TRUSTS AS PARTIES TO BUSINESS AGREEMENTS

Sir Walter Scott wrote, “Oh what a tangled web we weave.” Buyers seeking to purchase a business that is partially held in a trust may face this tangle more than others. They wonder, “With whom am I actually doing the deal?” and, “What are my legal rights should the deal fall through?”

On the flip side, if you are looking to sell your business, and part of the stock in your business is held by a trust, you might wonder how you can accomplish the goals you seek without substantial risk that the sale could be undone later in the event all legal requirements were not strictly followed.

Questions around trusts as shareholders of businesses can be complicated, but Wisconsin recently modified its statutes to include some very clear and specific parameters for buying and selling business interests held in a trust.

This article will help people on both sides of the coin to assess their rights and risks when engaging in business transactions where trusts are parties in one way or another.

Overview of Trusts as Parties to Business Contracts

In contemplating a business contract involving a trust, there are three main questions you should ask:

1. Does the trustee have the authority to do what I need him or her to do?
2. What is required for the trustee to exercise his or her authority?
3. What is my risk if it turns out after the fact that the requirements above were not met?

Let’s consider each of these questions in turn:

1. **Does the trustee have the authority to do what I need him or her to do?**

Wisconsin law gives certain powers to a trustee, but those powers can be trumped by the powers granted in the actual trust. This simply means that you need to know what the trust itself says. There are two documents that should lay everything out for you: the trust agreement or a Certification of Trust. As a buyer, you do not always have a legal right to see a trust agreement in its entirety, but you do have the legal right to receive a Certification of Trust.

Therefore, when you are in a business transaction involving a trust, you will want to ask for a copy of the trust agreement itself or a Certification of Trust.

In a Certification of Trust, the trustee certifies, or swears to, the following information:

- That the trust exists, and the date on which it was created
- The identity of the settlor
- The identity and address of the currently acting trustee
- The trustee's powers (This is the section that will tell you whether a trustee has authority to complete the type of transaction you seek)
- Whether the trust is revocable or irrevocable
- That the trust has not been revoked, modified, or amended in any manner that would cause the representations in the certification to be incorrect
- The authority of a co-trustee to sign and whether all co-trustees are required to sign in order to exercise the powers of the trustee
- The manner in which title to trust property may be taken

Again, Wisconsin law provides certain "default" rules regarding trusts, but those can be changed in the actual trust agreement. Therefore, you need the details from the trust agreement or a Certification of Trust to understand whether and how to accomplish your goals.

2. What is required for the trustee to exercise his or her authority?

You will also want to ask, "Is there more than one trustee?"

Wisconsin's default rule is that there must be consent by a majority of the trustees in order to conduct a business transaction, however, the trust agreement may preempt that rule by stating that it is possible for one trustee to delegate a function to a co-trustee, or require more or less than consent by a majority of the trustees to act.

As a buyer, you are mostly concerned with whether there are multiple trustees. What if there are two trustees and one of them says "yes" to your business transaction and one says "no"? Do both trustees need to sign off? If there are three trustees, there may be a majority or unanimous consent rule in the trust agreement. You should know from the Certification of Trust how many trustees are responsible for the trust and how many it will take to get the deal done.

3. What is my risk if it turns out after the fact that the requirements above were not met?

From a buyer's perspective, one of the biggest concerns about conducting a business transaction that involves a trust is whether they will ultimately have someone to hold accountable should the transaction fail or should there be other issues. From a seller's perspective, you need to keep this in mind so that you understand a trustee's risk in engaging in business transactions.

Legally, usually a trustee who signs off on a transaction as trustee cannot be held personally liable by the buyer on that contract. However, the buyer does have legal protections.

If you, as a buyer, enter into a transaction in good faith, you can enforce any legal issues against the trust property, but not against the trustee personally. If you have requested a Certificate of Trust and conducted the transaction properly based on that information, then you can show that you did your due diligence and worked in good faith. These are your remedies:

- A person who in good faith enters into a transaction in reliance upon a Certification of Trust may enforce the transaction against the trust property as though the representations made in the Certification of Trust were correct.
- A person who in good faith deals with a trustee is not required to inquire into the extent of a trustee's powers, or the propriety of the trustee's exercise of those powers.
- A person who in good faith and for value deals with a trustee without knowledge that the trustee is exceeding or improperly exercising his powers is protected from liability as though the trustee properly exercised his powers.

If you have any questions, please contact Attorney Megan O. Harried at O'Neil Cannon at 414-276-5000.

