

# LEGAL NOTES

INFORMATION FOR OUR BUSINESS AND CORPORATE CLIENTS

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## Piercing the Corporate Veil: Does Your Corporation Have an Achilles Heel?

As every business-person knows, one of the reasons to incorporate a business is to eliminate personal liability. Owners shield themselves and their assets from corporate obligations by operating through a corporate entity. Many shareholders believe that their company's creditors can not sue the shareholders, and if such a suit were brought, no court would find the shareholders personally liable for the company's debts. Unfortunately for shareholders, this type of litigation may be successful. When a corporation's creditors sue the shareholders for the obligations of the corporation and the creditors win, lawyers call this, "Piercing the Corporate Veil."

The entity that was meant to protect shareholders, to shield them like a veil, is torn away.

This is not an action that courts often permit. Courts normally protect shareholders from a corporation's creditors, but this is poor consolation to the unusual shareholder who is sued by a corporate creditor. The Pennsylvania Superior Court recently held that if a shareholder/officer makes payments of corporate debts using personal checks, that shareholder/officer can be held personally liable for corporate obligations. The shareholder has an "Achilles Heel" if he or she fails to distinguish corporate assets from personal assets, and this is can be enough for some courts to justify piercing the corporate veil. In effect, shareholders can open up a chink in their corporate armor, allowing business creditors to invade their personal assets.

This is a problem which primarily involves closely-held corporations. In order for shareholders of closely-held corporations to protect themselves, they should take special care to act at arms-length when dealing with the corporation. In other words, a shareholder should fully document all transactions with the corporation, treating the corporation as a separate legal entity. The shareholders should not bypass the formalities of decision-making within the corporation. The corpo-

ration should act in the interest of the shareholders, but first all decisions should be approved by the board of directors and corporate officers for reasons that are consistent with the interests of the corporation.

In addition, shareholders and corporate officers should take great care in drafting contracts to prevent the shareholders of a corporation being found personally liable for corporate obligations. If, when dealing with corporate creditors, a sole shareholder, president and officer acts as if the corporation is his alter ego, courts may find that the corporate veil can be pierced and the owner may be held personally liable. To avoid this problem, officers should make certain outside parties understand the officers are acting on behalf of the corporation, even though they also happen to be shareholders.

Piercing the corporate veil is unusual, and courts continue to start from the general rule that the corporate entity should be recognized and upheld, unless unusual circumstances call for an exception. Respecting the formalities of corporate decision-making will prevent your company from becoming such an exception.

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# Obtaining a Zoning Variance for Commercial Use in a Residential Community

Obtaining a zoning variance for certain uses in or close to residential communities can often be challenging. This situation occurs when a business is viewed by members of a residential community as undesirable. Recently, Fineman & Bach faced this challenge when representing a large national restaurant chain in its attempt to obtain a zoning variance for a fast food restaurant.

The restaurant was proposed for a major intersection in Philadelphia. The restaurant site was located extremely close to houses, with some houses directly across the street. Two factors played an important part in securing approval for the restaurant. The first factor involved a detailed analysis of the character of the land use. The second, an equally as important factor, was outreach to the appropriate community groups before posting of zoning notices.

## An Analysis of the Neighborhood

The site was zoned G-2 Industrial, a zoning normally reserved for light industrial uses. It was located on the side of the street which was predominantly zoned commercial. Over the years, large industrial uses faded and the area now consisted mostly of automobile and other car-related uses.

To understand the significance of the changes and to persuade the Zoning Board and the community that the G-2 Industrial zoning did not accurately reflect the current character of the area, we believed we needed to retain a land-use expert. Through his expertise, we hoped to demonstrate that the use of the location for a restaurant was an acceptable alternative. Our client agreed and we retained a very well respected land-use expert.

## Outreach to the Appropriate Community Groups

Retaining the land-use expert was

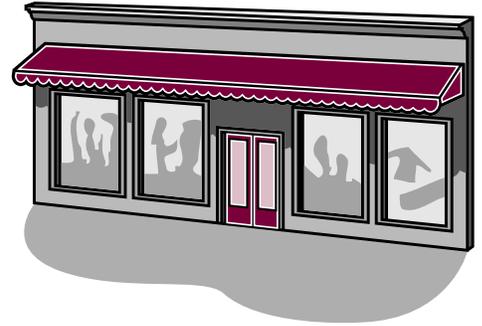
only one piece of the puzzle. No matter how impressive the expert's credentials, we could not be successful without trying to educate the residents. Clearly, the residents had a stake because the site was located extremely close to their homes. The restaurant plans also included a drive-through window and satellite dish - both potentially unpopular features. Without community involvement, the potential opposition from the residents could have doomed our client's proposal.

