

THE JURIS DOCTOR SMALL BUSINESS WATCH

A NEWSLETTER FOCUSING
ON PLANNING FOR THE
SMALL BUSINESS

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TRUST BUT VERIFY

Matt Mueller opened a business account at Fifth Third Bank in the name of Mueller Tree Service on which Mueller was the sole signatory. Fifth Third mailed monthly statements to Mueller that included the canceled checks. Mueller Tree Service employed Mark Miller as a laborer and then as a foreman and paid him a weekly salary in cash. At no time was Miller given official access to the account and was never a signatory on the account. One day, Mueller discovered that over a three year period Miller misappropriated funds belonging to the business by forging Mueller's name on checks to the tune of over \$ 100,000. Mueller immediately informed Fifth Third and, shortly thereafter, sued Miller, Miller's wife and Fifth Third Bank.

Fifth Third maintained that Mueller did not promptly examine the bank statements and advise of any unauthorized payments nor exercise ordinary care to prevent the forgeries. The court thought Fifth Third was correct and

summarily dismissed Mueller's case.

What did Mueller do wrong? The law* requires a customer to promptly examine statements, discover any forgery** and notify the bank. If the customer fails to do so, the customer cannot recover from the bank. What is "prompt" depends on the circumstances.*** If the customer fails to use reasonable care to promptly examine and notify, and the bank pays on other forged items involving the same forger, the customer has a reasonable time (not exceeding 30 days) to report the first item. Before the bank receives notice of the first forgery, the bank is not liable for paying subsequent items to the same forger. Certain duties of care are also imposed on a bank in paying checks. But in any event, regardless of care used by either customer or bank, a customer is precluded from asserting any claim not reported to the bank within one year.

Since Miller was paid the same weekly salary in cash,

multiple checks made out to Miller should have been discovered upon reasonable inspection. This and Miller's actual possession of the checks denoted a failure by the sole signatory to maintain and review the account. An affidavit submitted by Mueller stating that for the past several years he had traveled out of state to pursue other business opportunities did not sway the court.

For the owner of a small business, time can be a commodity in short supply and it is tempting to delegate. However, delegation without appropriate oversight can have expensive consequences.

Mueller v. Miller et al 11th Dist. (2005)

*R.C. 1303.49, 1304.35

** Forgery here is used to mean an alteration or unauthorized signature

*** The customer only has this duty if the bank sends statements that comply with the statute.

SHAREHOLDER LIABLE FOR DAMAGES FOR FAILURE TO DO BUSINESS IN CORPORATE NAME

A major, if not the primary reason people do business through a corporation is that, generally, unless they expressly undertake an obligation, they are not liable for the debts of the corporation. However, there are exceptions to the general rule. Where the shareholders fail to maintain sufficient corporate formalities, the corporate structure may be disregarded and the shareholders held personally liable for corporate obligations. This is the result in Music Express.*

Music Express Broadcasting Corporation sued Aloha Sports and also one of its shareholders, David Rice, for breach of contract saying Rice so dominated and controlled Aloha Sports that Aloha Sports was Rice's "alter ego" and "the corporate veil should be pierced," i.e., the corporate entity disregarded. In other words, Music Express not only wanted Aloha Sports to be liable for damages but also Rice.

The court said Rice deposited funds in his personal account without the proper accounting, misrepresented Aloha's ability to perform the contract, and ceased operations without notice, making both Rice and Aloha Express liable for \$14,833 in damages.

The criteria in Ohio for piercing the

corporate veil is the "Belvedere" test taken from the case of the same name**. The shareholder may be liable for the obligations of the corporation when:

1. Control over the corporation is so complete that the corporation has no separate mind, will, or existence of its own. In other words, the shareholder and the corporation are indistinguishable.
2. Control over the corporation is exercised in a manner to commit fraud or an illegal act. This prong has been expanded by some lower courts to include actions which, though not fraudulent or illegal, produce an unjust or inequitable result.
3. The person who brought the suit is damaged.

It is imperative that shareholders, especially shareholders in closely held corporations, treat the corporation as if it was a separate legal entity, account properly, and maintain corporate minutes and other formalities in order to keep their limited liability protection.

*Music Express Broadcasting Corporation v Aloha Sports, Inc., 11th District (2005)

**Belvedere Condominium Unit Owners' Assoc. v. R.E. Roark Cos. Inc.

DANIEL H. MCKINNEY AGAIN NAMED CINCINNATI SUPER LAWYER BY LAW AND POLITICS AND THE CINCINNATI MAGAZINE

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ENGLISH ONLY IN THE WORK PLACE?

