Business Law Section Newsletter

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Message from the Chair

by Robert A. Kaye

It is my proud privilege to serve as the new chair of the Business Law Section. I will attempt to continue the tradition of leadership so ably demonstrated by my predecessor, Gianfranco Pietrafesa, as well as by his predecessors.

I hope you are taking advantage of the many resources our section offers, which include:

- This very fine newsletter, published several times each year, offering informative articles on a variety of topics of interest to business lawyers;
- Sponsorship of mandatory continuing legal education programs throughout the year, including brown bag luncheon webinars and the day-long Business Law Symposium;
- Holding joint meetings with other sections, such as the Tax Law Section or Labor and Employment Law Section;
- The CommunityNet on the state bar association's website, where members may solicit views from or offer worthy information to fellow practitioners;
- Support for the Inns of Transactional Counsel that currently operate in the Morris-Essex and Hudson-Bergen areas; and
- A variety of committees devoted to particular areas of interest to the business bar, including labor, intellectual property, environmental, health and other topics.

Our Business Entities Committee, ably led by Ira Marcus and Denise Walsh, deserves special mention. The committee has been intimately involved in the years-long process to overhaul our limited liability company act. As this newsletter goes to press, a Revised Uniform Limited Liability Company Act, passed by the Legislature in June, awaits the signature of the governor.

As with any organization, the benefits derived from our section are made possible by the support and contributions of the members. Please take a moment to consider how you may be able to get more from your membership; write an article for the newsletter, join a committee, become a presenter or panelist at one of our programs, join an inn of transactional counsel or attend one of the many events throughout the year.

I and my predecessors recognize that the strength of the Business Law Section is due in large part to the diversity of our membership, and I remain committed to expanding that diversity to ensure our section reaps the benefit of the full spectrum of knowledge and experiences provided by a diverse membership.

We constantly strive to better serve our members and potential members. If you have ideas you would like to share, please contact me at 201-348-6000 or rkaye@chasanlaw.com.

Notes from the Editors

by Denise Walsh, Edward Sturchio and Thomas Zalewski

As you may have heard, the *Business Law Section Newsletter* has increased its publication from two to three times per year. We are pleased to present this second edition of the *Business Law Section Newsletter* for 2012.

We also are pleased to welcome the Business Law Section's new chair, Robert A. Kaye. We wish him much luck and success in this new role with the section.

This edition of the *Business Law Section Newsletter* includes articles addressing a diverse range of subjects sure to be of interest to business lawyers. Articles included in this edition cover transferee liability for trust beneficiaries, a thought-provoking court decision relating to tax treatment of distributions to a business owner-employee, the rights of trade creditors in bankruptcy matters, the importance of intellectual property protection to business transactions, and a model law firm summer apprentice program. We thank the authors for their contributions, and hope you find the articles to be informative and of value to your practice.

As always, we encourage you to submit an article for publication in the newsletter on a topic of interest to you and other members of the community of business lawyers in New Jersey. We also look forward to hearing from you, the readers, about topics you would like to see addressed in future editions. Please feel free to reach out to any of us with suggestions.

Call for Articles

We are seeking articles for the December 2012 issue of the *Business Law Section Newsletter* on topics of interest to business lawyers in New Jersey.
The deadline for submitting articles for the December edition is Oct. 15, 2012.

Interested in submitting? You can contact any of the following editors:

Ed Sturchio at 973-966-8243 or esturchio@daypitney.com
Denise Walsh at 973-740-1200, ext. 608 or dwalsh@marcusbrodylaw.com
Tom Zalewski at 973-966-8115 or tzalewski@daypitney.com

We look forward to hearing from you.

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Mark Your Calendar for These Upcoming Events

Jan. 15, 2013
Business Law Section, NJSCPA and Bankers Cooperative
5:30 p.m. at Mayfair Farms in West Orange

March 13, 2013
Joint meeting with the Tax Section
6 p.m. at the New Jersey Law Center in New Brunswick

April 12, 2013
Business Law Symposium
Pine Manor in Edison

Commentary: An Instructive Decision

by Stuart L. Pachman

The Seventh Circuit's Judge Richard Posner is a repository of legal and economic knowledge whose opinions evidence a sharp wit and a limited tolerance for fools. Consider his decision in *Mulcahy, Pauritsch, Salvador & Co., Ltd. v. C.I.R.,* [1] with its enlightening explanation of the hard to discern line separating salary from dividends when a corporation distributes money to shareholder/employees. Judge Posner reduces tax law, corporate principles, and economic theory into understandable prose with a salting of sound commonsense.

