

page 2

Ex-wife doesn't refinance home;  
husband can force her to sell

Manufacturer is sued for  
confusing safety instructions

More workers are able to sue for  
age discrimination

page 3

Some gifts to charity should be  
made now, not in your will

page 4

New, easier forms will help  
mortgage shoppers

# Legal Matters®

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## Starting an LLC? What you need to know

**M**any new business owners think it's easy to set up an LLC. That's partly the result of companies and websites that claim to offer simple, "standardized" LLC operating agreements. Just fill in the blanks and you're off!

In reality, there's no such thing as a "standard" LLC operating agreement. You have a lot of choices to make, and even if you're starting a very simple business, your choices will have a profound effect on you down the road if the business takes off.

Unlike a traditional corporation, an LLC is designed to be very flexible and give you a lot of options. But unless you specify an option, you may be stuck with a legal "default" rule that you never considered and that isn't to your advantage. This could lead to problems that are very difficult and costly to resolve.

Here's a very brief list of things to consider (among many others):

**Ownership percentage.** The most common way to divide ownership is in proportion to the capital contributed by the members, but this might not make the most sense. For example, what if one member contributes in the form of services or plays a greater role in operations?

**Management.** Who will be in charge and make operating decisions? What types of decisions will be left to a manager, and what types will be subject to a member vote? If there's a vote, will it be by a majority of the members, a majority of the percentage interest, or a majority of those in attendance? Should a two-thirds or other super-majority be



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necessary for certain important decisions? If so, which ones?

**Voting rights.** An LLC can assign different voting rights to members. A person with a 10% membership interest could have a 30% voting interest, for instance, while other "passive" members could have no voting interest. Or one or more members could have a veto power over certain decisions.

Be careful: A lot of "form" LLC agreements require 100% of members to constitute a quorum – which means that a disgruntled owner could stymie a vote on an important matter simply by not showing

*continued on page 3*

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310 Grant Street, Suite 2310 | Pittsburgh, PA 15219 | (412) 471-1800 | [www.vuonogray.com](http://www.vuonogray.com)



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In a divorce, it's common for one spouse to keep the house and assume the mortgage. But what happens if the spouse doesn't refinance and remove the other spouse's name from the loan?

## Ex-wife doesn't refinance home; husband can force her to sell

In a divorce, it's common for one spouse to keep the couple's home and assume the mortgage. Typically, the spouse keeping the home will refinance the mortgage in order to remove the other spouse's name, so the other spouse isn't jointly responsible for the debt.

But what happens if the spouse fails to refinance?

This happened in a recent case in New Jersey. An ex-wife was awarded the couple's home with the understanding that she would refinance it within nine months. She failed to do so – and then made several late mortgage payments.

Because the husband's name was still attached to the mortgage, his credit was damaged by the late payments, making it harder for him to get a mortgage on his own new home.

The husband went to court, and a judge granted him a power of attorney to list and sell the home. The court even gave him permission to evict his ex-wife if necessary to complete a sale.

This may sound like an extreme solution. But it should be noted that the husband could suffer additional consequences from the wife's actions, beyond having trouble getting a mortgage. For instance, he could have trouble renting an apartment, because a landlord might be scared off by his credit rating. He also might find it difficult to buy or lease a car, and he might even have trouble getting a new job, because a lot of employers run credit checks on job applicants.

## Manufacturer is sued for confusing safety instructions

You should always follow a manufacturer's safety instructions. If you get hurt because you didn't follow the instructions, you might not be able to be compensated for your injuries.

However, you should always talk to a lawyer before you decide that you made a mistake and an accident was your fault. For instance, it might turn out that the instructions weren't clear enough to protect you.

In one recent Tennessee case, a man named King Bradley bought two new ratchet straps to secure his hunting treestand. He set up the stand, but waited several months to use it for hunting. When he did, he was injured when the straps broke.

Bradley sued the manufacturer of the straps.

The manufacturer had provided a warning that the straps should not be left out "in sunlight or other weather when not in use," and "must be stored inside when not in use."

But a federal appeals court said Bradley could sue anyway, because this warning was vague and confusing. For instance, it wasn't clear whether "use" meant simply having the straps outside to support to stand, or actually using the stand for hunting.

In addition, the manufacturer didn't say anything about how quickly the straps could deteriorate if they were left outside, or what Bradley should do to check them for wear and tear.

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## More workers are able to sue for age discrimination

More employees have a right to sue for age discrimination, as a result of two recent court decisions.

In one case, salesman Robert Liebman was fired at age 49 after working for the Metropolitan Life Insurance Company for 27 years. He sued under the federal age discrimination law, which prohibits discrimination against workers over 40.

MetLife argued that Liebman's firing couldn't possibly be age discrimination because it replaced him with someone who was 42 years old, and thus was also protected by the law.

But a federal appeals court in Atlanta said it didn't matter that Liebman's replacement was also over 40. As long as his replacement was "substantially younger," Liebman could sue, and have a jury decide if he was discriminated against.

In the second case, a medical device company

in Illinois posted an ad for a job in its legal department, saying that it would only consider candidates who had no more than seven years of experience.

