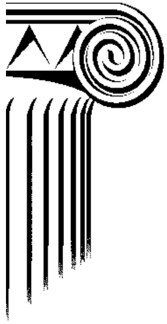

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PUT IT IN WRITING! (PART II)

By Burt J. Blustein, J.D.

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In the first installment of this article, we explored the reasons why it is so important to get agreements in writing, under the legal doctrine known as the "Statute of Frauds." This installment will look at two common areas where the law mandates that an agreement *must* be in writing to be enforceable.

Under New York law, a promise to answer for the debt of another -- more commonly referred to as a *guarantee* -- must be in writing to be enforceable. One reason for this requirement is to protect against an unintentional oral commitment from becoming a guarantee of another's debt. The requirement that a guarantee be in writing helps safeguard against false claims of agreement that would be easily made in the absence of a writing.

Unlike other forms of oral agreements, many of which are enforceable, a guarantee generally becomes effective only when the primary obligor defaults; there is, accordingly, no evidence of any performance, because the performance rests with a third party. Generally, in other enforceable oral agreements, there is some level of performance that creates an evidentiary basis for proof of the underlying oral contract. Conversely, a guarantee is by its nature a "standby" agreement, passive in substance. Its existence only becomes active if there is a default on the underlying primary obligation. Unlike the underlying debt where, even absent a written agreement there should be ample evidence of that transaction – for instance, a copy of a check evidencing the transfer of money or of the repayment of some of the debt -- none of those overt acts would be present in an oral guarantee, thereby relegating the proof to one party's word against another.

As in the area of personal guarantees, most agreements affecting the use, occupancy and ownership of real property must be in writing. The rationale for this rule is that the property rights in real estate are so substantial that they should not be governed by anything other than a written agreement. However, that is not true with respect to *all* agreements affecting real estate. For example, a lease of real property for less than one year can be in the form of an oral agreement. Evidently, the reasoning is that an agreement for less than one year is not substantial enough to require a protection of the Statute of Frauds.

Now that we have established that there are certain agreements that must be in writing to be enforceable, the next question is what must be contained in the writing in order to make it enforceable. It is easy to describe the applicable guidelines in the abstract, but it is infinitely more difficult to apply those guidelines on a factual pattern and determine whether the particular writing is sufficient to meet the requirements of the statute. Indeed, whether a particular writing in a given case is sufficient to legally memorialize the terms of the parties' agreement has been the subject of thousands of cases over the years, and such litigation will undoubtedly go on unabated into the future.

An agreement to be enforceable does not have any specific form. For example, with a guarantee, the writing only has to contain enough information to identify the nature of the guarantee with evidence of an intent by the guarantor to be bound by the responsibility to pay for the debt of another. Additionally, it must contain the signature of the person who intends to be bound. An enforceable guarantee can be as simple as: I, the undersigned, promise to pay to you John Smith's obligation under his promissory note for $10,000, if he does not pay to you all or any part of that obligation.

The requirements for a valid written real estate contract for the sale and purchase of real property is deceptively simple. Such assumed simplicity can and often has led clients to unanticipated problems. The essential elements required in a contract for the purchase of real property are (i) that the property must be described with enough definiteness in order to permit it to be identified with reasonable certainty; (ii) the parties to the contract have to be adequately identified; and (iii) the purchase price, the terms of payment and of course, the writing must be signed by both parties.

It is common practice for many real estate brokers to pressure buyers and sellers into signing what they call a "binder". The word "binder" should send a message that it has a significance and that the writing, even though it is described as merely an expression of an intent, can and has very often been found to be a legally binding contract. Until recently, it was unclear whether the inclusion of words to the effect that the contract was "subject to the approval of the buyer or seller's attorney" was enough of a buffer to prevent the contract from becoming binding. However, in recent appellate decisions the courts have clarified this issue and have determined that including a provision such as "subject to approval by the attorneys for the buyer" will constitute enough of a qualification to make the written agreement conditioned upon the approval of the applicable party's attorney.

WHAT YOU NEED TO KNOW WHEN PURCHASING A BUSINESS

By Richard J. Shapiro, J.D.

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Even in a troubled economy, there will always be those risk takers having the passion and conviction to own and operate their own business. Some will start a business from scratch; others will prefer purchasing an established business.