An owner/employee, Judge Posner explains, is entitled both to fair compensation for services (labor) as well as a fair return on investment (capital), the former deductible (to the corporation); the latter, not so. Both are taxable to the shareholder, but a shareholder's return on equity through corporate dividends is (presently) subject to a lower tax rate. Using simple arithmetic, Judge Posner first shows us the true dollars and cents benefit that results when an owner/employee in a C-corporation receives $100 as compensation for services rather than as a dividend, thus demonstrating why, notwithstanding the lower tax rate, owners/employees prefer salary to dividends to the extent they 'can get away with' it.

In a small professional service firm (think lawyers, accountants, physicians) with limited non-professional employees, operating out of rental space using a small amount of furniture and equipment, there is, the court noted, little distinction between firm revenue and the salaries paid to the professionals for their labor. Where "the amount of capital is negligible," the court tacitly appears to approve the practice of "zeroing out" at the end of the year.[2]

In the case before the court, however, the taxpayer was a substantial accounting firm with tangible and intangible capital. The business amounted to more than a simple reflection of owners' services. Consequently an independent owner (a non-employee investor) might raise an eyebrow at the quantum of compensation that would detract from his or her return on equity.

The lucid discussion of legal rules and economic physics is not all that makes the case a good read. The underlying facts are reminiscent of a television series portraying the human dynamics in a business or professional relationship. The taxpayer corporation consisted of three "founding shareholders" and a larger group of "other shareholders" all providing accounting services to clients of the corporation. Each of the three founders, to disguise from the other shareholders the true amount the three were pulling out, set up his own entity that received 'consulting fees' from the firm. It was the deduction taken by the corporate taxpayer for those 'fees' that was disallowed.

Aside from entertainment, there are at least two pertinent takeaways from Judge Posner's decision for the business lawyer:

The first lesson relates to the court's observation that the participants would have been better served had their C-corporation been operated as a pass through entity (*e.g.*, S-corp., LLC, LLP, or even an LP). This observation highlights the important question lawyers face for clients regarding the appropriate choice of entity or form of doing business. Once a form of entity is chosen, tax consequences follow "whether contemplated or not."[3]

The second lesson stems from the fact that although the Internal Revenue Code provides that reasonable good-faith efforts to determine tax liability offer a degree of protection from the imposition of penalties, taking tax advice from oneself, does not measure up. Compare, in the corporate context, the potential liability of directors under N.J.S. 14A:6-14(2).

Finally, for those who appreciate legal principles stated in the vernacular, Judge Posner tells us that a "corporation cannot avoid tax by using a cockeyed

method of distributing profits to its owners,"[4] and concludes with: "That an *accounting* firm should so screw up its taxes is the most remarkable feature of this case."[5]

Stuart L. Pachman is a member of Brach Eichler L.L.C. with offices in Roseland. He is a general practitioner, with an emphasis on business and nonprofit organizations, including counseling, organizational documents, contracts, and commercial litigation. He is a director of and a former chair of the Business Law Section, and is the author of Title 14A Corporations, *published by Gann Law Books.*

Endnotes

1. 680 F.3d 867 (7th Cir. 2012).
2. *Id.*
3. 680 F.3d at 871.
4. *Id.* at 874. *Compare Schulmann v. Dir. Div. of Tax.*, 423 N.J. Super. 333 (App. Div. 2011).
5. 680 F.3d at 873.
6. *Id.* at 875.

A Cautionary Tale for Estate Fiduciaries and Beneficiaries of Estates with Closely Held Business Interests

by Maria A. Cestone

The decision in the case of the *U.S. v. Johnson et al.,*[1] dated May 23, 2012, is mandatory reading for any corporate, tax and estate planning advisor of individuals owning interests in closely held entities. Although this matter arises out of Utah, the court relied on federal tax statutes in favorably interpreting transferee liability statutes to avoid transferee liability to trust beneficiaries. However, a contribution agreement signed by the beneficiaries was deemed insufficient to avoid personal liability for unpaid estate taxes under the federal claims statute and, consequently, the estate's legal representatives were held liable.

Anna Smith died testate on Sept. 2, 1991, and was survived by her four children. Prior to her death, she executed her estate planning documents. She prepared a family trust, as well as a last will and testament. The will provided for a pourover of her probate assets to the trust. She named two of her children as co-trustees of the trust and as personal representatives of her will.

Pursuant to the will, the personal representatives were directed to ensure that the "debts, last illness, and funeral and burial expenses be paid as soon after death as reasonably convenient." The will further directed that "claims against the estate" be settled in the discretion of the personal representatives, although it did not contain an express direction to pay federal estate tax. The "rest and residue" of the estate was to be paid over to the co-trustees, added to the trust principal and administered as provided by the trust agreement, which directed that specific distributions be made from the principal to certain individuals upon the death of the decedent.