It got a resume from 59-year-old Dale Kleber, who had previously served as general counsel of a Fortune 500 company, CEO of a national trade organization, and interim CEO of a different medical device business. The company didn't even give Kleber an interview, and hired a 29-year-old instead.

Kleber sued for age discrimination, arguing that the company's cap on candidates' experience was an illegal attempt to weed out older workers.

And a federal judge allowed the case to go forward. The judge said it wasn't age discrimination to refuse to interview an applicant who was overqualified, but a jury should be able to decide whether the company's cap on years of experience was simply an attempt to avoid older candidates in general.

# Starting an LLC? Here's what you need to know

continued from page 1

up at a meeting.

**Representations and warranties.** Are the members making promises about what they're bringing to the table, for which they can be held legally responsible?

**Profits and losses.** How will these be distributed to the members? Will profits be distributed on a regular basis, such as quarterly, or at will? If they're distributed at will, who will decide? If they're distributed on a regular basis, how will it be determined how much should be distributed and how much should be retained as operating capital?

**Taxes.** LLCs don't pay taxes; the members do. But because the operating agreement determines how income and losses are allocated for tax purposes, these provisions are very important. As an example: Some people who receive an LLC interest in return for providing services are surprised to discover that, under the agreement, the LLC interest is taxable to them. And some people are surprised to discover that they owe taxes on an LLC's undistributed profits.

**Accounting.** What method of accounting will you use? What will be your fiscal year? What rights will the members have to inspect the books and have them audited?

**Capital calls.** What are the rules if the LLC needs more cash from the members?

**New members.** What are the provisions for bringing in a new member? Is there a way that current members can prevent the dilution of their ownership or voting share?

**Member withdrawal.** What happens if a member wants to leave, or cash out? Must the member

sell his or her interest to the other owners, or can it be sold to a third party? If it can be sold to a third party, must the other members approve the sale? Can they have a right of first refusal? If the withdrawing member had management rights, can the sale exclude those rights? Must the departing member sign a non-compete or confidentiality agreement?

**Buyouts.** Can a member be forced out? How, and under what circumstances? For instance, a buyout may be mandated if a member dies, becomes disabled, files bankruptcy, or is terminated by the business. Also, how will the value of the member's share be determined for buyout purposes?

**Disputes.** You might want to provide that any disputes among members must be settled by mediation and/or arbitration, rather than a lawsuit.

**Amendments.** If the operating agreement needs to be changed later, what is the process for this? You want to make the amendment provisions as friendly as possible. Beware: some "form" agreements and state default rules say that an agreement can't be altered without the consent of *all* the members.

**Dissolution.** If you need to dissolve the LLC, you'll want a rule that says how a dissolution vote will be taken and how the LLC assets will be divided up. Not having such a provision can lead to nasty disputes if things don't work out.

As you can see, simply using a "standard" LLC agreement without considering all the issues with an attorney can be a recipe for disaster down the road.



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## Some gifts to charity should be made now, not in your will

In the past, many people's wills included a sizable donation to charity. Because the federal estate tax was so burdensome, including charitable bequests in a will was a good idea since it reduced the amount of tax the estate had to pay.

Now, however, the federal estate tax applies only to estates of more than \$5.45 million. As a result, for a great many people, leaving money to charity in a will no longer provides any tax benefit.

On the other hand, federal income and capital gains taxes have gone up, a new surcharge has been

added on investment income, and many states have raised their income and capital gains taxes as well. As a result, many people could reap significant tax savings if they made planned annual gifts to charity while they're alive, as opposed to making bequests in a will.

If you have an older will that includes a significant charitable bequest, this might be a good time to reconsider whether you could save taxes by writing the charity out of your will and instead making regular donations each year.

## New, easier forms will help mortgage shoppers

In the past, one reason many potential homebuyers have found mortgages intimidating is that lenders send them lengthy, complex “disclosure” forms that are confusing and



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hard to understand. This can make it difficult to figure out exactly what you’re getting into, and whether one mortgage product is really better than another.

However, the federal government is now requiring new, simplified forms to make shopping for a mortgage easier. The new forms make it much less

complicated to understand your costs and obligations, and to engage in comparison shopping.

Previously, mortgage applicants received two separate forms after applying for a loan – an early Truth in Lending Statement and a Good Faith Estimate. At closing, they got two more forms – a final Truth in Lending Statement and a HUD-1 Settlement Statement.

These forms were administered by two different federal

agencies with different regulations, and they were often confusing and contained overlapping information. Buyers who got the settlement statement at closing sometimes didn’t fully understand it, but were reluctant to ask questions or challenge anything at the last moment with everyone already at the table.

Now, however, buyers who apply for a loan will get a single form, called a Loan Estimate. This form clearly sets out the terms of the loan, and makes it easy to compare the features of one loan with another.

The two closing forms have been replaced by a single form called a Closing Disclosure, which provides a clear accounting of the transaction.

The Closing Disclosure must be given to buyers at least three business days before the actual closing. This gives a buyer time to look it over and ask any questions, without feeling rushed or intimidated.

The U.S. Consumer Financial Protection Bureau, which created the new forms, tested them with consumers and found that they improved buyers’ ability to compare different loans by as much as 42 percent.