LAING RECOGNIZED BY THE NADC AS ONE OF THE FINEST LAWYERS IN THE COUNTRY

Dean P. Laing, of O'Neil, Cannon, Hollman, DeJong and Laing S.C, has been selected to the 2015 list as a member of the Nation's Top One Percent by the National Association of Distinguished Counsel. NADC is an organization dedicated to promoting the highest standards of legal excellence. Its mission is to objectively recognize the attorneys who elevate the standards of the Bar and provide a benchmark for other lawyers to emulate.

Members are thoroughly vetted by a research team, selected by a blue ribbon panel of attorneys with podium status from independently neutral organizations, and approved by a judicial review board as exhibiting virtue in the practice of law. Due to the incredible selectivity of the appointment process, only the top 1% of attorneys in the United States are awarded membership in NADC. This elite class of advocates consists of the finest leaders of the legal profession from across the nation.

EMPLOYMENT LAWSCENE ALERT: CONTINUED EMPLOYMENT IS RULED VALID CONSIDERATION FOR NON-COMPETES IN WISCONSIN

On April 30, 2015, the Supreme Court of Wisconsin issued its long-awaited decision in *Runzheimer International Ltd. v. Friedlen*, in which it came to the conclusion that the promise of continued at-will employment is valid consideration for a restrictive covenant.

In *Runzheimer*, the employee had worked for his employer for fifteen years when the employer required all employees to sign restrictive covenants or be terminated. The employee signed the restrictive covenant, but after he was terminated more than two years later, he went to work for a competitor in breach of that agreement, and the employer sued. The employee then claimed that the agreement was invalid because it lacked consideration.

In Wisconsin, forbearance in exercising a legal right is valid consideration. The Court reasoned that, because Wisconsin is an employment at-will state, companies have a legal right to terminate employees at any time for a good reason, a bad reason, or no reason at all, as long as it does not violate existing law or public policy. Therefore, giving up the legal right to terminate an employee at that moment in exchange for the employee signing a covenant not to compete is valid consideration.

The court emphasized that its holding in *Runzheimer* is consistent with its 1994 holding in *NBZ, Inc. v. Pilarski* where the Wisconsin Supreme Court held that the promise of continued employment did not provide sufficient consideration to support a restrictive covenant entered into by an existing employee. The Wisconsin Supreme Court distinguished its holding in *NBZ* by finding that, in that case, the employee's employment had not been conditioned upon her signature and the employer did not promise to do anything else in exchange. Without these elements, there can be no consideration to support enforcement of the agreement under Wisconsin law.

Therefore, under the Wisconsin Supreme Court's holding in *Runzheimer*, in order for continued at-will employment to be valid consideration for a restrictive covenant agreement, employers must condition the employee's continued employment upon the employee actually signing the agreement. In order to maintain that position in any action that might challenge the issue of consideration, an employer must actually terminate any employee who refuses to sign the restrictive covenant for it to validly assert that continued employment was conditioned upon the employee's signature to the agreement.

Wisconsin has now joined the majority of jurisdictions, which hold that a promise to continue an at-will employee's employment is lawful consideration for a restrictive covenant. The *Runzheimer* decision now permits Wisconsin employers to require their existing employees to sign new or modified restrictive covenant agreements without promising employees anything more than continued at-will employment.

EMPLOYMENT LAWSCENE ALERT: SUPREME COURT SETS STANDARD FOR EEOC CONCILIATION EFFORTS

On Wednesday, April 29, 2015, the U.S. Supreme Court issued its unanimous decision in *Mach Mining LLC v. Equal Employment Opportunity Commission*, addressing the issue of the level of judicial review allowed regarding the EEOC's duty to conciliate charges of discrimination prior to litigation. We have discussed this decision in this blog from its early stages (here, here, and here), and the Supreme Court has finally proven what we said in July 2013, that the EEOC's conciliation efforts are indeed subject to judicial review, to be true. However, the Supreme Court did not choose to hold the EEOC to the "good faith" standard that many employers had hoped for or the mere facial examination that the EEOC had championed, instead striking a balance between the two by limiting the court's review to a "narrow" one. In rendering its decision, the Supreme Court recognized the EEOC's extensive discretion to determine the kind and amount of communication necessary with any employer to satisfy its statutory duty to engage in conciliation efforts prior to filing suit. Under this new standard, a court's review is limited to reviewing only that the EEOC gave the employer notice of the charge and an opportunity to achieve voluntary compliance.

