Summer 2005. Volume 2. Issue 2

LB&C
L'Abbate, Balkan, Colavita & Contini, L.L.P.
REAL ESTATE, TRUSTS & ESTATES, BUSINESS PRACTICE GROUPS ■ when it really matters

PROTECTING YOUR BUSINESS WHEN EMPLOYEES LEAVE

Jane M. Myers. Esq.

The loss of key employees can be devastating to a business if its customers follow the key employee out the door. More often than not, executives find themselves ill-prepared to adequately respond to the loss of a key employee. If the departing employee is truly key to the business, there is typically a scramble to protect the company's trade secrets, confidential information and the loss of other personnel. Critical to minimizing both the loss of key employees and a company's exposure to litigation is understanding the realities of the inherent conflicts between employer and exiting employees, the rules of workplace competition, and the position of the New York courts on issues concerning trade secrets, confidential information and restrictive covenants.

The Conflict Between Employers & Employees

Within the employer-employee relationship there exist two competing objectives. The employer who devotes substantial time and money to train and develop a key employee wants to keep the employee contractually chained, while the employee wants unrestricted mobility in the workplace. An employee who decides to leave a company desires the ability to earn a living without restriction from the former employer. On the other hand, the company is concerned with aggressive and perhaps unscrupulous competitors who might cherry pick employees for the purpose of acquiring proprietary information (i.e., R&D data, customer lists, financial statistics, marketing plans, etc.) which could compromise the former employer's competitive position and give the competitor an unfair advantage.

Typically, it is not until after a key employee leaves and the former employer regains its equilibrium, that a more aggressive plan is undertaken to "stop the bleeding". In this effort, restrictive covenants and injunctions take center stage and the drama quickly unfolds. In order to fully appreciate how restrictive covenants can be applied and are viewed by the courts, it is important to understand:

- The rules of competition in the marketplace;
- What kind of company information can be protected as a trade secret or confidential information;
- Restrictive covenants and other methods by which a company can protect its trade secrets and confidential information; and
- The recourse a company can take in the event its proprietary information is exposed or likely to be acquired by a competitor;

IN THIS ISSUE

Protecting Your Business When Employees Leave 1
Shield Your Assets from Estate Taxes 2
About Our Firm LBC&C 3
The Need for a Living Will and a Health Care Proxy 3
LBC&C Firm Locations....back cover4

Rules of Competition in New York

In New York, the general rules of competition are that, after employment has ended, the former employee may compete with your company, may work for a competitor and may solicit his or her former employer's customers. In other words, the employee has freedom of advancement. However, this freedom is not unrestricted. The rules of competition also provide that the employee cannot compete against a former employer by using its trade secrets or confidential information, or by breaching an enforceable restrictive covenant. What is key is to identify information that can be protected as confidential or trade secrets.

Is the Information Really Confidential or Secret?

Keep in mind that just because a company believes that its information is proprietary and confidential, that does not make it so. While New York courts decide whether information is confidential or a trade secret on a case-by-case basis, there is a long line of cases that provide guidance. Typically, trade secrets are technical or scientific information. The formula for Coca Cola, circuitry for a computer chip, or engineering blueprints for a new product are all common examples. The formula for Coca Cola is an especially good example of a trade secret since its formula is reported to be

continued on back cover

SHIELD YOUR ASSETS FROM ESTATE TAXES...THE MANY ADVANTAGES OF A BYPASS TRUST

Mark S. Charwat, J.D., CPA and Ilene D. Samuel, Esq.

A bypass trust is one of the fundamental tools of estate planning. Also referred to as a credit shelter trust, a bypass trust permits a husband and wife to shield a portion of their assets from inclusion in the survivor's taxable estate, thereby saving estate taxes.

Establishing a Bypass Trust

A bypass trust is relatively easy to establish, and it works as follows. Husband and wife, rather than leaving all of their assets to the other, divide their assets during their lifetimes so that each of them has assets in his or her name sufficient to fund, either fully or partially, a bypass trust for the survivor. Full funding of a bypass trust refers to fully using the "federal estate tax exemption".

Every person is entitled to a federal estate tax exemption. The amount of the federal estate tax exemption has increased substantially over the past several years. It is presently $1.5 million and will increase to $2 million for 2006, 2007 and 2008.