The trustees were also directed as follows:

> to pay any and all debts and obligations of the Grantor, the last illness, funeral, and burial expenses of the Grantor and any State and Federal income, *inheritance and estate taxes* which may then be owing or which may become due and owing as a result of the Grantor's death. [emphasis added].

After these specific distributions were made, the co-trustees were directed to divide one-third of the remaining trust *corpus* into four equal parts, to be distributed to four family limited partnerships (which had been established respectively for each beneficiary). The remaining two-thirds of the principal and undistributed income of the trust would be distributed equally to the beneficiaries. The decedent's non-probate assets consisted of several life insurance policies valued at approximately $370,000, payable to the decedent's children.

The trustees thereafter filed the federal estate tax return with the IRS on June 1, 1992. They valued the gross estate at $15,958,765, and calculated the federal estate tax liability to be $6,631,448. The bulk of the decedent's estate consisted of 9,994 shares of stock in State Line Hotel, which was valued at $11,508,400.

As permitted by statute, the trustees elected to defer payment of some of the federal estate tax liability under Section 6166. Section 6166 allows an estate to defer paying part of its estate tax if more than 35 percent of the estate is comprised of closely held business interests. Upon receipt of the estate tax return, the IRS assessed the estate for unpaid taxes.

Later that year, on Dec. 31, 1992, the trustees and heirs executed an agreement distributing all the remaining trust assets to the heirs. Specific mention was made of the federal estate tax liability, as follows:

> 6. Liability for Taxes. Each of the BENEFICIARIES acknowledges that the assets distributed to him or her will accomplish a complete distribution of the assets of the Trust. A portion of the total federal estate tax upon the Estate of Anna Smith is being deferred and is the equal obligation of the BENEFICIARIES

> to pay as the same becomes due. Likewise, if, upon audit, additional federal estate taxes or Utah Inheritance taxes are found to be owing, the responsibility for any such additional taxes, interest or penalties will be borne equally by the BENEFICIARIES.

The IRS issued a notice of deficiency against the estate on May 30, 1995, having made a determination that the hotel shares were worth $15,000,000 at the date of the decedent's death in 1991. The government's change in valuation resulted in alleged additional estate tax of $2,444,367. The estate contested the notice of deficiency, and a settlement was reached by which the estate agreed to pay an additional $240,381 in federal estate tax. The total federal estate tax liability thereafter became $6,871,829.

The Bankruptcy

Until this point, the estate administration proceeded normally; however, in Jan. 2002 (11 years after the decedent's death), the hotel filed Chapter 11 bankruptcy in Nevada. According to the court's recitation of events, the bankruptcy court approved the sale of all hotel assets to a third party "free and clear of all liens, claims, and encumbrances." The heirs received no value for their hotel shares, but each did receive $126,000 annually for signing a two-year non-compete agreement. In addition, each heir reported losses of over $1,000,000 in connection with the hotel stock that he or she owned (which was used to offset taxable income).

By 2003, the estate defaulted on its federal estate tax liability, after having paid $5,000,000 of the total amount due and owing. By 2005, the IRS issued a notice and demand for payment of the tax liability to the personal representatives. Notwithstanding the IRS's notice and demand, full payment was not made, and collections failed to obtain payment through levies on the estate, the trust and the defendants. This resulting court action—based on allegations of personal and transferee liability—was deemed to be a continuation of the government's attempts to collect the outstanding tax liability.

Interestingly, the government brought this action against the estate distributees—the heirs and the co-trustees. It relied on Section 6324(a)(2) as the basis for claiming that each heir is liable for the estate tax and that this statute imputes *personal liability* for federal estate taxes to individuals receiving property from the estate at the time of a decedent's death. That section names as potential liable parties as, *inter alia*, a spouse, transferee, trustee, surviving tenant, and beneficiary.

The co-trustees admitted to falling within this statute's application. Additionally, the heirs admitted that as beneficiaries of the life insurance proceeds, they fell within the scope of Section 6324(a)(2) as well. However, the heirs denied that they became distributees when property from the trust *corpus* was distributed to them and, consequently, denied all liability arising from their status as trust beneficiaries.

In addition to personal liability, the government focused on *transferee liability* in an effort to affix liability. Three constituent parts of transferee liability were examined:

Timing of Distributions. The government had contended that the heirs were personally liable for the estate tax because they became transferees when property from trust *corpus* was distributed to them. The heirs argued that they were not transferees because the property was not distributed to them *immediately* upon the decedent's death. The court agreed, and interpreted this section in favor of the heirs, holding that a person falls within Section 6324(a)(2) only if he or she has or received property from the gross estate immediately upon the date of a decedent's death rather than at some point thereafter.