If you are considering purchasing an existing business, it is critical that you conduct a "due diligence review" to ensure that you have all the relevant information needed to evaluate the associated risks and likely rewards. The due diligence review will encompass such issues as:

- A market analysis of the ongoing demand for the business's products or service
- An evaluation of the capabilities of the existing employees, and whether additional employees will be required
- A review of the suitability of existing equipment and facilities
- A detailed review of the company's books (to be performed by an experienced accountant) to ensure that the purchase price is fair and reasonable
- A legal review that will include items such as (i) analysis of the company's organization documents such as bylaws, operating agreements, shareholder agreements, stock records and partnership agreements; (ii) review of the company's contracts and leases with third parties; (iii) a search of county and state records for liens, judgments and other public records affecting the company and its current owners; (iv) a review of any trademarks or copyrights being transferred; (v) analysis of any employment contracts and union agreements; and (vi) a review of the company's retirement plans to ensure adequate funding and record management

In conducting the due diligence review, the seller, purchaser, and their respective representatives should sign a confidentiality and non-disclosure agreement protecting confidential information associated with the transaction.

A significant issue is whether the sale will be structured as an "asset sale," or rather as the sale of the company stock or limited liability company membership interests, as applicable. In most cases the purchaser will prefer to acquire the company's assets rather than the seller's stock or other ownership interest. If you purchase the seller's stock, then you will be acquiring not only the company's underlying assets, but also the company's liabilities. With a stock sale, the purchaser will also forfeit potentially favorable tax advantages achieved through allocation of the purchase price among various asset types.

Either during or at the conclusion of the due diligence period, the parties will need to formalize their agreement in a contract of sale. The contract will incorporate a number of standard provisions, including:

- the purchase price and the amount of the down payment
- whether the purchaser will be purchasing only business assets, or the seller's stock or LLC membership interests
- the amount to be financed, including the terms of any seller financing and collateral to be used as security
- the allocation of purchase price among the various asset classes (i.e., real estate, machinery, goodwill, leasehold, covenant not to compete, inventory, etc.)
- the extent to which the purchaser will assume the seller's liabilities
- representations and warranties for both seller and purchaser
- the closing date
- a list of assets to be conveyed
- a statement of any existing or pending litigation for either party
- any conditions to closing, such as governmental or bank approvals
- the seller's agreement to indemnify the purchaser against any unassumed liabilities

After the contract is signed, the purchaser will need to complete any remaining due diligence items. If the purchaser is acquiring real estate as part of the deal, he will need to have a title search performed to ensure he is acquiring clear title. If bank financing is being used to finance part of the purchase price, the bank will go through its own due diligence procedure. Once all pre-closing items are completed, the closing will take place. If the full purchase price is being paid at closing – either from the buyer's own funds (rarely) or through commercial financing -- the seller will walk away with the full sale proceeds at closing. More commonly,

the seller will be taking back a note for a portion of the sale price.

At closing, the seller's attorney will prepare various documents that may include (1) bills of sale, (2) deeds (if real estate is part of the purchase), (3) assignments of equipment leases, (4) one or more promissory notes, (5) mortgages and security agreements, (6) employment agreements, (7) resolutions authorizing the sale of assets by the corporation or LLC, (8) equipment lists, (9) covenants not to compete, (10), assignments of phone numbers, websites, copyrights, trademarks and other intellectual property, (11) resignations of officers, (12) sales tax returns, (13) escrow agreements, (14) personal guarantees and (15) motor vehicle registrations.

If the seller is providing financing, after the closing the security agreement and UCC financing statements will be filed with the appropriate governing bodies to properly secure seller's interest in the business assets and any other collateral used to secure the purchaser's obligation to pay on the promissory note. These filings will ensure that the seller has "first position" to reclaim any of the collateral in the event that the purchaser shall default in any payments under the promissory note(s).

Purchasing a business is a significant life event. It is essential that a prospective business purchaser retain an experienced attorney and accountant to ensure that the purchaser's interests are fully protected during each phase of the transaction.

Construction Contracts: "Pay When Paid" vs. "Pay If Paid" Clauses

By Gardiner S. Barone, J.D.

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Although to the unwary there may appear to be no distinction between the two types of clauses, there is a marked difference between a "pay when paid" and a "pay if paid" payment clause. A properly worded "pay *if* paid" clause may actually shift the burden of nonpayment by the owner to the subcontractor, and, therefore, is a highly desirable provision for any contractor to insert into its contracts. Conversely, a "pay *when* paid" clause is designed to delay the time for payment to its subcontractors and suppliers, but it does not relieve the contractor from its obligation to eventually make payment to its subcontractor or suppliers.