Estate Tax Benefits

The following is an example of the estate tax benefits of a bypass trust. Assume that husband and wife have total assets of $5 million. If they were to leave all of their $5 million of assets to the survivor, and the survivor were to pass away during 2006, 2007 or 2008 with $5 million of assets, then federal and New York estate taxes of $1,591,464 on the survivor's taxable estate would be anticipated!

On the other hand, if the New York couple were to decide to utilize a bypass trust, and if they divided their assets so that each of them had $2 million or more in his or her individual name, then the first spouse to pass away would be able to fund a $2 million bypass trust for the survivor. Consequently, the survivor would not have a $5 million taxable estate, but a taxable estate of only $2,900,400 (which includes a reduction of $99,600 for the New York estate tax paid on the estate of the first spouse).

If the survivor were to pass away during 2006, 2007 or 2008 with a $2,900,400 taxable estate, then federal and New York estate taxes on the survivor's estate would be $558,280. Compared to federal and New York estate taxes of $1,591,464 without a bypass trust, and considering a $99,600 New York estate tax on the estate of the first spouse when establishing the bypass trust, this amounts to a savings of $933,584 simply by utilizing a bypass trust. This is a savings of nearly $1 million!

Structuring Your Needs and Requirements

A bypass trust is often liberally structured (i) so that the surviving spouse will receive all of the income from the trust and (ii) that the principal of the trust could be invaded for the surviving spouse's health, maintenance, support and education. The intent of a liberally drafted bypass trust is for the trust to meet or help meet the survivor's needs and requirements. Properly structured, the assets in the bypass trust, although fully available to meet the needs of the survivor, are not includible in his or her taxable estate, nor are they taxed in the estate of the first spouse, except only for a New York estate tax of $99,600 applicable to establishing the $2 million bypass trust.

As illustrated above, since the value of the survivor's taxable estate will be reduced by diverting a portion of the first spouse's assets to the trust, estate taxes on the survivor's estate will also be reduced or possibly even avoided, depending on the value of assets held by the survivor and the estate tax exemption applicable at the time of the survivor's demise.

Added Advantages of a Bypass Trust

In addition to saving estate taxes, there are other benefits arising from a bypass trust. An important benefit is that it protects the trust's assets from creditors and also spousal claims (in the event the surviving spouse should remarry). Thus it provides greater assurance that the assets will eventually be distributed as intended by the first spouse, in most cases to children and/or grandchildren, than if all the assets were left outright to the surviving spouse.

Another advantage of a bypass trust is that the trust need not be solely for the surviving spouse, but it may be a sprinkling trust for the surviving spouse and children, with the trustee given power to "sprinkle" the income and principal among the spouse and children as may be best determined at such time. Additionally, the bypass trust may be limited solely for the children, or where the children are mature, the amount of the estate tax exemption may be distributed outright to them and not held in trust.

A fourth advantage of a bypass trust is that it will leave the survivor with less assets, perhaps sufficiently small for the survivor to gift his or her assets to children and, after expiration of the "look back period", qualify the survivor for Medicaid. (The federal lifetime gift tax exemption is only $1 million and will not increase along with increases in the estate tax exemption.) In order to protect the assets in the trust from Medicaid claims the trust can provide that if the survivor were to enter a nursing home or other similar type of facility, the bypass trust would be converted into a supplemental needs trust.

continued on page 3

For almost a quarter century LBC&C has built its reputation as one of the most skillful and successful law firms in the metropolitan area offering a complete spectrum of legal services encompassing every aspect of the law. As a full service law firm with a staff of over 100, LBC&C provides legal counseling, as well as litigation services for clients from business issues to employment and labor practices. Always on the alert to new trends in business and changes in the law, LBC&C is continuously striving to keep clients ahead of their competitors. Working in conjunction with each other, the Practice Groups at LBC&C provide a network of legal experience that is unrivaled. For additional information visit our website at www.lbcclaw.com

SHIELD YOUR ASSETS continued from page 2

Medicaid and elder law planning is particularly complex and other considerations are involved.

All assets do not qualify to fund a bypass trust. Jointly owned assets do not qualify, and qualified plan assets, such as IRAs, 401(K) plans, pension plans, etc. do not qualify except that with special provisions IRA plan assets may be utilized.

