

Business Brief

Business and Client Advisory



CORPORATE FIDUCIARY DUTY

Frequently, business owners believe that sharing ownership in their business will motivate, as well as reward, key employees. Sometimes, businesses merely want to raise capital by selling small portions of their business. Before selling or giving away equity, business owners ought to know about "fiduciary duty." Officers, directors, controlling shareholders and general partners all are bound by this duty. As soon as an ownership interest in a business is acquired by someone else (no matter how small), that person may have standing to bring a lawsuit against the majority owners, partner, officers and directors alleging breach of fiduciary duty.

Fiduciary duty is defined as the duty of (1) care, (2) loyalty and (3) disclosure. A director, sole shareholder or controlling and dominant shareholder is bound by this when dealing with the corporation or creditors. Furthermore, such dealings are subject to rigorous scrutiny. This prohibits "self dealing." Claims of self-dealing may include allegations of excessive compensation, starting a separate or competing business, investing in other businesses, and selling assets. This duty of care requires the exercise of due care in managing the affairs of the business. This duty often translates into the need to rigidly follow corporate formalities, such as regular shareholder and directors meetings and more formal accounting.

Business relationships, like marriages, usually start out with the best of intentions. Similarly, business relationships all too frequently end in a bitter dissolution. It is not unusual for minority shareholders to become disenchanted, envious, or even hostile toward the majority. All too frequently, this leads to lawsuits alleging breach of fiduciary duty.

Consequently, owners of a controlling business interest are encouraged to engage counsel prior to initiating any transactions creating minority ownership interests. Alternatively, in many situations, owners can utilize other means of motivating and rewarding key employees based upon the success of the business. A simple phone call to counsel may be all that is needed to determine whether or not a proposed transaction raises these issues and explore other options for the business. Please call our office if you have any questions regarding this important topic.

HAVE YOU PREPARED YOUR CORPORATE MINUTES?

The preparation of corporate minutes for shareholders and directors should not be treated as a purely routine function. Certified copies of minutes provide *prima facie* evidence of all matters covered by the corporation and are subject to inspection, not only by directors and officers of the corporation, but also by outside parties, such as independent auditors, taxing authorities and adverse parties in litigation. Furthermore, minutes that are not carefully prepared, can become "open game" for opportunists seeking to "pierce the corporate veil" and expose individual shareholders to personal liability for corporate obligations.

For all of these reasons, the minutes of a corporation must be thoroughly prepared and examined on a regular basis. Corporate clients are therefore advised to seek legal counsel to prepare, maintain and review their corporate minutes recurrently. Reputable law firms have "corporate maintenance" programs designed specifically for this purpose. For more information about Vogt & Resnick's Corporate Maintenance Program, please contact this office.

PROVIDING EMPLOYEE REFERENCES

Employers are reluctant to provide job references. Employers' hesitancy is grounded in fear of litigation by ex-employees. A bad reference could give rise to many different types of claims, including defamation, interference with prospective advantage, blacklisting under Labor Code section 1050, or even retaliation for protected activity in which the employee engaged during his or her employment.

Practical Tips

Most employers choose to provide at least some information in response to reference requests. For example, it is not uncommon for employers to verify dates of employment, positions held and rates of pay, but nothing more. Some employers choose to go further and provide letters of recommendation or answer more substantive questions, such as whether the applicant is subject to rehire. Regardless of the specific practice chosen by employers, the following tips could help avoid many legal and practical problems:

1. *Establish a policy regarding reference requests and communicate and apply it consistently.* Whatever reference practice an employer adopts, it should be memorialized in a formal policy. If the policy is well communicated, no one should have false expectations, and managers and supervisors are less likely to deviate from the employer's practices. Management employees should be instructed that "off-the-record" comments are strictly prohibited. In addition, the policy must be consistently enforced to avoid claims of discriminatory treatment.
2. *Designate only certain individuals to handle all reference requests.* This provides assurances the policy is being applied consistently. It also helps avoid contradicting references, as it is not unusual for management employees to have different opinions regarding what information should be communicated about a former employee.
3. *Require any reference request be in writing.* This provides valuable documentation and strengthens any common-interest privilege claim; the common-interest privilege only applies if there is a request from one whom the employer reasonably believes is a prospective employer. Employers also should document all the communications and only provide the reference or verification in writing.
4. *Obtain a written authorization and release from the subject employee.* This will memorialize the employee agrees the employer has permission to provide the reference and cannot sue for any information conveyed. Some employers obtain a standard release from all departing employees, regardless of whether there is a pending reference request. The individual may even be made aware in advance of what information the employer intends to convey. This strengthens any authorization and avoids the anger that frequently can arise with surprisingly negative reference.
5. *Provide truthful and factual information.* This is the most important tip and often the most difficult for employers to follow. Truth is a defense to almost any claim. Employers sometimes provide false glowing references, then, are placed in the unenviable position of trying to defend their own adverse action against the employee. References should be factual, rather than conclusive. For example, it is better to state a person failed to follow specific directives, as opposed to the person is "insubordinate" or "incompetent."