It has always been the law under Title VII that, prior to the EEOC suing an employer for discrimination, it must first engage in conciliation. Not until after efforts at conciliation have failed may the EEOC file a lawsuit in federal court. The Supreme Court held that Congress meant to allow judicial review of administrative actions, including the duty to attempt to conciliate. The Court obviously rejected the EEOC's "just trust us" method of review.

According to the Supreme Court, in order to show that the EEOC has met its statutory burden to conciliate, it must notify the employer of the claim and give the employer an opportunity to discuss the matter. The judicial review is limited to those elements. Simply, the EEOC must inform the employer about the specific discrimination alleged by describing what the employer has done and which employees have suffered. The EEOC must then try to engage the employer in a discussion in order to give it a chance to remedy the alleged discrimination, although the EEOC is still allowed substantial flexibility in the process. The Court found that delving into whether or not the EEOC had conciliated in good faith conflicted with the latitude Title VII gives the EEOC, imposed extra procedural requirements, and was in conflict with Title VII's protection of the confidentiality of conciliation efforts. It is still within the discretion of the EEOC to accept a settlement or bring a lawsuit. Typically, a sworn affidavit from the EEOC that it has performed these obligations will be sufficient.

If the employer alleges through concrete evidence, either through its own affidavit or otherwise, that the EEOC has failed in its duty to conciliate, courts are allowed to engage in necessary fact-finding to decide the issue. If a court decides that the EEOC did not meet its statutory duty to conciliate matters prior to filing suit, the appropriate remedy is to stay the action, rather than dismissal, and order the EEOC to undertake the mandated conciliation efforts.

Although the EEOC will likely still be aggressive in its litigation efforts, the Supreme Court's decision will ensure that the EEOC must engage in some form of articulable conciliation efforts, even if it is just a minimal effort, before commencing suit against an employer. Employers who believe that the EEOC has not met its statutory obligation to engage in conciliation will still have, thanks to the Supreme Court's decision, the "failure-to-conciliate" defense in its quiver.

STUDENT LOANS: RECENT FEDERAL WARNING SHOTS TO FINANCIAL INSTITUTIONS

You can hardly throw a textbook today without hitting a media story about student loans. From the debt burden that graduates face to the actual loans that students have access to and how they're structured, our country is taking a hard look at college costs and financing. Now the landscape is shifting.

Students, who used to hold little power in the loan process, are gaining a voice. Financial institutions should take note and adjust their loan-making processes or face more regulation and potential losses down the road.

This article shares information about recent federal announcements and their implications to the banking industry.

<u>Recent Federal "Guidance"</u>

There are, essentially, two types of student loans: 1) standard payment plans with established payment amounts and timelines from the moment a student graduates, and 2) graduated repayment plans under which the student's initial payments are lower and then increase approximately every two years. Most graduated repayment plans require monthly payments over ten years.

The problem with graduated payment plans (and, let's face it, many other student loans) is that some students don't end up making as much money as they expected upon graduation and they struggle to pay their debt. A deeper look into some of the loan structures themselves led federal regulators to make a recent announcement to financial institutions that originate private student loans.

On January 29, 2015, federal financial regulatory agencies issued guidance for financial institutions that originate private student loans with graduated repayment terms. Some of the guidance may seem common sense, but clearly the regulators saw practices in the private banking industry that made them take note.

Financial institutions should see these guidelines as a warning shot: you've got to study your private student loan-making process and even your student loan culture or face more federal attention down the road.

The federal agencies issued the following principles for financial institutions that make private student loans with graduated repayment terms to ensure that they "prudently underwrite the loans in a manner consistent with safe and sound lending practices":

- Ensure orderly repayment by calibrating repayment terms to reasonable standards based on debt;
- Avoid payment shock by including repayment terms that a borrower can meet over the life of the loan;
- Align payment terms with income and do not structure repayment terms to mask delinquencies or defer losses;
- Provide clear disclosures to the borrower as required by applicable laws and regulations, including the Truth in Lending Act;
- Comply with all consumer laws, regulations, and reporting standards; and
- Contact borrowers before reset dates to help establish student debt as a priority and aid borrowers in responding to any challenges.

More Power to the Students Coming

Further proof of a shifting landscape: The White House is studying whether it should be easier to wipe out student loans in the bankruptcy process. Currently, federal law prohibits student loans from being discharged in bankruptcy, except in rare cases. In a nutshell, banks need to work with students to arrive at fair repayment plans, or they may risk losing their assets in that student's bankruptcy process.

The takeaway from this recent “guidance”? Students are gaining power in the loan process and banks need to be much more careful about how they structure loans and how they communicate with students throughout the life of a loan.

What Should You Do?