In 2009 the estate tax exemption is scheduled to increase from $2 million to $3.5 million, and in 2010 the federal estate tax is to be revoked, but then reinstated in 2011 with an estate tax exemption of only $1 million! (The New York estate tax exemption is only $1 million and is not expected to increase.) As a result of strong political pressure for permanently revoking or at least greatly increasing the federal estate tax exemption, it is widely anticipated that the federal estate tax law will be revised and not revoked. While we feel confident that the estate tax exemption will remain at $2 million during the years 2006, 2007 and 2008, and probably increase to $3.5 million in 2009, it is difficult to predict at this time what changes will be made for 2010 and thereafter.

A bypass trust is a fundamental estate planning strategy. However, there are other strategies to reduce estate taxes, such as gifts, family limited partnerships, life insurance trusts, etc. Whether a bypass trust may be appropriate for you will depend on your circumstances, intentions and the extent and nature of your assets.

For advice on how a bypass trust can be made a part of your estate plan, an experienced estate planning attorney should be consulted. Your attorney should always be consulted concerning all legal matters. If you should have any questions or if we may be of assistance with respect thereto, do not hesitate to contact us.

THE LATEST . . .

What's happening here at LBC&C.

- Mercedes Colwin has won the prestigious Notre Dame University's Graciela Olivarz award given in honor of the first female and Hispanic to graduate from Notre Dame Law School.
- Ms. Colwin has also been chosen as one of Forbes Business America's Most Influential Women.

THE NEED FOR A LIVING WILL & HEALTH CARE PROXY

Mark S. Charwat, J.D., CPA

Every person possesses the right to accept or to refuse medical treatment. This right is derived from the common law and is also based on the constitutional right to privacy expressed in the Fourteenth Amendment. Since every person has the right to control and direct his or her medical care it is important that such wishes be clearly expressed. Specifically, many persons wish to limit efforts to sustain life where mechanical or artificial means are required, where consciousness as we know it is gone, where further medical treatment is futile and where recovery is hopeless.

The best way to establish one's wishes is by expressing it personally and concurrently or if incompetent or unable to express one's wishes, then by expressing it in a previously signed living will and also appointing a health care agent who knows such wishes. Where the patient is incompetent or cannot personally express himself or herself, and there is no living will or health care proxy, then the wishes of the patient regarding medical treatment must be established in a court by clear and convincing evidence, if there is any such evidence.

As illustrated by the *Terri Schiavo* case, having a living will and health care proxy may prove essential. However, its importance goes far beyond providing for or withholding treatment. These documents also have implications with respect to settling extremely difficult family situations, resolving matters in accordance with religious and moral convictions, providing relief from pain and suffering, obtaining vital medical information which is protected (even from a spouse) under the Health Insurance Portability and Accountability Act ("HIPAA") and, from a practical perspective, limiting costs and expenses.

A living will and a health care proxy may also avoid a guardianship proceeding. That is because where a patient fails to express his or her wishes a spouse or other close relative cannot simply substitute his or her judgment for that of the patient. A guardian is required in such instances. An exception to this rule is that a spouse or other designated close relative may consent to a Do Not Resuscitate order ("DNR").

Every person should have a living will expressing his or her wishes and also a health care proxy appointing the person or persons he or she wishes to act as health care agent for him or her. Subject to express limitations in the health care proxy, the health care agent is authorized to make any and all health care decisions for the patient that the patient could make. An exception is that the health care agent is not authorized to make decisions regarding the administration of artificial nutrition and hydration if the patient's wishes are not reasonably known to the agent or cannot with reasonable diligence be ascertained.

In close and difficult situations, even the decision of doctors is subject to the directions contained in the living will and those of the health care agent. Without these documents prolonged and bitter family discord, possible litigation, and unnecessary costs and expenses may result. Moreover, the patient may have lost the opportunity to control and direct his or her care and treatment.

The *Terry Schiavo* case was highly unusual in that it resulted in Congress and the President requesting that the federal courts determine whether Terry Schiavo's rights were constitutionally violated. Without getting into the desirability of such action, many persons were disturbed that what they once regarded as

continued on page back cover

PROTECTING YOUR BUSINESS continued from page 1

one of the most closely guarded industrial secrets in the world.

