

# Report From Counsel

Insights and Developments in the Law

Summer 2010

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## A Perfect Storm Environment for Business Succession Planning

*By J. Keith Phifer, Esq.*

As business and estate planning lawyers, too often we see clients make the mistake of confusing urgency with importance. Deadlines are everywhere in our professional and personal lives. Hopefully, more often than not, we meet the important deadlines, but almost always at the expense of something we deem less important. We might finish an important project at work but miss an important moment in our children's lives. We make time to attend a child's athletic event, but we might fail to invite an ailing parent for dinner or fail to complete a home improvement project. We accomplish one thing, we miss another. There aren't enough hours in the day.

But sometimes there is no deadline, no impending event that requires your focus. These things are often put off. Weeks, months, and years pass and they go unaddressed. Other deadlines loom. Because it is not urgent, it can wait.

In the business owner context, the stakes can loom much larger. A scenario plays out time and again involving the business owner spending decades building a thriving business. The purpose of the lifetime of work is almost always to provide security and comfort to the business owner's family, during retirement, and after. Eventually the business owner realizes it is nearing time to exit. But how? For the business owner the obstacles seem endless. Should I sell? How? To whom? Is there a key person or family members who would want the company? If so, will the customers stay? Is

the company going to pass equally to all children or just one of them? Are the children going to get along? How much is the company really worth? How much am I going to pay in income taxes or estate/gift taxes? These questions sometimes cripple an otherwise proactive approach to planning a business transition to a key person or the next generation.

Despite the seemingly overwhelming difficulties, there are clients who are successful in dealing with the issues of succession. And the reality is that once undertaken, the process isn't as overwhelming as it may appear.

We have helped clients do it time and time again. Perhaps an example of

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## Caveat Venditor: Exporting Carefully and Profitably to China

*The following article is written by Jack Daniels, a principal of Eastbridge Partners, LLC. Eastbridge is a consulting firm that specializes in procuring from and introducing products into the Chinese market and is a client of Schlossberg, LLC.*

Western manufacturers of high technology and industrial products are faced with an unprecedented opportunity in Mainland China. The demand for high quality and unique technical products, branded goods and modern trade merchandise is growing at a fast pace. This growth is being fueled by the procurement requirements of transplanted foreign companies, a burgeoning middle class of three hundred fifty million plus and the demands of domestic Chinese companies hungry for products that will give them a competi-

tive advantage.

The chance to build a new market also presents a great dilemma to exporters. The fundamental rules of commerce apply in China as they do around the world, however there are many differences in the way that successful companies' go-to-market, negotiate pricing and terms, prepare documentation, invoice and accept remittances and provide service. Executing these elements well is critical and is often the difference between a profitable order and failure.

Eastbridge has guided the commercial launch of dozens of companies building a new export market in China and have developed a checklist of the "Top Four Things You Need to Con-

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# Choosing an Executor for Your Will

The designation of an executor for a will is one of the critical steps in effective estate planning. The executor will be the individual responsible for the administration of the estate. He or she must execute the necessary documents to submit the will for probate. Then the executor must gather all of the testator's (person who makes the will) assets and distribute them in accordance with the terms of the will. Good recordkeeping will be essential because an accounting will have to be filed. Creditors' claims will have to be dealt with, and estate tax returns may have to be filed.

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In short, the job of the executor is a substantial responsibility and can be very time-consuming, especially when it comes to large or complicated estates. So that a suitable candidate can be named, the testator should take into account a variety of factors. These include the trustworthiness, sound judgment, financial acumen, age, and physical and mental capacity of the proposed executor. More than one executor can be named by the testator, and these coexecutors can share the duties of administering the estate.

In the case of married couples, the first instinct may be simply to name the other spouse as the executor and be done with it. While this may work just fine in some cases, the decision deserves more thought as to all of the ramifications of choosing one's spouse as the executor. Will the mourning, surviving spouse be up to fulfilling all of the executor's responsibilities so

soon after suffering such a loss? If the spouses are about the same age, will the surviving spouse be too frail, physically or mentally, to do the job when the time comes, perhaps many years after the executor has been named? All in all, a better choice may be an adult son or daughter, a sibling, niece, or nephew, or a close and trusted friend.

The job of executor will be substantially easier if the testator has first done his or her job by keeping complete and

accurate records of the assets that will comprise the estate. Upon naming the executor, the testator should review this information with the executor in detail. Another seemingly obvious matter that is often overlooked is simply making sure that the executor knows the location of all of the important papers relating to the estate.