Trustees Received Trust Corpus Upon Decedent's Death. The government posited that the existing line of cases on point address trust beneficiaries who were entitled to trust income and not trust *corpus* itself. The court, however, disagreed, and found that the immediate right to the trust *corpus* did indeed belong to the trustees upon the decedent's death, and not to the heirs. The court further stated that "whatever inchoate property interest" the heirs may be said to have received upon the decedent's death did not position them to be held personally liable for the estate tax. Further, the co-trustees were directed to distribute the remaining principal and undistributed income of the trust *only* after the estate's debts and obligations were satisfied (and the specific distributions were made).

Subsequent Transferees. The court addressed the status of the heirs as transferees using the lens of Section 6324(a)(2), as follows:

> Any part of such property transferred by (or transferred by a transferee of) such spouse, transferee, trustee, surviving tenant, person in possession or beneficiary to a purchaser or

> holder of a security interest shall be divested of the lien…and a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, or transferee of any such person, except any part transferred to a purchaser or a holder of a security interest.

The Court interpreted Congressional intent to conclude that the term "transferee" does not apply to subsequent transferees who receive property from a distributee following a decedent's death; accordingly, the heirs were not deemed to be transferees under Section 6324(a)(2).

With regard to their status as *beneficiaries*, the heirs did not dispute their status as beneficiaries of the decedent's life insurance policies, but did challenge the interpretation that this statute applied to them as trust beneficiaries. The court found that the term "beneficiary" was only meant to refer to insurance beneficiaries, and not trust beneficiaries. While the government expressed concern with abuses that could ensue, the court expressed satisfaction that the trustee's potential liability would help curb abuses envisioned by the government.

For example, one of the heirs, Eve H. Smith, was sued in her capacity as a beneficial transferee of certain assets distributed from the estate through the trust and as a partner of the James W. Smith Family Limited Partnership. While the government had asserted that Ms. Smith was a recipient of assets and cash, she was shown to have received neither and, further, she was not a party to the distribution agreement. The court stated that "the assertion that Ms. Smith should bear liability because she was a partner of certain limited partnerships is an even more attenuated argument than that made against the Heirs and direct beneficiaries of the Trust."

In sum, the court found the following regarding the transferee issue:

- the co-trustees fell within the scope of Section 6324(a)(2) to the extent of the value of the property in trust at the time of the decedent's death;
- the heirs were deemed to beneficiaries under Section 6324(a)(2) to the extent of the life insurance proceeds and beneficiary status was limited to that property only; and
- the heirs did not meet the definition of transferee under Section 6324(a)(2) and, therefore, were not liable as trust beneficiaries or as transferees.

Statute of Limitations

The defendants conceded that the trustees and beneficiaries of the life insurance proceeds would ordinarily be subject to liability under Section 6324(a)(2), but that claims here were time barred. Typically, the IRS has 10 years to collect the assessed taxes; in this case, the return was filed on June 1, 1992, and the IRS assessment was made on July 13, 1992. As a result, the 10 years would have run until July 13, 2012. However, the 10-year period was extended when the estate made the election to defer estate taxes under Section 6166(a), and the first installment would be payable five years after making the election. As a result of the election, the statute of limitations could be tolled for up to 15 years from the date of election. Rather than tolling the statute of limitations until 2007, however, the statute started running again in 2003 when the estate defaulted in making its yearly payment. This was not contested by the defendants.

Applicability of Section 6901 to Action Against Estate Distributees

Instead of suing the estate, however, the IRS chose to commence an action against the distributees of the estate who, in point of fact, never received an assessment. Section 6901 governs the method and procedure for collecting taxes from transferees who received estate assets. For purposes of Section 6901, the term "transferee" is defined as "donee, heir, legatee, devisee, and distributee, and with respect to estate taxes, also includes *any person* who, under 6324(a)(2), is personally liable for any part of such tax." [emphasis added]. Hence, the term "transferee" would be broader under Section 6901 than it is under Section 6324(a)(2) and, further, it encompasses the co-trustees and the life insurance beneficiaries in this particular case.

Fiduciary Liability

The government also contended that the personal representatives of the estate would be liable for the state tax pursuant to 31 U.S.C. §3713(b), which states as follows:

> A representative of a person or an estate… paying any part of a debt of the person or estate before paying a claim of the government is liable to the extent of the payment for unpaid claims of the Government.

As a result, if the estate has insufficient assets to pay its debts or is insolvent, a personal representative must give priority to the United States and first pay that liability. If this is not done, the representative can be held liable.

In this case, the personal representatives admitted to distributing estate assets prior to satisfying the government's claim. They claimed, *inter alia*, that the distribution agreement should bind the distributees, not them, on account of the right of contribution language it contained. They further claimed as a defense that there had been sufficient monies to pay the tax originally. The court, however, rejected the accounting/timing issue and, instead, interpreted the statute as providing recourse when a representative distributes assets of an estate before paying estate taxes.