Sephora operates retail cosmetic stores throughout the U.S. including a store near Rockefeller Center in New York. Sephora refers to sales floor staff as the "cast" and the sales floor as a "stage". Five former employees of this store, along with the EEOC, sued Sephora for discrimination on the basis of national origin in violation of Title VII by restricting their right to speak their native language. During the suit Sephora filed for summary judgment at the heart of which was a memo to Sephora managers.

In summary, the memo said Sephora did not have an English-only policy. Cast members may speak whatever language they choose, however, cast members who are on stage during business hours are expected to speak English whenever clients are present. They may communicate with clients in other languages if the client wishes to do so. Cast members may speak any language they choose before opening and after closing, when no clients are in the store, when off stage such as in the break room, or when they are not on Sephora time. Cast members may be asked to speak English in other situations if there is a business need, for example, where safety is an issue.

Sephora maintained that the policy did not violate Title VII. Title VII of the Civil Right Act of 1964 protects employees from employment discrimination on the basis of race, color, religion, sex or national origin.

Even though a policy is neutral on its face, it can be discriminatory if it has disparate impact against members of one of the protected classes.

The test is three pronged.

Prong one: The court assumed in the abstract, for the purpose of moving forward, that the plaintiffs had satisfied the first part of the test - that the policy had a disparate impact on the bilingual group.

Prong two: The burden of persuasion then shifted to Sephora to demonstrate the policy was "job related and consistent with business necessity". For example other cases have determined a permissible purpose would be to stem hostility between bilingual employees and those speaking only English.

Sephora said its policy that English be spoken in the presence of customers was to foster politeness and approachability as components in customer service. The court agreed that these goals were consistent with a business necessity.

Prong three: With Sephora meeting its burden of persuasion on the second prong, the burden of persuasion shifted back to the employees to show that there was a less discriminatory alternative to the employer's policy. Employees argued that the problem perceived by Sephora was really employees standing around talking to each other instead of greeting and assisting customers. Therefore, a less restrictive policy would be a rule that merely emphasized greeting the customer and discouraged cast from standing around talking with each other. In the court's opinion, this argument ignored the disruptive foreign language use in front of customers and it held Sephora's English language policy was legally permissible.

INSURANCE BROKER STEALS FUNDS IT DOES HAPPEN

A recent case points out a common problem for small business insured employee benefit plans. Day, owner of an insurance brokerage firm, stole hundreds of thousands of insurance premium dollars from 29 employees. His scheme was to have his client write premium checks to his insurance company. He stole the funds and sent clients false insurance policies. The Department of Labor (DOL) sued Day alleging Day was an ERISA* fiduciary because he had authority and control over disposition of plan assets. Although the case does

not so state, it appears likely that DOL was attempting to reach Day's fiduciary bond to satisfy any judgment. The court agreed with DOL but a note of caution is advised on relying on this case. The better lesson to be learned is to pay insurance premiums to the insurer directly, and if that is not possible, verify that payments through agents have been remitted.

* *Employee Retirement Income Security Act of 1974*

CREDITORS RECEIVE GREATER PROTECTION WHERE CUSTOMER IS BANKRUPT

You've been requesting payment from a customer forever and finally you get the check, followed a week later by another, and then another. You breathe a sigh of relief only to find that a bankruptcy trustee informs you the customer has filed bankruptcy and the payments you received are a preference and must be paid to the bankruptcy estate. Based on the number of creditors and the amount recovered, you realize you are going to be back to zero. Before the recent 2005 Bankruptcy Act*, a trustee could recover payments made to creditors during the 90 day period prior to the filing of the petition. But following the act, a trustee cannot recover where the aggregate of payments made to a creditor was less than \$5,000. Furthermore, the trustee must now bring preferences less than \$10,000 in the court where the creditor is located. This will deter the trustee from pursuing preferences less than this amount and make defense of a ny preference action that is brought easier for the

creditor to defend. Also, creditors no longer have to prove that a payment was ordinary as determined by objective industry standards only that the payment was ordinary according the relationship that existed between the parties.

Goods sold to a debtor prior to the filing of the petition can be reclaimed under certain conditions. The new Bankruptcy Act allows a seller to demand that goods sold within 45 days prior to the bankruptcy filing be returned instead of only 10 days under the old law.

Landlords also benefit. A debtor used to be allowed 60 days to reject a commercial lease but courts routinely granted numerous extensions. Now a deadline may be extended for one 90 day period and any failure to assume the lease during the period will be deemed a rejection.

*Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

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