Financial institutions need to take a hard look at their private student loan-making process, their relationships with students throughout the life of a loan, and their very culture around student loans. You have received a warning: “Do this right, and do it fairly, or face consequences.”

If you have any questions, please contact Attorney Melissa S. Blair at O’Neil, Cannon, Hollman, DeJong and Laing S.C. at 414-276-5000.

ATTORNEYS WITTENBERG AND KILLORAN CONTRIBUTE TO THE AMERICAN BAR ASSOCIATION SECTION OF LITIGATION HEALTH LAW LITIGATION NEWSLETTER

O’Neil, Cannon, Hollman, DeJong and Laing S.C. attorneys Christa Wittenberg and Grant Killoran recently contributed articles to the Spring 2015 Edition of the *Health Law Litigation Newsletter* published by the American Bar Association Section of Litigation.

Attorney Wittenberg, an associate in the firm’s Litigation Practice Group, authored an article entitled “The Constitutional Framework for Public Health Responses to Disease Outbreaks,” analyzing the role of federal and state government in responding to contagious disease outbreaks, such as the recent Ebola virus crisis.

Attorney Killoran, the Chair of the firm’s Litigation Practice Group and one of the State Bar of Wisconsin’s Delegates to the ABA House of Delegates, authored an article entitled “American Bar Association House of Delegates Update” discussing a number of resolutions passed by the ABA House of Delegates at the ABA Mid-Year Meeting in Houston in February.

A complete copy of the Spring 2015 Edition of the ABA Section of Litigation *Health Law Litigation Newsletter* can be found at americanbar.org.

ATTORNEYS GUMINA AND REIB PUBLISH LABOR AND EMPLOYMENT LAW ARTICLE SERIES IN INSIDECOUNSEL MAGAZINE

Attorneys Joseph Gumina and Erica Reib authored a Labor and Employment Law article series entitled, "Anticipating and Managing Wage and Hour Pitfalls" on *InsideCounsel.com*. This monthly magazine serves general counsel and other top in-house legal professionals and provides strategic tools to help them better manage their legal departments.

To learn more about the wage and hour topics below, click on the article links. Attorneys Joseph Gumina and Erica Reib can be reached at 414-276-5000 if you would like further information.

- "A primer for inside counsel on donning and doffing under the FLSA," published 3/20/2015
- "Paying employees correctly under the FLSA with preliminary and postliminary activities," published 4/3/2015
- "Education on unpaid internships for the in-house counsel," published 4/17/2015
- "Unpacking the surprisingly tricky 'regular rate' in overtime calculation," published 5/1/2015
- A primer for inside counsel on meeting FLSA overtime exemption tests," published 5/15/2015
- "Independent contractors—Avoiding misclassification under the FLSA," published 5/29/2015

SEVENTH CIRCUIT RULES THAT LENDER'S TITLE INSURANCE POLICY DOES NOT COVER RISK OF INADEQUATE CONSTRUCTION FUNDING

Does a Lender's title insurance policy cover construction liens filed by unpaid contractors where the lender has discontinued disbursing its construction loan mid-stream due to insufficient funds to complete the project? In *BB-Syndication Services, Inc. v. First American Title Insurance Co.*, 780 F.3d 825 (7th Cir. 2015), the United States Court of Appeals for the Seventh Circuit has emphatically answered "No."

The *BB-Syndication Services, Inc. v. First American Title Insurance Co.* litigation arose from the financial collapse of a major Kansas City mixed-use construction project. At the inception of construction, a dispute arose between the general contractor and the owner-borrower regarding the cost of construction. The contractor claimed that design changes made by the owner and its architect entitled the contractor to a price increase of over $22M. If the contractor's allegations were true, then the construction project would be underfunded by over $22M. The borrower disputed the price increase, and construction continued while the dispute between the contractor and the borrower progressed through arbitration.

With knowledge of the potential funding shortfall, the construction lender chose to proceed with financing the costs of construction as it progressed. The lender continued to fund the monthly construction draws for over one and one-half years, before it finally elected to cease all further construction loan disbursements, citing the huge loan imbalance and other defaults by the borrower. By then, the lender had disbursed about $61M of its $86M construction loan. Construction stopped, unpaid contractors filed construction liens totaling millions of dollars against the property, and the borrower filed bankruptcy.

In response to the liens, which had priority under Missouri law, the lender made a claim against the title insurance policy that insured the priority of its mortgage. The lender demanded that First American pay off all of the liens under the loan policy's construction lien coverage. First American ultimately denied coverage on grounds that the lender's own conduct—ceasing all funding of construction and refusing to release undisbursed loan proceeds to pay the contractors—had caused the liens to be filed, triggering policy exclusion 3(a). Exclusion 3(a) bars coverage for liens and encumbrances that are "created, suffered, assumed, or agreed" to by the insured.