As for payment for the executor's services, if the estate is very simple,

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## MySpace, Students, and Free Speech

In separate cases, two public school students used MySpace to post disparaging comments about each of their principals. Each of the students was punished with a suspension from school, and each made a federal case out of it, literally, by suing on the basis of alleged infringement of the right of free speech. Both cases arose in the same state, and the same federal appellate court decided appeals in the cases on the same day. The parallels end there, however, because one student succeeded in his First Amendment argument while the other student did not.

The explanation for the different outcomes in the cases boils down to different conclusions as to whether the speech engaged in by the students had at least the potential to be substantially disruptive of school activities, even though both forms of speech occurred off of school grounds. No doubt, in both cases, the targeted principals had bruised feelings, at the very least, but that was not the pivotal consideration.

### Profile Goes Too Far

In the unsuccessful case, an eighth grader's suspension was upheld after

she created a personal "profile" of her principal in which she went so far as to suggest that he was a pedophile and a sex addict. The court acknowledged that criticisms of school officials, even when in bad taste, are not to be censored. However, more than simply being critical or disrespectful, the language used by the student was highly offensive, potentially very damaging to the principal and the school, and maybe even illegal. The insinuations, even if made in jest, went right to the heart of whether the principal was fit to serve in his position, undermining his authority within the school.

### Parody May Be Allowed

By contrast, the same court found that a school had gone too far when it suspended a high school student after he created a profile of his principal on MySpace, using his grandmother's home computer. In this case, the content of the posting could be described as a parody, as it made fun of the principal because of his large size. The parody used some offensive language,

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## Exporting to China

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sider” when planning an export plan for China.

### 1. Do Your Homework

For many companies, the first opportunity to export to China comes in the form of a blind inquiry from a trading company, large state-owned industrial enterprise or a private company. With access to the Internet so common in China, potential customers can often find you more easily than you can find them. Many of these inquiries request quotations for very large quantities of merchandise without any pressure to negotiate a price break.

What sounds like a sellers’ paradise may indeed be something quite different. If your export department engages with this type of customer at arm’s length, the chance of getting burned is significant. Quite often these “customers” will request that you write letters of invitation to allow them to visit your factory. In other cases they will ask for a travel allowance to offset the cost of the trip to meet you. In both cases, your antennae should go up. These elements are often deceptive practices that support visa fraud or out-and-out theft.

Don’t forward letters of invitation without first checking trade references in your home country. At times, a stipend to cover the costs of factory visits is legitimate, but these should never be paid in advance. Rather it can be deducted from the price once you receive a real order.

### 2. Extend Your Reach

Once you have made the decision to support a serious commercial campaign in China, it’s time to consider appointing a corps of distributors or manufacturers’ representatives. While it looks attractive to sign-on with a

large trading company, which maintains offices throughout China, these companies may not be the best fit for you. Large trading companies are knowledgeable about international logistics, currency conversion and hedging and getting paid, however they are unlikely to have much if any expertise in your technical field.

This factor combined with China’s physical size and multiplicity of dialects, languages and cultures helps explain why regional trading companies are often more successful than their nationwide competitors. In a society that places a great deal of value on personal relationships in business, it’s understandable that trading locally can provide a significant advantage.

### 3. Sales Agreements and Contracts

Once you have that order, it’s necessary to ink an agreement that will offer your company every possible advantage. The agreements that you’ve been using with domestic customers are generally not useful in China. Even the contracts that you have used in support of export orders may not stand up there.

The elements to consider include: Incoterms, Chinese customers are offended by ex works terms, preferring at a minimum FOB; consideration of which party bears the risk of loss, should the order be damaged or disappear in transit; retention of the title and security interest; payment terms featuring significant down payments via wire transfer with the balance paid through an irrevocable letter of credit; and warranty terms that you can support with your current resource base.

An additional key point to include in this type of sales agreement is the exclusive use of arbitration should there be a conflict. As is the case at home, you should make every effort to stay out of court in China. Arbitration

through the China International Economic and Trade Arbitration Commission (“CIETAC”) is routine, effective and affordable. Make certain that the contract specifies that the arbitration and supporting documents will be in English and the venue in China will be in a place that you or your representative can travel to easily.

### 4. Field Technical Support

Your engineering or field applications staff can’t hop in a car and drive to Guangzhou . . . and there will be a need for training, follow-up support and maintenance.

Before the product ships, and often after it is necessary to provide some form of remote technical service. This can be accomplished by e-mail, telephone and video conference. A helpful strategy is to assign one person in the home office to coordinate all communications with your Chinese customers. It’s simply too daunting to require them to navigate your company’s internal phone tree and organization.

Once you have secured an order, many companies find it useful to estimate the costs associated with onsite implementation in China and build this element into the purchase price. Another approach is to engage a fee-for-services maintenance company. These can be found in many of China’s eastern cities.