The court held:

> Were courts to excuse personal representatives from liability when they secure contribution agreements, the Government would have to bring an action in contract, prove it is a third-party beneficiary of the agreement, and then establish its right of contribution.

Here, the co-trustees admitted distributing assets to themselves and two relatives rather than applying them to the tax liability with the acknowledgment that the distribution would result in a complete distribution of the trust. The court re-characterized the distribution agreement as a "hold harmless" agreement to protect the personal representatives from tax liability in the event the heirs failed to pay estate tax. Lastly, even though the agreement stated that the heirs would be responsible to pay taxes, this was not the 'right of contribution' agreement contemplated by court cases through the years and, in fact, this particular distribution agreement was deemed "immaterial" in determining liability under Section 3713(b).

The court agreed that Section 3713(b) is a straightforward analysis, and that it was designed to collect unpaid taxes from the very individuals who dispersed the estate's assets without satisfying the estate's tax liability. The court further stated that those individuals who distributed the estate's assets did indeed accept the risk that the heirs might fail to pay the tax. The court further stated that the personal representatives, rather than the government, were in the best position to seek reimbursement from individuals who accepted the assets when a deferred obligation to pay the tax was in place.

Conclusion

Though couched in the form of a summary judgment motion, this case is truly a lesson for fiduciaries who undertake a Section 6166 election to defer payment of estate taxes. Even with a Section 6166 election in place, the estate or trust fiduciaries would be wise to retain those assets until full and final payment of the estate tax liability. An early distribution where other trust and/or estate assets do not exist to satisfy the tax liability will expose fiduciaries to personal liability as described. The risk might be minimized if fiduciaries could, for example, obtain a pledge of assets that are unlikely to lose significant/material value in the context of a contribution agreement; however, that risk can only be minimized, not avoided, even with a contribution agreement in effect. ■

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Endnote

1. 2012 U.S. Dist. LEXIS 72194 (May 23, 2012); 109 A.F.T.R.2d (RIA) 2253.

Don't Reclaim; Get Paid On Your 20-Day Claim

by Karina Pia Lucid

As part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA),[1] Congress created a little known, but significant, remedy for certain trade creditors. Under BAPCPA, vendors who had delivered goods to the debtor within 20 days of the filing of the debtor's petition for relief became entitled to a "super priority" administrative claim—putting their right to receive payment in full for their claims against the debtor ahead of nearly every other creditor.

Interested in finding out how to help your client take advantage of this wonderful tool? Read on, because it is *not* as simple as filing a proof of claim.

Trade creditors and their attorneys outside of bankruptcy are commonly aware that, pursuant to Section 2-702(2) of the Uniform Commercial Code (UCC)[2] an unpaid seller of goods may reclaim goods that were delivered to and received by an insolvent debtor. The UCC requires that such a creditor must make a written demand for reclamation within 10 days of the debtor's receipt of the goods, noting that the debtor was insolvent at the time of delivery. This right to reclamation is preserved in a bankruptcy case pursuant to Section 546(c) of Title 11 of the United States Code.[3]

Section 503(b)(9) goes further. Pursuant to Section 503(b)(9), a vendor is entitled to an administrative expense claim for "the value of any goods received by the debtor within 20 days before the date of commencement of a case under [the Bankruptcy Code] in which the goods have been sold to the debtor in the ordinary course of such debtor's business." Thus, if a creditor is granted an "administrative expense" claim for goods delivered within the 20-day period, or a 20-day claim, their claim must be paid in full if other administrative claims, including the debtor's attorney's fees, are being paid in full. That is quite a nice position to hold.

So, how do you know if your client's claim qualifies for the 20-day claim treatment?

First let's look at the language of Section 503(b)(9) carefully. What is the 'value' of the goods? In general, you can count on bankruptcy courts to give a seller the benefit of the price contracted for on their invoice of sale as a fair representation of the value of the goods sold to the debtor. However, be aware that the presumption can be overcome. A debtor may object to the amount of the claim based on several facts, including the inclusion of delivery or other service-type charges on the invoice.

Remember, it is only the value of the goods themselves that is entitled to the 'super-priority' claim status. Service items are not entitled to administrative claim treatment. So, if your client has incurred freight charges or has paid overtime to its employees to expedite a shipment to the debtor, and these costs were contractually to be passed along to the debtor, you should be prepared to argue over the inclusion of those fees in your client's 20-day claim.

Now let's analyze the clause requiring that the goods be "sold to the debtor in the ordinary course of the debtor's business." The Bankruptcy Code does not provide a definition or any specific guidance to help us understand exactly what is meant by the "ordinary course of the debtor's business," so we must look to other sources for interpretation of this provision.

