

ETHICS RULES THAT START WITH 3 AND 4

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CHOICE AND ACQUISITION OF ENTITIES IN TEXAS COURSE

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CHAPTER 8

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BIOGRAPHICAL



INFORMATION

BOND & SMYSER, LLP

Bond & Smyser, LLP is a business law firm for people that own and operate their own business. We provide business structure and financing services to middle market business owners and the persons who finance middle market businesses, to help them start, grow, properly operate and, ultimately, cash out of the business. We provide personal, one on one counseling to the business owner or financier, particularly during transitions, such as growth, financings and sales. We are legal experts in business law, finance law, including equity and debt, and tax. We prepare formation documents, securities investment agreements, loan agreements and purchase and sale agreements. We are known for our high level of expertise and pragmatic and focused solutions.

ADRIENNE RANDLE BOND - EDUCATION

Ms. Bond is a magna cum laude graduate of Rice University (B.A. 1980) and graduated Columbia University Law School (JD, 1980) as a Harlan Fiske Stone Scholar.

PROFESSIONAL ACTIVITIES

She is a frequent author and lecturer on corporate and securities law issues, and has served as Adjunct Professor of Corporate Law at the University of Houston Law Center. Ms. Bond is a past President of the Women's Finance Exchange and has been a member of the State Bar of Texas' Corporation Law, Continuing Education and Venture Capital Committees and is a member of the Limited Liability Company, Partnership and Unincorporated Entity Committee and the Venture Capital Committee of the American Bar Association.

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ETHICS RULES THAT START WITH 3 AND 4

Additional Ethics – A Brief review of litigation matter that impact business lawyers, or the ethics rules that start with 3 and 4.

I asked for the time slot as a result of having to study ALL of the ethics rules. I found, to my dismay, that I was very conversant with the rules on confidentiality and conflicts (i.e. those rules that start with “1”), but there are rules from the litigation area concerning permissive and mandatory disclosure of information. Additionally, the Texas rules and the Model Rules (which are adopted in several major jurisdictions other than Texas) are different in significant respects. This paper is brief and includes two fact patterns with questions. I will supply the correct answers in the lecture.

Fact Pattern #1

Attorney is representing BIGOIL in connection with a securities fraud allegation against BIGOIL. BIGOIL claims he did not make the misrepresentation and produces Sweetthing to testify. Sweetthing will testify that BIGOIL sent an email that explained all of the facts that make the statement made by BIGOIL accurate, rather than a misrepresentation. Attorney knows that Sweetthing is lying, but BIGOIL insists that attorney call Sweetthing to testify on behalf of BIGOIL at trial.

Is Attorney subject to discipline if she calls Sweetthing?

- A. Yes, unless, before calling Sweetthing, Attorney informs the court of her belief.
- B. Yes, because Attorney knows Sweetthing will be testifying falsely.
- C. No, unless Attorney relies on the alibi defense in her argument before the jury.
- D. No, because BIGOIL has insisted that Sweetthing be called as a witness on BIGOIL’s behalf.

Same facts, but Sweetthing is going to supply her facts in a mediation before trial.

Some facts, but Attorney is not sure, but suspects Sweetthing lying.

Fact Pattern #2

Attorney represented Mr. Forefingers, as oilfield drilling expert in the sale of his drilling business. Mr. Forefingers is nearing sixty and has decided to retire because the revenue in his 40-year business has started to deteriorate in the prior quarter because the Blow-Out Preventer designed by Mr. Forefingers has failed three times in a technical operation in horizontal well in a shale play in the last month. He has not been sued, is being represented by his insurance company and the insurance company has not indicated it will deny the claim. Mr. Forefingers tells Attorney he will be grateful to clear \$5 million in this sale. Attorney and Mr. Forefingers are in negotiations with a potential purchaser, and the potential Buyer appears to be losing interest. Attorney states “Drilling in the shale is very profitable now and Mr. Forefingers has been active in the shale plays. Shale is where the action is in the oil patch.” Based on the negotiating skills of Attorney, Buyer buys the business, but because of the cloud from the BOP failures, the business does not succeed in attracting additional horizontal shale drilling. Buyer is disappointed because the business does not achieve the EBITDA it did prior to sale.

Is Attorney subject to discipline?