Building a sustainable market in China is desirable and feasible for most companies. If you view your company not only as a producer of goods, but also a patient friend and teacher of your new customers in China, the odds of success are much greater. In addition, companies that build thriving export sales are more likely to succeed in other commercial activities in China.

For further information, please contact Jack Daniels directly at [jdaniels@eastbridgepartners.com](mailto:jdaniels@eastbridgepartners.com).

*Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects, but rather to provide insight into legal developments and issues. The reader should always consult with legal counsel before taking action on matters covered by this newsletter.*

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## Business Succession

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a success story we recently handled might help others approach the issue. “Joe Business” runs a very successful company. Joe’s company grosses approximately \$15,000,000 per year in revenue. Joe is in his mid-fifties and has been making small, tax free gifts of company stock for years which has resulted in his 3 children owning a total of approximately 10% of the company. In the last 5 years, it has become evident that Joe, Jr., will eventually run the company, as Joe, Jr. has become an important part of the business. Joe’s other children, Billy and Sally, have moved on in other directions.

Joe is not ready to give up control of the company, but Joe is aware of the fact that upon Joe’s death, estate taxes could place a significant burden on the children. Assuming Joe’s entire estate (the company and other assets) are worth \$10 million, easily almost half of that could be swallowed up by estate taxes, possibly requiring that the business be sold in order to pay the estate taxes. In this instance, Joe has taken the first steps of putting an estate plan in place and starting the gifting process, but there is still a significant tax liability to pay upon his death.

Joe decides to transfer the company to Joe, Jr., eventually. Billy and Sally will obtain an inheritance of real estate and liquid investments of equal value. Joe, in consultation with us and his CPA, decide that the current environment, with a historically low capital gains rate (which will minimize the tax impact of the sale), low interest rates (which will allow Joe, Jr. to pay the purchase price by way of a promissory note with an interest rate of less than 3%), a favorable appraisal of the business (which means a low purchase price), and an uncertain future for the estate tax, is the best time to transfer most of the company to Joe, Jr. Joe asks us to work with the CPA to structure the transaction.

We recapitalized the company into voting and non voting shares. Billy and Sally transfer their shares to Joe, Jr. Joe, Jr. purchases the nonvoting shares from Joe (which represent 99% of the shares). Joe retains 1% of the shares, but this 1% consists of all of the voting shares. Because of the bad economy the company did not have a good 2009. This results in a low valuation for the company. For succession planning purposes, a bad economy can be a good thing. The purchase price is paid by a note with a low interest rate (again, another favorable result of the poor economy). Cash flows of the company are reconciled so that Joe, Jr. can make the payments to Joe. Joe gifts his liquid assets to Billy and Sally. As the economy recovers in 2010 and beyond, the value of the company increases significantly but the value is now in the next generation. The only party that doesn’t make out well in this scenario is Uncle Sam.

Ultimately, Joe is able to remove 99% of the value of the business from his estate while incurring minimal tax cost. Joe is able to restructure his estate plan so that his children benefit equally. Lastly Joe is able to retain control of his business until he feels confident that Joe, Jr. can manage it on his own (when Joe will sell the last 1% to Joe, Jr.) Joe has accomplished his goals.

Every situation is different. Business transition planning makes sense regardless of whether your business is worth \$20 million or less than \$1 million. It may appear like a daunting task. And there might not appear to be a deadline looming. But the truth is that for most clients a viable business succession plan needs to be a top priority, or you risk losing a great deal of what you worked so hard to achieve. There are many options with respect to structuring such a plan, but the economic environment for doing so is about as favorable as it can be at this time. Please contact us to discuss a plan that fits your business.

## Choosing an Executor

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and especially if the executor is also a major beneficiary of the estate, additional compensation may not be necessary. Otherwise, the will may provide for a fee for the executor, which may be calculated as a flat fee, an hourly fee, or a percentage of the estate assets.

A testator should not forget an even more elementary first step: asking for the consent of the prospective executor, no matter how close a relationship there may be between the individuals. For the benefit of all concerned, the executor must be willing, not just able, to carry out the important responsibilities that come with this job.

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## MySpace

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but on the whole it did not disrupt, or have the potential to disrupt, the student’s school, even though it was highly embarrassing for the principal.

It bears emphasizing that in both cases the students enjoyed much more freedom of expression, although not without limits, than they would have had while at school or in school-sponsored activities. In those settings, as the court noted in one of the cases, there is no First Amendment protection for lewd, vulgar, indecent, and plainly offensive speech, and school officials do not offend the First Amendment by exercising editorial control over student speech so long as their actions are reasonably related to legitimate pedagogical concerns. In short, the lesson for students from these cases could be not only “don’t try this at home,” but also, and more emphatically, “never try this at school.”