Unlike Section 547 of the Bankruptcy Code, which applies to preference actions, Section 503(b)(9) requires courts to apply a debtor-centered standard to determine whether a sale was made in the ordinary course. In contrast to Section 503(b)(9), Section 547(c)(2) states that a transfer or sale is "ordinary" if it is "made in the ordinary course of business or financial affairs of the debtor and the transferee; or [ ] made according to ordinary business terms."[4] Accordingly, when interpreting cases under Section 547, bankruptcy courts apply a subjective test that looks at the relationship between the parties.[5] Thus, applying preference case law to 20-day claims can be tricky.

The next step would commonly be to look to the UCC for some guidance, but the UCC is not much more helpful. Section 1-201(9) of the UCC provides that "[a] person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices." Thus, the UCC, in contrast to the debtor-centered approach of Section 503(b)(9), directs courts to look at the ordinary business practices of the seller, not the buyer.

Is a seller then expected to have such diligence to sell only to a buyer whose actual business practices the seller is intimately familiar with? That hardly seems realistic. Bankruptcy courts are courts of equity. Where the Bankruptcy Code falls short, there is always fairness, and a vendor that is seeking payment of a 20-day claim might do well to include reference to Section 105(a) of the Bankruptcy Code, which invokes the court's authority and power to issue "any order [ ] that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]."

Finally, what about the timing issue? The super-priority status is afforded to claims for goods "received by the debtor within 20 days of the commencement of [the] case." Sounds like simple math, right? Wrong. Of course, it has been argued that the 20 days prior to the commencement of the case does not include the filing date itself. It has also been argued that proof that goods were shipped to the debtor is not enough; a vendor with a 20-day claim must also be prepared to provide proof that the goods were actually received by the debtor, and be prepared to show when that delivery occurred. In some cases, if the delivery was made on the actual day of the commencement of the case, a vendor may have to show the actual time of delivery in order to prove the shipment was not received by the debtor *after* the case was commenced.

In assessing a similar timing provision, one court opined that "[i]t would be absurd if goods received prepetition on the day of the filing of the petition would not give rise to an administrative claim but they would if received the preceding day."[6] But just because it might be considered absurd by most, doesn't prevent the argument from being raised by a debtor or a creditors' committee that is trying to preserve precious cash for continuing operations or for a distribution to creditors that do not have super-priority status.

Now, let's consider how to go about presenting your client's 20-day claim to the bankruptcy court. Your first instinct is probably to prepare and file a proof of claim. Well, the current Form B-10, used for the filing of claims in bankruptcy cases, specifically indicates that the form is not to be used for claims that arise under Section 503 of the Bankruptcy Code. If the debtor consents to the amount of the 20-day claim, you may be able to obtain a stipulation and consent to the claim, which would then be subject to notice and objections by other creditors. If no objections are filed, your client's 20-day claim may be approved by the court without further need for motion practice, adversary complaint, or argument.

However, best practice is not to rely on such good fortune. The best practice, in the author's experience, is to immediately file an emergent motion seeking to compel payment of the 20-day claim on an administrative expense priority basis. Without the filing of such a motion, the holder of the much coveted 503(b)(9) claim may well run the risk of the goods being sold, the money being used for other expenses and the claim becoming valueless.

There are certainly other considerations with respect to the 20-day claim, and this article is not meant to be an exhaustive discussion on the subject. But now you are aware of some of the key and critical issues to address the moment you answer the phone and find that you have a client in the bittersweet position of having delivered goods to a debtor within 20 days of the commencement of the debtor's bankruptcy case. ■

Karina Pia Lucid is a bankruptcy attorney at Karina Pia Lucid, Esq., LLC, with experience in creditors' rights representation in large and mid-sized Chapter 11 cases. Her practice now also includes individual and small business Chapter 7 and Chapter 13 cases.

Endnotes

1. Pub. L. No. 109-8.
2. U.C.C. §2-702 (2004).
3. 11 U.S.C. § 101 *et seq.*
4. 11 U.S.C. 547(c)(2).
5. *See, e.g., In re Elrod Holdings Corp.* 426 B.R.106 (Bankr. D. Del. 2010); *see also, In re Ahaza Sys., Inc.*, 482 F.3d 1118 (9th Cir. 2007).
6. *In re Barbaran*, 2007 WL 973945, *4, n. 6 (March 29, 2007).

Maximizing Value Through IP: Failure to Register Trademarks or Intellectual Property Can Cost a Business in the Event of a Sale

by Denise Walsh and Robert Shepherd

When starting a business, most business owners think about financing, hiring employees and marketing to potential customers and clients. The last thing a new business owner may think about is the sale of the business. However, most investment bankers advise business owners to start preparing for sale from day one. This means that, from the date of its formation, the business should be organized so a future buyer could step in at anytime and seamlessly take over operations.