BB-Syndication ultimately filed suit against First American. The District Court granted summary judgment in favor of First American, holding that exclusion 3(a) barred all coverage for all of the construction liens. BB-Syndication appealed. In a pivotal opinion, the Seventh Circuit affirmed the District Court's decision, holding that the lender had "created" the liens.

Perhaps the most significant aspect of the Seventh Circuit's opinion is its reasoning. In the few court decisions in other prior cases facing this issue, the outcome has turned upon the following two factors: 1) the existence or nonexistence of a disbursement agreement between the construction lender and the title company; and 2) whether or not the lender had disbursed the entire loan amount. The Seventh Circuit expressly criticized the reasoning of those prior decisions, and charted its own course. The Court recognized that construction lenders typically possess the power to exercise significant control over the loan transaction and over the construction project, particularly with regard to the project's finances. The Seventh Circuit concluded that construction lenders have both the ability and the duty to investigate, monitor, and to ensure the construction project's economic viability, both at inception and throughout construction. The Court held that "[w]hen liens arise from insufficient funds, the insured lender has ’created’ them by failing to discover and prevent cost overruns—either at the beginning of the project or later.” Consequently, the Seventh Circuit adopted a simple rule that “exclusion 3(a) excludes coverage for liens that arise as a result of insufficient funds.”

The lesson for construction lenders is clear. They can no longer rely upon title insurance as a safety net against construction liens that arise due to insufficient construction funding. Instead, they must rely upon their own due diligence and other financial instruments, such as third-party guarantees or performance bonds. On the other hand, title insurers can take comfort that they will not be left holding the bag when a construction lender decides to quit disbursing a construction loan due to insufficient funding.

Mr. Slawinski represented the First American Title Insurance Co. in the BB-Syndication Services, Inc. litigation. He may be contacted by telephone at 414-276-5000 or via e-mail at steve.slawinski@wilaw.com.

THE WILAW CONNECTION QUARTERLY NEWSLETTER

- “Attack of the Zombie Property”
- “Electronic Signatures—The Law is Catching Up”
- Employment LawScene™ Alert: “How FMLA Leave Should—and Should Not—Affect Your Employees’ Performance Evaluations”
- Dean Laing Elected as President and Managing Shareholder
- Featured Tax and Wealth Advisor™ Alert: “The Second Sin—”Mistaking Fairly With Equally”
- Publication Watch: *Inside Counsel*, “Anticipating and Managing Wage and Hour Pitfalls”
- Pleased to Announce:
  - Tim Van de Kamp Elected as Shareholder
  - Attorney Joe Maier, Recognized as a Five Star Professional
  - Super Lawyers List
- Upcoming Events:
  - Join Us for the Fifth Annual MJC 5K Run for Justice at Veteran’s Park
  - Hot Topics for Small Firms and Solo Practitioners

EMPLOYMENT LAWSCENE ALERT: HONESTY IS THE BEST POLICY IN PERFORMANCE REVIEWS

On February 10, 2015, the *Wall Street Journal* published an article entitled “Everything Is Awesome! Why You Can’t Tell Employees They’re Doing a Bad Job” extolling the virtues of praising employees’ strengths and scaling back on criticism. Although this may be good for employees’ confidence levels, it is bad for companies when they have to defend a discrimination lawsuit or oppose a bid for unemployment benefits.For example, in September 2011, a New York woman sued in federal court claiming that her employer “mommy-tracked” her by attempting to demote her, refusing to promote her, and cutting her bonus after she took maternity leave, despite repeatedly earning positive performance ratings during her career with the company. The company argued that she was lawfully terminated because her reviews were done by an “easy grader” and she was not meeting the company’s other metrics. In January 2015, the federal judge overseeing the case stated that the case looked strong enough to go to trial due in part to the questions of fact presented by the positive performance reviews.

Performance reviews are valuable tools for employers. While they may be used to boost an employee’s self-esteem and confidence, employers should carefully train their supervisors and manager to give honest feedback and critiques when necessary. Problems should not be sugar-coated; the issue, the steps to correct the issue, and the consequences for failing to correct the issue need to be included in evaluations and reviews. These honest assessments on an employee’s performance are essential to being able to discipline and terminate an employee if that becomes necessary, as well as defending the company from a lawsuit or claim for unemployment compensation.