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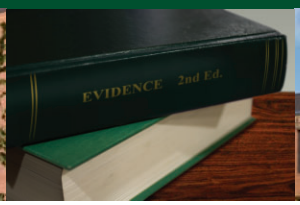


Operating Agreements and Limited Liability Companies

By Lin Hanson

We see a lot of LLCs formed by accountants or other non-lawyers, often with no Operating Agreement. The Illinois Limited Liability Company Act ("Act") has no provision requiring a written Operating Agreement. You wouldn't dream of having a corporation without bylaws. It's just as big a mistake to operate an LLC without an Operating Agreement. Example: Voting power is equal among all the members, even though their investment in the LLC is not equal, **unless the Operating Agreement says otherwise**. Distributions from the company (income) are to be made equally among the members (1/3s), even though A owns 50% of the company, and B and C each own 25%, **unless the Operating Agreement says otherwise**.

An Operating Agreement should include the duties of Managers to the company and the other members. Many LLCs are formed to own and manage real estate. Often the developer is a manager. Is the developer "burdened" by a duty to this company, so that he must offer every other, future deal he makes to this company first? Or is the manager free to do other deals

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Electronic Information Storage: Reducing the Risk of Sanctions During Discovery

By Derek Samz

To stay competitive and keep up with others, businesses have had to rely increasingly on electronic documents, storage, and communications. These requirements have created a volume of electronic documents that is increasing at an exponential rate. Businesses now also must make the difficult decision of what information needs to be retained, and what can be deleted or destroyed. Complicating this decision is the increasing demand to find and produce these documents during the course of litigation.

Failure to retain and produce electronic documents can have adverse effects on the prospects of successful litigation. Courts have imposed sanctions on parties that have destroyed relevant electronic media, ranging from monetary fines to instructing the jury to infer that the deleted evidence was damaging to the case of the non-producing party. Therefore, it is critical that businesses establish general electronic document retention policies, as well as means to identify items which may be critical to success in future litigation. Unfortunately, a necessary corollary to establishing these policies is increased costs in terms of time and storage space.

The hardest task is simply identifying what material safely can be deleted. Federal Rule of Civil Procedure 37, which went into effect January 1, 2007, attempts to provide a guideline to avoid sanctions for failure to produce electronic information. The Rule provides that "absent exceptional circumstances, the court may not impose sanctions under these rules on a party for failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system." The Rule does not give an example of "routine, good faith operation." However, it seems that a party would be protected from sanctions by establishing a reasonable document destruction policy, i.e., one that sets guidelines for destruction based on the passage of time rather than human determination.

While creating a document retention policy that operates based on a set time period is a good start, businesses must be careful to follow statutory document retention periods for their industry, and to preserve any information related to suspected litigation. For example, a party may not be protected from sanctions under Rule 37 if the court determines that the party knew litigation was likely to occur in the future, but failed to save relevant electronically stored information from being destroyed. This situation can arise when a terminated employee storms out of the employer's building threatening to sue for discrimination, and the employer has the employee's personnel file electronically stored. The personnel

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without an obligation to this company? The answer could be either way, depending on the Operating Agreement.

Admission of new members takes 100% approval of existing members. This applies to heirs and takers under your will, as well as gifts to your children. An Operating Agreement can create a class of "permitted transferees."

The authority, and perhaps more important limitations on authority, of managers to bind the LLC can be spelled out in the Operating Agreement. Is any succession in management built in? All these issues should be addressed in the Operating Agreement.

If one or more members guarantees a loan to the LLC, does he or she have a right to contribution from other members if called upon to make good on their guarantee? Should the decision-makers be indemnified against personal liability for decisions made and actions taken in good faith on behalf of the LLC? Deal with these issues in the Operating Agreement.

Does the LLC have the right to make capital call(s) on its members? Under what circumstances? These issues should be anticipated and dealt with in the Operating Agreement.

The Act appears to give no guidance whatever as to the conduct of meetings. Issues of notice, quorum, percentage approval required for action, and so forth need to be in the Operating Agreement. Are there bigger issues such as merger, liquidation, sale of assets in bulk, etc., which require a higher percentage vote for approval? These matters are not covered by the Act and should be addressed in the Operating Agreement.

Will managers receive a salary or other form of compensation? How are distributions to be made, and what about timing of distributions? Remember, the typical LLC is taxed as a partnership, hence its profits fall to the personal tax returns of the members. Is the LLC required to make distribution of some or all of its profits to help those members pay income taxes? Are there actions or occurrences which terminate a member's participation in the company?

The Operating Agreement should address these issues, and the related issues of succession. We can help you create a well thought-out Operating Agreement which reflects your wishes about who will operate the company and how it will be operated, whenever you form or join an LLC. ■

Brother, Can You Spare a Dime?
By Richard Laubenstein

Shakespeare once said "neither a borrower nor a lender be." Shakespeare obviously didn't have a large family. If you have been able to build up a nice nest egg, you may soon find siblings, children or other members of your family and friends asking you to help them out.

Before you lend a helping hand, consider that almost 14% of personal loans (those made by individuals to family or friends) end up in default. That's almost ten times the national average of defaults on bank loans. The main reason for the difference? Bankers aren't afraid to ask questions before they decide to make a loan.

You are about to assume a big risk. Before you do, you have a right to know how your money is going to be used. If you are helping your family member or friend with a loan for their business, ask how much of their own money is being put at risk. Are there any other lenders? Can your loan be secured by equipment, stock, vehicles or real estate?

