



Business Law Letter

THE LAW OFFICES OF BORTON PETRINI LLP

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If you are interested in receiving the Business Law Letter newsletter, or have someone to whom you would like it sent, call (661) 322-3051, ext. 170 or e-mail publish@bpclaw.com and leave your name, e-mail and/or mailing address to request a free copy.

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Business Owners Should Perform “Corporate” Spring Cleaning

By Michael S. Abril

Updating Corporate Books And Records Is Necessary To Defend Against Alter Ego Claims

Many small business owners form corporations or limited liability companies for their businesses. The idea behind operating through a corporation or limited liability company is to obtain the protection of limited liability. Limited liability, in short, means that the owner cannot be held responsible for the entity's obligations except to the extent of their capital contribution or if the owner personally guarantees a corporate or LLC obligation.

Forming a corporation or limited liability company has become much easier in the age of word processors and “mills” who promise to set up the entity for literally pennies. However, some mills do nothing more than file the basic documents. In other cases, additional corporate documents, such as bylaws and minutes are provided, but are not completed or tailored to the particular company.

Ideally, a business owner will hire a competent legal counsel to properly prepare all the documents necessary to give the corporation or LLC its legal life.

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Michael S. Abril, Editor



Michael S. Abril is a Partner in the Bakersfield office of Borton, Petrini & Conron, LLP. Michael did his undergraduate work at the University of California, Davis. He received his MBA and J.D. degrees from the University of Southern California in 1986.

Michael, among other things, organizes new corporations and limited liability companies. He monitors corporate governance matters for existing business entities and advises officers and directors on operational matters.

Michael's successful practice is enhanced by his involvement in a variety of educational and professional affiliations. Michael formerly served as a Director of the Kern County Bar Association and as Co-Chair of the Agri-Business Committee of the Business Law Section of the State Bar of California. Michael is a member of the American Bankruptcy Institute, the Financial Lawyers Conference, the Business Law and Real Property sections of the State Bar, and the Central California Bankruptcy Association. Michael teaches Business Law and Business Ethics as an Adjunct Instructor at the University of Phoenix and University of La Verne.

Michael, who was born and raised in Bakersfield, California, is married to Alice; is the father of daughter Paige and son Blair; and considers his Boston Terrier, Bruno, as part of his immediate family.

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However, many business owners fail to maintain their corporate and LLC records through periodic updates, or in the case of a corporation, fail to hold annual meetings.

Some successful companies find out the hard way when they either cannot sell their company or there is a delay in the sale because the company records are not in order. I was involved a few years ago in a stock sale involving a 25-year old corporation. The sale would have resulted in a \$1 million profit to the owners. I discovered during due diligence that the only corporate filing was the articles of incorporation. The bylaws and minutes that were provided by the mill were included in the corporate minute book, but were never completed. There were no resolutions by the Board during the 25-year history of the company. Therefore, in order to get the transaction moving along, I spent several hours updating the corporate records. This delay helped kill the deal.

We recommend that business owners retain our firm to conduct a corporate audit. This is different from an IRS audit in that the end result of the audit is not to penalize you, but rather, to identify where corporate formalities have not been properly maintained. As we mentioned above, the primary motivation of a business owner in setting up a corporation or LLC is to enjoy limited liability. However, the law of alter ego in California states that if the business owner has not maintained corporate formalities, a creditor of the corporation can ask the court to disregard the corporate form. Therefore, we recommend that any company who has not had a formal review of its records in the last five (5) years retain us to conduct a corporate

audit. In most instances, a corporate audit can be performed in approximately four (4) to six (6) hours. Depending on what the audit reveals, there may be additional work involved.