To a large extent a company, by its own actions, determines whether or not its information is really "secret" and "confidential". Customer lists typically fall into this category. In many cases, executives are often shocked to learn that, despite what they may believe, the company's customer list is not protectable as confidential information. The test is that if the names on the list can be readily obtained through open sources, such as industry directories or the company's website, the customer list will not qualify for trade secret confidential information protection. However, information specific to the customer which is obtained through the company's personal contact with that customer (e.g., product use, purchasing history, equipment specifications, number of end-users, pricing discounts, etc.) will generally be regarded as "confidential" and, therefore, protected. However, if so-called "trade secrets" are disclosed at company seminars, lectures or through printed literature, they will not be regarded as trade secrets.

Effective Use of Restrictive Covenants

In the best case scenario, companies should have key employees sign carefully drafted restrictive covenants at the time employment begins. The protection provided to the company by a good employment contract starts on the employee's first day of employment and continues after employment ends. However, how long an employee can be restricted post-employment and the scope of the restriction will depend on several factors.

To be enforceable, the courts first look to see if the employer really has a legitimate business interest to protect. If the answer is "yes", the courts then look for restrictive covenants to be "reasonable" as to geographic territory, duration and the scope of restrictions on the employee's business activities, e.g., the employee is to be restricted from serving as a sales person or from participating in a product development role.

In addition to being "reasonable", a restrictive covenant must be supported by adequate "consideration" to be enforceable. An employer can condition employment on the prospective employee signing a restrictive covenant before the new job begins. Whether the employment agreement is signed before or after employment commences, if the restrictive covenant contains a provision for payment to the employee after employment terminates and during the restriction period, the courts are more likely to uphold the agreement.

Usually, the issue of "consideration" becomes critical when an employee is asked to sign a restrictive covenant long after he or she has been employed. Courts do not look favorably upon restrictive covenants that are entered into under those circumstances since there is usually no consideration. To pass the "consideration test" for an existing employee, an employer can provide a substantial salary increase or bonus, or a significant promotion -- each of which have been found by New York courts to be adequate consideration to support a restrictive covenant entered into after employment has commenced.

The tug-of-war between a former employer and a prospective employer over a key employee often sparks litigation. How to minimize the risk of litigation will be presented in the next issue of this newsletter.

LIVING WILL & HEALTH CARE PROXY continued from page 3

a close family matter could be subject to the whims of legislators and the subject of national discourse. Therefore, to guard against legislators and state officials becoming involved in matters which most persons would prefer be handled solely and exclusively by designated family members (after consultation with doctors), our form of living will and health care proxy specifically excludes legislators and other non-designated persons from participation in such difficult and personal decisions.

As a result of recent rulings, the health care proxy should list designated persons in successive order, e.g., my wife, and if she shall not be reasonable available, willing and competent to serve then my daughter, and if she shall not be reasonably available, willing and competent to serve then my son, etc. The persons you wish to designate should not be listed as one or more of a group of persons.

If your health care proxy designates persons as agents who are part of a group, and not successively, then the health care proxy should be modified to specify the order of authority.

If there is a need for a living will and health care proxy for medical questions, then there would most probably be a need for a durable general power of attorney for financial matters. In addition to preparing Wills for our clients, our practice is to also provide them with these other documents so that both medical questions and financial matters may be dealt with if the client should be unable to do so.

We recognize that this is a difficult subject and that the rules are more complex than those briefly referred to above. Additionally, the above statements refer to New York law, and the laws of other states may vary. Your attorney should always be consulted concerning all legal matters. If you should have any questions or if we may be of assistance with respect thereto, do not hesitate to contact us.

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The Attorneys at

LB&C

when it really matters

Editor
Mark S. Charwat, Esq.
mcharwat@lbcclaw.com

Contributing Writers
Jane M. Myers, Esq.
jmyers@lbcclaw.com

Ilene D. Samuel, Esq.
isamuel@lbcclaw.com

www.lbcclaw.com

Long Island Office
1050 Franklin Avenue
Garden City, NY 11530
T.516.294.8844 F.516.294.8202

New York City Office
One Battery Park Plaza
New York, NY 10004
T.212.825.6900 F.212.825.0657

New Jersey Office
7 Regent Street, Suite 711
Livingston, NJ 07039
T.973.422.0422 F.973.422.0420