Consequently, we initiated contact with the residents before applying to the Zoning Board. We identified a local community group which had fought aggressively against "undesirable" uses. The community group greatly appreciated being consulted and provided some suggestions to our client's representative who attended one of their meetings.

As a result of these discussions, our client agreed to provide additional "No Littering" signs and trash baskets on the sidewalks adjacent to the site. Incorporating these suggestions helped calm the community group's reservations about the use. Eventually, the community group sent a letter to the Zoning Board indicating its non-opposition to the use of the site for a fast-food restaurant.

Once we secured the letter of non-opposition from the community group, we approached the district councilperson. Once the council person learned of the community group's support, we had no serious political opposition.

These outreach efforts effectively preempted any problem that might have arisen when the notices for the zoning hearing for the fast-food restaurant were eventually posted on the site. By the time the notices were posted, we had already solidified sup-



port from the local community group and local councilperson.

## The Hearing is Crucial

We were now ready for the zoning hearing. At the hearing, our expert made an excellent presentation. We also presented the letters from the community and councilperson. The zoning approvals were granted unanimously.

This case demonstrates the crucial components needed for success before a Zoning Board. When presenting a zoning application, make certain to "do your homework" by having the following elements in place:

- Testimony from a qualified expert
- Flexibility in your negotiations with the community
- Outreach to the appropriate community groups before posting the zoning notices
- Having a thorough knowledge of the character of the surrounding neighborhood

Because we had all of these elements in place, a new fast-food restaurant will open for business in Philadelphia with little controversy or opposition from the residents. This type of preparation is essential for any business-owner who desires favorable consideration from any local Zoning Board.

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# The Myths and Realities of Living Trusts

**T**raditionally, the “will”, is the center piece of each estate plan. A will is a document that directs who will receive your property, and how they will receive it. In Pennsylvania anyone who is at least 18 and of “sound mind” may make a will. A will must be in writing and signed by the testator, the person making the will. In contrast to many other states, such as New Jersey, Pennsylvania does not require two people to witness the testator’s signature.

Many commentators have promoted “Living Trusts “ as an alternative to a will and as a document every individual should have. The term “Living Trust” refers to a trust that is created by and for the benefit of an individual, the “settlor”, that may be revoked, amended or terminated at any time by the settlor. Typically, the settlor takes his assets and titles them in the name of the trust, but retains the right to use and withdraw the assets at any time and for any reason. In many cases, the settlor is also the initial trustee for the trust. For income tax purposes, such a trust is ignored and the settlor reports all of the trust income on his personal income tax return, as if the trust did not exist. At the settlor’s death, the assets of the trust pass directly to the beneficiaries listed in the trust documents, and serves as a replacement for the will.

## Do You Need a Living Trust?

The claim is that living trusts will avoid the cost and delay a probate, ensure privacy and save taxes. In some states, such as California, Florida and New York, probate involves formal and involved court procedures which add to the cost and delay of distributing the estate to the beneficiaries. In Pennsylvania, however, the probate process is straightforward and uncomplicated.

## Myth 1: Avoiding Probate is a Good Thing.

The term “probate” is literally defined as the procedure to prove that a will is a valid document and is currently used to refer to all matters pertaining to the administration of the estate. The probate process in Pennsylvania is streamlined and inexpensive. Probating a will and appointing a fiduciary or executor to administer the estate is not complicated, and usually only requires a visit to the Register of Wills in the county in which the decedent died. Once an executor or fiduciary is appointed, he steps into the shoes of the decedent, collects his property, pays his debts and taxes and distributes the remaining assets according to the terms of the decedent’s will.

In comparison, a living trust is a document used to avoid probate, but to avoid probate, you cannot own any assets in your individual name. So those who would sell you the living trust would also have you place *all* your assets in the trust. For example, John Doe would no longer have a bank account in his name, but instead the name on the account would be “John Doe’s Living Trust.” The cost of a living trust, however, can be substantial. Many of those people who would like

you to sell you a living trust, will charge you not only to prepare the document, but also to title all of your assets in the name of the trust. These fees can be substantial and typically exceed the cost of a will by several thousand dollars.

## Myth 2: Quicker Results with a Living Will

The trustee of a living trust must perform many of the same duties as an executor of an estate. At the settlor’s death, the trustee remains liable for all taxes and claims against the settlor and the trust, and distributions from the living trust may be postponed until all of the claims and/or taxes are quantified and determined with accuracy. If the trustee makes an early distribution and does not have sufficient funds with which to pay the Pennsylvania Inheritance tax or United States Estate tax, the trustee can be personally liable for such taxes. This is exactly the same result as if the trust assets were subject to the probate process.