A concern normally raised by corporate audits is the revelation that a business is operating through various affiliates or subsidiaries. This is particularly important because by definition, the affiliates or subsidiaries are separate legal entities. In some

instances, the same employees are used by the business owner to work in one or more affiliates and/or subsidiaries. We have been involved in several cases where a separate subsidiary was created by the business owner to handle high risk/high liability transactions in order to insulate the parent from lawsuits. In one situation involving a fatal accident involving a high risk subsidiary, the plaintiff’s lawyer confirmed that an employee of the parent had provided services on the vehicle that caused plaintiff’s injuries. As a result of this discovery, the plaintiff was able to add the parent as a defendant. The jury found the parent equally responsible for the plaintiff’s injuries. This is a classic example of where limited liability is denied because the business owner failed to maintain the separateness of

the parent from the subsidiary. The parent’s liability could have been avoided by an employee leasing agreement.

In summary, failing to clean up a garage or attic may cause you hardship when you later move. Failing to maintain corporate formalities, however, could subject you to personal liability for corporate debts, and thus, jeopardize the personal wealth you have generated from your successful business operations.

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THE BORTON PETRINI BUSINESS HOUR

IMPROVE YOUR BUSINESS SAVVY WITH THE BORTON PETRINI BUSINESS HOUR

You can get a wealth of free information on legal aspects of business and other business related topics by listening to the Borton Petrini Business Hour on KERN 1410 AM Radio in Bakersfield every Sunday evening at 6:00 p.m.

Upcoming broadcasts that would interest the business owner, as follows:

- May 14 - Do's and Don'ts of Hiring
- May 21 - Health Plans for Business
- May 28 - Estate Planning Follow-Up
- June 4 - Operating a Successful Business
- June 11 - Legal Issues Concerning Agricultural
- June 18 - Do's and Don'ts of Real Estate Sales
- June 25 - Understanding California Disability Laws
- July 2 - How to Become a Contractor
- July 9 - Prosecuting and Defending Business Cases
- July 16 - Physical and Financial Elder Abuse

In these broadcasts, there is commentary by experienced lawyers from Borton Petrini LLP intermixed with business people and other professionals whose careers are in the areas under discussion.

The Firm intends to keep up this community service for some time to come, to help upgrade knowledge in areas likely to infuse business know-how in the community.

A Note From the Editor: Estate Planning and Your Business

We feature an article entitled, "Business Owners Should Perform 'Corporate' Spring Cleaning" in this first edition of the Business Law Letter. The article identifies various problems that crop up after a business owner incorporates or forms an LLC for his or her business. In future editions of the Business Law Letter, we will discuss tips to help your business operate smoothly and successfully.

One tip we wanted to offer now is to have an estate plan. Estate planning is beyond the scope of the Business Law Letter. In short, however, an estate plan, and specifically a revocable living trust, provides for the distribution of a business owner's assets, including stock or LLC interests, upon death in a manner that avoids the formal probate process.

One of the advantages of holding an ownership interest of a business in a living trust is that, since ownership of the business is held by the trust, not the individual, control of the business can easily transfer from the decedent business owner (typically the original trustee or co-trustee of the trust) to the other co-trustee (normally a surviving spouse) or a successor trustee. Even if a business owner dies with a Will, there is often a lag between the death of the owner and the issuance of letters appointing the executor. Accordingly, a revocable living trust can assure the business owner that the business will operate smoothly and seamlessly in the event of a sudden and unexpected death of the business owner.

Although one's death is not something to focus on, business continuity is important to business owners. Therefore, we strongly recommend that every business owner see an estate-planning attorney to set up a revocable living trust or to transfer the business ownership to an already established revocable living trust.

John Petrini, editor of Borton Petrini, LLP's Estate Planning Quarterly Report, or Grant Peters in our Bakersfield office can assist you in such matters.

DISCLAIMER: THE INFORMATION PROVIDED IN THIS UPDATE IS NOT A SUBSTITUTE FOR LEGAL ADVICE. READERS SHOULD BE ADVISED THAT IF THEY HAVE QUESTIONS ABOUT THIS OR ANY OTHER AREA OF BUSINESS LAW, THEY SHOULD SEEK THE ADVICE OF COMPETENT COUNSEL SPECIALIZING IN BUSINESS LAW.

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