Throughout the United States, "pay ***if p***aid" clauses typically make the contractor's obligation to pay its subcontractors and suppliers contingent on the contractor being paid by the owner. The contractor's obligation to make a payment is subject to the express condition precedent of payment by the owner, and if the owner does not pay the contractor, the contactor does not have to pay its subcontractors and suppliers.

The typical "pay ***if*** paid" clause provides:

> "all payments to Subcontractor by Contractor are expressly contingent upon and subject to receipt of payment for the Work by Contractor from Owner ...."

There is an obvious benefit of such a clause to a contractor who does not get paid by the owner, as the clause prevents the subcontractors and suppliers from forcing the contractor to pay them when the contractor has not been paid. In

short, the “pay *if* paid” clause shifts to the subcontractors and suppliers the risk of non-payment by the owner.

In New York, however, a “pay ***if*** *p*aid” clause is unenforceable, as it indefinitely suspends the contractor’s obligation to make a payment. New York Courts consider this type of provision to be contrary to the public policy underlying the Lien Law. Therefore, to be enforceable in New York, a contractual provision in which the contractor attempts to transfer the risk of non-payment to its subcontractors and suppliers must be precisely worded to avoid being construed as an unenforceable “pay ***if*** paid” clause.

A typical “pay ***when*** paid” clause provides:

> “"The total price paid to subcontractor shall be [contract price], no part of which shall be paid until 5 days after payment is received from owner."
>
> or
>
> ". . . the Contractor shall pay the Subcontractor each progress payment and final payment . . . within three working days after he receives payment from the Owner .. "

The objective of a “pay *when* paid” clause is to *suspend* the contractor’s obligation to pay subcontractors and suppliers *until* the contractor is paid by the owner. However, if the clause is not carefully worded, it is likely to be construed as a “pay *if* paid” clause that will be unenforceable; in such a circumstance, the contractor’s desire to “sequence” its obligation to pay its subcontractors and suppliers will be rendered ineffective.

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Settlement with Town in Case for Special Fact Exception

Our litigation department is proud to report another successful outcome to a lawsuit involving a developer. In 2009 we were hired by a developer who believed his efforts to subdivide land in Orange County had been obstructed and delayed for over seven years by the Township. During that time, the Town amended its zoning laws, which reduced the maximum development potential of the land from 39 lots to 31 lots. The amendments also imposed onerous and expensive testing requirements that further hindered the subdivision and development of land. Shortly after we were retained, we commenced a lawsuit to secure a *Special Fact Exemption* from the zoning amendments. We drafted the papers with the specific intent to demonstrate to the Town that if it did not reach a settlement with our client, it would be put through an expensive and humbling trial.

A Special Fact Exception involves concepts of “vested rights,” where a court is constrained to determine each case according to its own unique circumstances. Before granting a Special Fact Exception, a court must find that the planning board engaged in “dilatory actions” that resulted in an “unreasonable delay” in processing the application, and, but for the delays, the application could have been grated before the zoning laws were amended.

In this matter we asserted that the “dilatory actions” consisted of a lack of communication between the Town and its consultants, inconsistent directives by the Town’s consultants, and the raising of issues in the later stages of the application process that should have been raised during earlier stages.

To demonstrate to the Town our preparedness to go to trial, we retained at the onset of the case two trial experts who had previously provided

testimony in another matter that was awarded a Special Fact Exception.

Without even opposing the lawsuit, the Town conceded its position. We negotiated a settlement with the Town whereby it acknowledged that our client was entitled to a Special Fact Exception from the new zoning laws, as well as approval of its 39 lot subdivision without having to comply with the onerous and expensive testing requirements.

EDUCATIONAL WORKSHOPS

Blustein, Shapiro, Rich & Barone, LLP offers complimentary educational workshops to our clients and friends. Here's our upcoming workshop schedule:

Estate Plans That Work™

May 18, 2010 – 3:00 p.m. to 6:00 p.m.
June 8, 2010 – 3:00 p.m. to 6:00 p.m.

Protecting Your Assets from Nursing Home Costs

June 17, 2010 – 10:00 a.m. to 12:00 p.m.

To register for a workshop, call Donna at 291-0011 x.242, or register online at www.mid-hudsonlaw.com by going to the "Event Calendar" link.

All workshops will be held in the BSRB Education Center at our 10 Matthews Street location.