Your family member or friend may have a history of getting in debt over his or her head. If your borrower wants you to give them money that will be used to pay off other debt, you should ask how the borrower intends to change his or her spending habits. If your borrower continues in his or her cycle of debt, you could well find yourself in the position of having loaned and lost money that you were counting on for your future. You should not make a loan to family or friends unless you can afford to put your money at risk.

If you decide to make a private loan, make sure that the loan is well documented. Documenting the loan helps increase the likelihood of repayment. Borrowers take the loan (and the corresponding obligation to repay it) more seriously if it is in writing. In Illinois, interest rates are limited unless the agreement is placed in writing. If you have to sue to try to collect, you cannot collect your attorneys fees and costs unless the agreement is in writing. Our firm can help you prepare a note, repayment schedule and documents to secure your loan.

Documenting your private loans will help keep your own financial records straight. For example, if you have several children and you have advanced a loan to one of your children, having that loan documented will help keep the peace between your family members in the event you die, so that the various rights and claims to your estate can be determined.

In practical terms, if you have been blessed with the good fortune of having money socked away, you may be unable to turn down a family member in need. If you make a loan that winds up being uncollectible, and you have documented the loan, you may be able to write it off your taxes as a bad debt. If you can afford it, and you feel the money is going for a good cause, you may consider making the advance of money a gift from the beginning, instead of calling it a loan. We can help you document the gift for federal tax purposes. We can also help you maximize the amount of money available to you by assisting you with tax advice. Whether you make a loan or a gift, you should give us a call to help you document your transaction. Our October newsletter will discuss gifting proceeds from the sale of your assets. ■

Employment of Unauthorized Workers

By Margherita M. Albarello

The U.S. Immigration and Customs Enforcement bureau (ICE) is responsible for enforcing the nation's immigration and customs laws. One of ICE's stated goals is to more aggressively audit companies to investigate their compliance with the Immigration Reform and Control Act (IRCA). The ICE reports that in fiscal year 2006, it arrested 716 individuals on criminal charges (including employers and employees) and 3,667 individuals on administrative charges in worksite enforcement investigations, a seven-fold increase as compared to INS arrests during 2002. In light of the ICE's increased enforcement, employers should reacquaint themselves with their obligation to verify their employees' eligibility to work in the United States and take steps to review, and, if necessary, strengthen their compliance program. We can assist you in this process, including performing an on-site audit of your hiring practices.

• **The employer's obligations.** IRCA requires U.S. employers to verify the employment eligibility of all new employees and follow IRCA's record-keeping requirements. It prohibits U.S. employers from knowingly hiring or continuing to employ foreign nationals not authorized to work in the United States. A record of the verification is made on Form I-9, Employment Eligibility Verification, located at the federal government web site (www.uscis.gov). Note that while the I-9 version shown the government site names 10 different documents in List A that employers can accept to verify a new employee's identity and eligibility, a "Special Instructions" section on the site says that 4 of these documents no longer are acceptable. The deleted documents are: (1) certificate of U.S. Citizenship, (2) Certificate of Naturalization Form, (3) Unexpired Re-entry Permit, and (4) Unexpired Refugee Travel Document. In addition, new hires may show one other document that isn't listed on the original I-9 – an Employment Authorization Document. Employers must keep the I-9 records until the later of (a) 3 years after the date of hire, or (b) 1 years after the date of termination. I-9 forms are not filed with the U.S. government. However, the forms must be made available at the employer's worksite within 3 days of the government's request to inspect the documents.

Employers are not expected to be document experts. In reviewing the genuineness of the documents presented by employees, employers are held to a reasonableness standard. For example, you unknowingly may accept a document that is not in fact genuine, or one which is genuine but does not belong to the person who presented it. If the document reasonably appears to be genuine or to relate to the person who presented it, you should not be held liable under ICRA. In cases where a new owner of a business is a successor in interest, having acquired an existing business, the new employer may keep the acquired employer's I-9s rather than complete new I-9 s on employees who were also employees of the acquired employer. However, buyers may want to err on the side of caution and renew the I-9 process, as the buyer may be responsible for any errors or omissions committed by the seller.

• **IRCA and independent contractors.** Employers generally are not required to verify the employment eligibility of independent contractors. However, an employer may not knowingly use an independent contractor relationship to obtain the services of unauthorized workers. If the employer knows or has reason to know that the contractor uses unauthorized workers, the employer may be liable for IRCA violations. Employers may wish to include a clause in their independent contractor agreements whereby the contractor warrant that its employees are authorized to work in the U.S.

• **Penalties for failure to comply.** An employer who commits a "paperwork violation" for mistakes in completing or maintaining Forms I-9 is subject to penalties of $110 to $1,100 **for each violation**. An employer who knowingly hires or continues to employ foreign nationals not authorized to work in the U.S. is subject to first offense civil fines of $250 to $2,200 **for each unauthorized worker**, and fines of up to $11,000 for subsequent offenses. If it is established that the employer had a "pattern or practice" of knowingly hiring or continuing to employ unauthorized workers, criminal penalties, including prison terms, are possible. Employers who commit document fraud – *e.g.*, fraudulently completing a Form I-9 or knowingly accepting a forged or counterfeit document for verification purposes – are subject to first offense fines of up to $2,200 **for each occurrence** and up to $5,500 for subsequent offenses. ■

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information likely will be at issue in the event the employee carries out his threat. If the employer does not save this information, and it is subsequently destroyed, **even pursuant to a "routine, good faith operation,"** the employer may face sanctions, including the inference that the destroyed file was harmful to the employer's case.

"The dog ate my homework" excuse didn't work in school and won't work in court. We recommend that you establish and follow a document retention and deletion policy. It should be in writing, distributed to your employees, and enforced. If you have a plan, we can review it for you. If you do not have a plan, we can help craft one. ■

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