proportional contribution method to determine the marital share to be subsequently divided by the Court. As an example: if Sam owned a house prior to marriage which had an equity value at the time of marriage of \$100,000 (\$300,000 fair market value less \$200,000 outstanding mortgage balance); and during the marriage, Sam and Sue's earnings were used to reduce the mortgage by \$50,000 (\$200,000 - \$150,000 as of the date of separation) and the equity in the house's current value was \$250,000 (\$400,000 fair market value - \$150,000 mortgage balance), the total contributions would be \$150,000 (\$100,000 + \$50,000). Sam's separate share would be worth 2/3 of the total contributions or \$166,750 (2/3 x \$250,000) and the marital share to be divided by the Court would be 1/3 of the total contributions or \$83,250 (1/3 x \$250,000).

When dividing a part-marital/part-separate defined contribution plan such as an IRA or KEOGH, or an investment account, the court will commonly use the Brandenburg Formula if a direct tracing of contributions and investment history is absent. When examining a business that was started prior to the marriage but continued during the marriage, the Court will look at the active appreciation of the business during the marriage.

The key to receiving credit for separate contributions is tracing. Documents are essential, since testimony alone is usually deemed insufficient for this purpose. Appraisals, tax assessments, and settlement sheets are evidence of value of real estate at the time of the marriage and at the separation. Other viable sources of proof include business valuations or offers to purchase or sell. Mortgage statements can provide evidence of loan contributions. Bank and investment account statements can verify deposits and withdrawals of separate and/or marital contributions.

One of the advantages of a Prenuptial Agreement is that it commonly identifies what will be separate property and the value of that property if there should be a divorce.

But with or without a Prenuptial Agreement, documentation is critical. The lesson to be learned is KEEP all records indefinitely. While this may mean lots of storage space, if there are no documents to sufficiently trace separate assets, there is great risk that all property acquired during the marriage will be considered marital and divided accordingly. ♦

CHANGES IN JURISDICTIONAL LIMITS IN THE VIRGINIA COURTS

(As of July 1, 2002)

Up to \$2,000	The Small Claims Court has concurrent jurisdiction with the General District Court.
\$2,000 - \$4,500	The General District Court has exclusive jurisdiction.
\$4,500 - \$15,000	The General District Court will retain concurrent jurisdiction with the Circuit Court.

Claims filed in the wrong court will not be recognized and therefore will be dismissed. Additionally, an improper filing will not toll the statute of limitations. ♦

NON-COMPETITION

Particularly in service businesses where employees have personal contact with clients and customers, failing to consider the techniques necessary to prevent the employee from stealing clients can be extremely costly. All states limit the extent to which an employer may restrict his employee's future employment opportunities, but it is a rare circumstance in which the legitimate business interests of the entity cannot be addressed through a well-crafted agreement limiting or preventing improper competition. An audit can determine whether your employees are or should be subject to proper employment restriction, and the ways in which this issue can be addressed.

TRADE SECRETS

A corollary to non-competition issues, Trade Secret protections are designed to prevent the rogue employee from making off with and profiting from the business techniques developed by the employer. Trade Secrets are subject to broad enforcement, but enforcement is predicated on compliance with certain preconditions related to the internal protection of the secret, and the means and manner by which the employee is placed upon notice that a particular item constitutes a Trade Secret. An audit can determine whether your business practices include Trade Secrets, and, if so, whether they are properly protected.

INTELLECTUAL PROPERTY

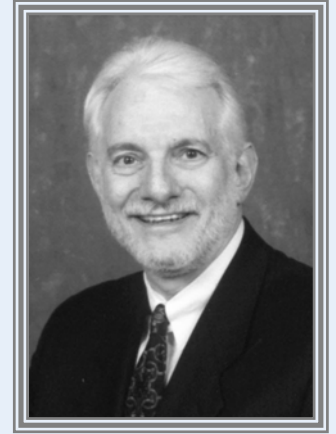
While most companies possess some intellectual property rights, many don't realize that they own such rights or don't understand the means and costs of protecting them. Because of the state and federal structures involved, and the registration costs charged by both bodies, it can be expensive to protect trade names, trademarks, copyrights, slogans, designs, or business techniques in this manner. However, businesses ought to make the decision based upon the sort of cost-benefit analysis that an audit can provide.