## Myth 3: Save Money with a Living Trust.

There are generally three costs associated with the probate of an estate: fees charged by the executor, legal fees, and administration expenses. In Pennsylvania, there is no fixed rate or percentage for determining the compensation of either an executor or an attorney. Because the services to be provided at someone’s death are similar whether the decedent had a living trust or a will, typically the costs charged by the attorneys or the executor will also be similar regardless of which document the decedent chose.

Other administration expenses are nominal. Such expenses include probate fees, which depending on the county in which the person died, should not exceed a few hundred dollars for an estate between \$500,000 to \$750,000, the cost of advertising the Letters Testamentary (again a few hundred dollars), and the possible cost of filing an inventory with the Register of Wills, less than \$100. Typically, all such costs will not exceed \$1,000, depending on the size of the estate.

## Myth 4: Greater Privacy.

Many professionals claim that the use of a living trust may maintain the privacy of those who receive the decedent’s property. If real estate is transferred to the living trust, however, a copy of the trust document may need to be attached to the deed and recorded with the Recorder of Deeds for an effective transfer of the real estate. In addition, if the trustees of the living trust open a bank account and/or a brokerage account, many banks and brokerage houses require a copy of the trust document. Finally, when the Pennsylvania Inheritance Tax Return is filed by the trustees after the settlor’s death, a copy of the trust document must be attached to the return. The return is filed with the Register of Wills and becomes a document of public record. In Pennsylvania living trusts do not maintain a greater degree of privacy than would be afforded a will.

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### **Myth 5: A Living Trust Saves Taxes.**

The use of a living trust will not avoid either Pennsylvania Inheritance Tax or Federal Estate Tax. With proper planning, either a living trust or a will may reduce or eliminate taxes paid at death, but there is nothing special or unique about a living trust as a planning tool to minimize such taxes.

### **Are There Good Reasons for a Living Trust?**

There are, however, good reasons to have a living trust. A living trust is a document that could be used as an alternative to a power of attorney. A power of attorney is a document that allows one individual to handle and manage the affairs of someone else. A power of attorney is a very powerful document and the individual named as the agent has a limited fiduciary duty to the individual who gave him such a power. With a living trust, an individual may appoint someone to serve with him as a trustee during his lifetime and may evaluate the way such a person manages his property and his assets. If the settlor is satisfied with the performance of such a trustee, he may delegate more power to him and simply withdraw to a supervisory role. If the settlor is not satisfied with the way such a person manages his assets, he may revoke or alter the indenture of trust, or simply remove such an individual as a trustee. At all times, such a trustee has a fiduciary duty to act in the best interests of the beneficiary, who is typically the settlor during his lifetime. This can be a wonderful thing for those individuals with a declining state of health who want to be sure they will be taken care of when they can no longer care for themselves.

In conclusion, while there are some very good reasons to have a living trust, such a document is not the magic bullet many commentators would like you to buy and a traditional will may be both more practical and less expensive.

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## **Non-Disclosure Agreements Can Protect Trade Secrets**

**T**he misappropriation of trade secrets and confidential information is a threat to all businesses. The threat is from both internal sources such as employees and independent contractors, as well as external sources, such as venture partners and competitors.

The nondisclosure agreement has emerged as a mechanism for protecting a company's confidential information and trade secrets. However, many nondisclosure agreements are poorly drafted and subject an employee or venture partner to liability exposure, and create obligations that are otherwise inappropriate.

Although there is no one definition of "trade secrets", it typically includes information, programs or techniques which are used in one's business and which gives such business an opportunity to obtain an advantage over competitors who do not own or use such information, programs or techniques. Typically, trade secrets have three factors in common: (1) they are novel or not readily available to outsiders; (2) they have value, either actual or potential; and (3) the company safeguards this information.

Companies should have in place sufficient internal and external controls necessary to protect trade secrets. On an annual basis, companies should review their employee's exposure to trade secrets, and when new projects are commenced, the sufficiency of what is in place.

Some examples of internal and external controls are:

- passwords and security systems
- limiting access to physical areas and documents
- having legends placed on all confidential documents
- employee educational programs on trade secrets
- having a responsive legal action plan

As a general rule, any individual or entity with access to trade secrets should sign a nondisclosure agreement. This includes current and potential employees; and may also include contractors, consultants, and outside suppliers, with access to confidential information. Additionally, when considering a joint venture or license, nondisclosure agreements may also be appropriate.

In today's competitive business environment, it is important to protect your business by retaining those trade secrets which give your company its competitive edge. At the same time, companies must remain flexible and practical in order to hire key employees and to participate in joint ventures. A carefully drafted nondisclosure agreement can act as a mechanism for achieving these goals.

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