One fairly inexpensive method of preparing for sale at the outset of a business is to register the company's intellectual property with the United States Patent and Trademark Office (USPTO). Registration with the USPTO helps insure that the purchase price a business owner receives upon sale includes the value of the company's goodwill. Some key elements of goodwill are the company's name, trademark and/or service mark. For example, the name and symbol of a fast-food chain, as well as the name of its signature hamburger, may be some of the most valuable assets of the business.

Failure to register an entity's mark may result in a holdback, or even a reduction of the purchase price. One of the authors recently represented a business owner who sold his business after 20 years of operation. The seller failed to register the company's mark with the USPTO. Due to the premium being paid for the goodwill of the business, the buyer ran a trademark search. The results of the trademark search revealed that, unbeknownst to the seller, a third party had filed a trademark application with the USPTO for a similar mark. Although the company attained certain common law rights to the mark as a result of its use, and likely would prevail in litigation against the third party, the buyer was understandably apprehensive. At closing, the buyer required that a portion of the purchase price be placed in escrow pending resolution of the matter. Any legal fees incurred by the buyer in connection with the resolution were to be reimbursed out of the escrowed funds and the remaining funds, if any, were to be paid to the seller.

In another recent example, a business owner sold her business to a foreign buyer. Once again, the seller failed to register the company's mark. The company had used the mark since its inception and, therefore, attained certain common law rights to the mark. The seller knew of no third-party claims to the contrary. Notwithstanding, the buyer required a reduction in the purchase price due to the seller's failure to register the company's mark.

In many foreign countries, a person does not have any rights in a mark unless he or she registers the mark with the appropriate authorities. The buyer was unfamiliar with the protections afforded by the common law and was, therefore, uncomfortable with the fact that the business it was buying had not registered its mark. The buyer also wanted to register the mark in its own country and non-registration in the United States presented an obstacle to such foreign registration. From the buyer's perspective, the company was worth less absent federal registration.

The two scenarios described above could have been avoided if the business owners registered the marks of their respective companies from the outset of the business. Once a company registers its mark as a federal trademark, it has nationwide rights in that mark as it relates to the particular goods or services for which the mark is used.

From the date of registration, third parties are placed on constructive notice of the registrant's claim of ownership of the mark. The registering entity can keep others from using the same mark, as well as any 'confusingly similar' mark anywhere in the United States that the registrant is selling its goods and services. This is true even where the registrant is the second party to start to use the mark in a particular trading area. In other words, if the mark is registered by a company

located on the East Coast, it can stop a company on the West Coast from using the mark when the East Coast company begins to sell its goods on the West Coast, so long as the party on the West Coast started using the mark after it was registered. This represents a significant expansion of a company's common law rights.

Some additional benefits that flow from federal registration of a mark include the right to bring an action concerning the mark in federal court, the ability to prevent importation of infringing goods by filing the registration with the United States Customs Service and the opportunity to use such registration as a basis to obtain registration of the mark outside of the United States. Federal registration also allows the registrant to potentially recover treble damages, attorneys' fees and other remedies.

In the first example cited above, the company's registration of its mark with the USPTO would have placed the third-party applicant on notice of the company's ownership of the mark. The third party's application would have been denied by the USPTO at the outset, and would not have appeared in the trademark search results. There would no longer be a need for a holdback of any portion of the purchase price at closing, and the business owner would have walked away with more money at closing. If the third party began using the mark, the company could file an infringement lawsuit in federal court seeking treble damages, attorneys' fees and other remedies.

Likewise, in the second example, the company's federal registration of its mark would have assured the buyer that the company had exclusive rights to the mark. It also would have helped pave the way for the buyer to register the company's mark in its home country post-closing.

Once a company registers its mark, the question becomes how to value it. As has been noted in various contexts, the valuation of intellectual property can be difficult.[1] Notwithstanding the difficulty surrounding valuation, there is no question that the registration of a business's name, trademark and/or service mark comes with many benefits and, ultimately, increases the value of the business. The cost of registration by competent counsel is relatively low, even for a start-up company, and the downstream problems that may arise without registration can be significant, as illustrated by the above examples.

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Endnote

1. *Mergers & Acquisitions: The Deal Maker's Journal, Rountable Panel, The Official Publication of Association for Corporate Growth* (October 2008).

Keys to a Successful Summer Apprentice Program

by Lynn Anne Baronas

In recent years, more firms have begun to offer a modern update of the traditional legal apprentice model to the law students who come to work with and learn from them during the summer. The successful summer apprenticeship program will have five key components: 1) team-oriented learning; 2) individualized mentoring and support; 3) practical, hands-on training and experience; 4) a platform for understanding today's legal landscape; and 5) a context for discerning the roles and responsibilities of attorneys in the legal profession. Law students who are trained under the apprentice format will acquire real-world skills and experiences that equip them to be junior associates who hit the ground running.