Although there is no perfect or "fool proof" method for dealing with job reference requests, following some of the foregoing tips will diminish the risks associated with such requests. The decision of how much, if any, information to provide, involves a careful risk assessment by employers. Employers are encouraged to speak with counsel in developing the appropriate policy language. With a clear legislative and judicial desire to encourage employers to provide job references, the protections for employers should continue to be strengthened.

OBTAINING EMPLOYEE BACKGROUND CHECKS

Many employers now investigate creditworthiness before deciding whether to hire, promote, reassign, or retain an individual. A credit report can reveal bankruptcies, late payments, overdrawn credit, and debt-collection activities. Negative information can suggest an applicant is ill-suited for a position handling cash, corporate finances, or client's personal property. Personal service positions for public figures or celebrities are particularly sensitive; applicants whose credit reports reflect a chronic need for money could be easy targets for bribed breach of confidence or security. Concerns about credit many arise for a potential new hire, an existing employee in line for promotion, or an existing employee in a sensitive position whose personal finances may have changed for the worse.

Minefields of Looking Within

An employer who uses information in this context, however, becomes subject to the picayune requirements of the Fair Credit Reporting Act ("FCRA"). Before a credit report provided by a third-party agency can be used in an employment decision, the employer must:

- clearly and conspicuously disclose in writing to the applicant or employee that a report may be obtained;
- get written authorization from the targeted individual before obtaining the report; and
- certify that the requisite disclosure has been made to the authorizing applicant or employee, that the information will not be used to violate any state or federal law protecting equal employment opportunities and that a copy of the report and a summary of rights will be provided if any adverse employment decision is based on the report (15 U.S.C. 1681m; Cal. Civ. Code 1785.1-8).

Actions Begetting Actions

An adverse decision based on the report triggers a detailed process in which the employer must provide the employee or applicant with:

- the name, address, and toll-free telephone number of the reporting agency;
- assurance that the agency itself did not make the adverse decision;
- confirmation that a free copy of the file may be secured from the agency during the next 60 days; and
- an explanation of the right to dispute the completeness or accuracy of any information in the report. (15 U.S.C. 1681m(a).)

If an adverse employment action is based on a report secured by an entity affiliated with the employer through common ownership or control, the employer's notice must also disclose the type of information on which it relied (15 U.S.C. 1681(b) (2)).

Sleuthing Specifics

Employers who want to know even more about an applicant or employee- including information about general reputation, lifestyle, and character- may commission an investigative report. Such reports might be relevant when hiring a top executive, sensitive security personnel for celebrities (especially minors), or a corporate spokesperson whose background must be above reproach. Unless such heightened investigation springs from a suspicion of wrongdoing, a targeted consumer is entitled to the FCRA protections noted- as well as written notice that a more detailed investigative report will be sought. (Cal. Civ. Code 1786.16 (a)(2)(B).) The employer must also advise the applicant of the right to see and copy the report, to obtain a copy by mail, or receive a summary of it by telephone (Cal. Civ. Code 1786.22(b)).

Duties and Limits

If an employee or applicant makes a written request within a reasonable time after learning of being targeted for investigation, the employer must send a copy of the report within three business days if an outside agency conducts the investigation, or within seven days if the employer undertakes the report. Employers may not seek medical information without the applicant's consent (15 U.S.C. 1681b(g)). Though criminal convictions are discoverable, inquiries regarding arrests or detentions are off limits (Cal. Lab. Code 432.7).

-JUST FOR LAUGHS- NO CONTEST

From a list of cases heard in U.S., civil and criminal courts, published in October 24 issue of the ABA Journal eReport, the online magazine of the American Bar Association:

- *I Am the Beast Six Six Six v. Michigan State Police*
- *Friends of Kangaroo Rat v. California Dept. of Corrections*
- *State v. Big Hair*
- *Billy-Bob Teeth Inc. v. Novelty Inc.*
- *Herb v. Grow*
- *Henny Penny v. Chicken Little*
- *Fried v. Rice*
- *Loser v. Superior Court of Alameda County*
- *United State of America v. 2, 116 Boxes of Boned Beef, Weighing Approximately 154,121 Pounds, and 541 Boxes of Offal, Weighing Approximately 17,732 Pounds*
- *Plough v. Fields*
- *Farmer v. Heard*
- *Hamburger v. Fry*
- *Short v. Long*

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