POLICIES AND PROCEDURES

The cost implied by the size of the typical Policies and Procedures Manual can be off-putting, but both the similarities and differences in business needs can combine to reduce the costs below expectations. Standardization of policies regarding such day-to-day formalities as vacation and sick leave and details of job performance can enhance productivity and minimize trivial disputes. The establishment of policies designed to insure compliance with Wage and Hour and other federal guidelines, and to address various discrimination concerns, can increase the likelihood of compliance while providing a first line of defense in the case of an alleged violation.

Every business entity should consider the legal needs arising from these and other regular and re-occurring issues. Not only are Bean, Kinney attorneys experienced in producing the above-described documents, they offer their regular clients audits - at reduced rates - to identify holes in the corporate structure and their particular business needs, thereby increasing the ability of the company to tend to business without major distraction. ♦

MEET OUR LAWYERS ...



JAMES W. KORMAN

For more than three decades, James W. Korman has served Bean, Kinney clients and the Northern Virginia legal community as a law clerk, associate, partner, and managing partner of the firm. Under his stewardship, the firm has grown in size and stature to assume its position as a recognized leader in the profession locally.

A graduate of the College of William and Mary and of the George Washington University law school, he has made his mark as a trial attorney with extensive experience in commercial, banking, general business, domestic relations, and personal injury matters. Jim's honors and accomplishments are extensive. Among them, he is listed in "Best Lawyers in America," is "AV" rated by Martindale Hubbell, and is a fellow of the American Academy of Matrimonial Lawyers. Active in both the community and the bar, he served as a member of the Board of Directors of Temple Rodef Shalom, and has served on or chaired numerous bar committees. He is a member of the Virginia Bar Council, a past President of the Arlington Bar Association, and former Chair of the Virginia State Bar Committee on Women and Minorities. Most recently, Jim received the accolades of his peers with the 20th Annual Robert J. Arthur Distinguished Service Award from the Arlington Bar Association. This award recognizes his distinguished, dedicated, and unselfish service to the Association and to the legal profession throughout the Commonwealth of Virginia, as well as his efforts to enhance the professionalism of the Bar.

Mr. Korman is certified as an arbitrator by the Academy of Matrimonial Lawyers, serves as an adjunct professor at George Mason University Law School, and is a Neutral Case Evaluator for the Fairfax County Circuit Court. He has lectured and written extensively on various civil litigation topics including aspects of banking law, personal injury, discovery, and privilege. Mr. Korman is married to his best friend (and wife of thirty-five years) Barbara, and they have a daughter, Katherine. ♦



2000 North 14th Street
Suite 100
Arlington, Virginia 22201

PHONE: (703) 525-4000

FAX: (703) 525-2207

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See us at: www.beankinney.com

About Our Organization...

For over four decades, Bean, Kinney & Korman has been a leading Northern Virginia law firm that has continuously grown and diversified to meet the needs of its expanding community of clients and their increasingly complex legal needs. While we have grown in size and greatly expanded the depth and breadth of our capabilities, we have remained committed to those fundamental elements of value that are integral to our practice philosophy: experience, versatility, dedication to service, flexibility and efficiency.

Our responsive and exceptional quality service, coupled with our sensitivity to client needs, has established a professional reputation in which we take great pride. We are dedicated to achieving exceptional results for our clients in every matter we are entrusted to handle, mindful of each client's resources and unique circumstances. Delivering greater value to our clients day in and day out is how we will continue our reputation as one of the most highly regarded law firms in the Washington metropolitan region.

This paper was prepared by Bean, Kinney and Korman, P.C. as a service to clients and friends of the firm. The purpose of this paper is to provide a general review of current issues. It is not intended as a source of specific legal advice. © Bean, Kinney and Korman, P.C. 2002



2000 NORTH 14TH STREET, SUITE 100
ARLINGTON, VIRGINIA 22201