An effective summer apprenticeship program will involve law students in real-life, day-to-day client matters and provide on-the-job training under the close supervision of experienced mentors and advisors. Training might include programs that focus on a firm's values, including *pro bono* work, diversity and community service, as well as client development and law firm management and economics. Generally speaking, summer apprentices should receive training and experience in these four areas:

1. **Substantive Practice Areas:** Each summer apprentice should have the opportunity to work on at least one long-term case or transaction during their summer with a firm. In addition, apprentices benefit from working on discrete research and writing assignments. Where possible, a firm should attempt to match work assignments with the apprentices' expressed areas of interest; however, to increase their knowledge of and exposure to different areas of the law, a firm should also take care to ensure that apprentices have opportunities to work in a broad variety of substantive areas.

   Firms offering a summer apprentice program should provide law students with opportunities to learn about substantive practice areas through shadowing opportunities, which allow apprentices to observe firm lawyers at closings, court appearances, depositions and client meetings. Training workshops designed to further their understanding of specific skills in various areas of the law will also help apprentices learn about various substantive practice areas. For example, while working on transactional or litigation matters, an apprentice might attend workshops on drafting pleadings or basic transactional documents. Finally, a good summer apprentice program will ensure that firm attorneys have the opportunity to meet with apprentices to share insights and information about the substance of their practice areas.
2. **Core Value Training:** Learning about a firm's core values—including a commitment to *pro bono* work, community service, and diversity—should also be an integral part of the summer apprentice experience. The summer apprentice program will ensure that each apprentice works on at least one *pro bono* assignment during the course of the summer. In addition, the firm can make sure that apprentices are involved in matters important to the community. If the class is large enough, summer apprentices can coordinate and implement a group community service project, which will permit the group to practice teamwork.
3. **Client Development Training:** Client development training is an essential component of summer apprentice programming. Firm attorneys can share what they have learned about this important skill at workshops that spotlight how lawyers market their skills to current and prospective clients. To reinforce what is learned at the workshop, lawyers can encourage summer apprentices to accompany them at out-of-office events, where they can practice networking with other professionals. Apprentices might also benefit from opportunities to participate in more traditional client development events—including proposal writing and the development of client and continuing legal education presentations.

4. **Law firm Economics/Management Training:** In addition to learning about various substantive areas of law and client development, summer apprentice programs work best when they educate apprentices about law firm economics and management. This training should give apprentices a sense of how associates fit into the framework of a law firm and how individual contributions can translate into financial success. Apprentices should also receive training on time-entry skills, email and voicemail etiquette, client service, communication skills, legal writing skills and time management.

A well-run summer apprentice program encourages apprentices to attend bar association events, community events and firm-sponsored social events with firm colleagues throughout the summer. The program also provides apprentices with a support network of mentors, program coordinators and recruiting and professional development administrative staff. Each apprentice should have a partner, and where possible, an associate mentor, who can be available on an as-needed basis to discuss work assignments, assist apprentices in understanding the firm's processes and culture, and serve as guides and overall go-to people throughout the summer. Experienced attorneys should serve as summer program coordinators to meet with each apprentice individually on a periodic basis, participate in weekly check-in meetings, assist in identifying a broad array of work assignments and shadow opportunities, and serve as overall links between the firm and apprentice programming.

Those who coordinate a summer apprentice program must take care to allocate and track work assignments to ensure that apprentices receive timely substantive performance evaluations and feedback. Throughout the summer, a summer apprentice should have many opportunities to receive feedback about their performance and to ask questions about or to make suggestions regarding the program. For example, the program can offer weekly meetings at which the apprentice can raise general questions or discuss issues of common interest to others in the program. Similarly, firm attorneys need to commit to providing summer apprentices feedback on work product as projects progress. Each assigning attorney should complete a written evaluation of the projects the apprentices complete, and the apprentices should have access to these evaluations so that they may gauge their progress as the summer progresses.

Finally, the program should offer mid-summer and end-of-summer evaluation conferences so apprentices can check in with the hiring or recruiting committee members to discuss the variety and quantity of work assignments, potential tag-along or shadow opportunities, feedback about their substantive research, legal writing, and work product and performance to date. These meetings also offer an opportunity for apprentices to offer feedback on the program, generally.

A summer apprentice program based upon the elements described above will prove a win-win for all involved: It affords a firm the opportunity to groom students who return the following fall ready to hit the ground running, which, in turn, benefits clients and enhances the firm's ability to provide topnotch client service. The summer apprentices leave with practical skills and experiences, as well as a more fulsome sense of the legal profession. ■

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