- A. Yes, because Attorney made a false statement of fact to Buyer.
- B. Yes, because Attorney exaggerated the profitability of the business.

- C. No, because Attorney represented Seller, not Buyer.
- D. No, because Attorney's statement constitutes acceptable puffing in negotiations.

What if Attorney said:

“Shale plays are very attractive now, Mr. Forefingers could expect an EBITDA multiple in excess of 5X.”

OR

“Mr. Forefingers thinks shale plays are very profitable; I do not think he will take a penny less than \$10,000,000.”

What if there is a securities fraud claim against Attorney?

What is the impact of the language in Rule 4.01(b) (or 4.1(b) of the Model Rules) on the sale of a business (i) structured as an asset sale, or (ii) structured as a stock sale?

Model Rules of Professional Conduct

Client-Lawyer Relationship

Rule 1.0 Terminology

(m) “Tribunal” denotes a court, an arbitrator in a binding arbitration proceeding or a legislative body, administrative agency or other body acting in an adjudicative capacity. A legislative body, administrative agency or other body acts in an adjudicative capacity when a neutral official, after the presentation of evidence or legal argument by a party or parties, will render a binding legal judgment directly affecting a party's interests in a particular matter.

Rule 3.3 Candor Toward the Tribunal

- (a) A lawyer shall not knowingly:
 - 1. Make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer.
 - 2. Fail to disclose to the tribunal legal authority in the controlling jurisdiction know to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or
 - 3. Offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter that the lawyer reasonably believes is false.
- (b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal..
- (c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.
- (d) In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts know to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.

Transactions With Persons Other than Clients

Rule 4.1 Truthfulness in Statements to Others

In the course of representing a client a lawyer shall not knowingly:

- (a) Make a false statement of material fact or law to a third person; or
- (b) Fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6

“Tribunal” denotes any governmental body or official or any other person engaged in a process of resolving a particular dispute or controversy. “Tribunal” includes such institutions as courts and administrative agencies when engaging in adjudicatory or licensing activities as defined by applicable law or rules of practice or procedure, as well as judges, magistrates, special masters, referees, arbitrators, Mediators, hearing officers and comparable persons empowered to resolve or to recommend a resolution of a particular matter; but it does not include jurors, prospective jurors, legislative bodies or their committees, members or staffs, nor does it include other governmental bodies when acting in a legislative or rule-making capacity.

Rule 3.03 Candor Toward the Tribunal

- (a) A lawyer shall not knowingly:
 - 1. Make a false statement of material fact or law to a tribunal;
 - 2. Fail to disclose a fact to a tribunal when disclosure is necessary to avoid assisting a criminal or fraudulent act;
 - 3. In an ex parte proceeding, fail to disclose to the tribunal an unprivileged fact which the lawyer reasonably believes should be known by that entity for it to make an informed decision;
 - 4. Fail to disclose to the tribunal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or
 - 5. Offer or use evidence that the lawyer knows to be false.
- (b) If a lawyer has offered material evidence and comes to know of its falsity, the lawyer shall make a good faith effort to persuade the client to authorize the lawyer to correct or withdraw the false evidence. If such efforts are unsuccessful, the lawyer shall take reasonable remedial measures, including disclosure of the true facts.
- (c) The duties stated in paragraphs (a) and (b) continue until remedial legal measures are no longer reasonably possible.

IV. Non-Client Relationships

Rule 4.01. Truthfulness in Statements to Others

In the course of representing a client a lawyer shall not knowingly:

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 - The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.
 - In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.

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Definition

“Tribunal” denotes any governmental body or official or any other person engaged in a process of resolving a particular dispute or controversy. “Tribunal” includes such institutions as courts and administrative agencies when engaging in adjudicatory or licensing activities as defined by applicable law or rules of practice or procedure, as well as judges, magistrates, special masters, referees, arbitrators, Mediators, hearing officers and comparable persons empowered to resolve or to recommend a resolution of a particular matter; but it does not include jurors, prospective jurors, legislative bodies or their committees, members or staffs, not does it include other governmental bodies when acting in a legislative or rule-making capacity.

Model Rules of Professional Conduct

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 - A lawyer shall not knowingly:
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 - a) Make a false statement of material fact or law to a third person; or
 - b) Fail to disclose a material fact to a third person when disclosure is necessary to avoid making the lawyer a party to a criminal act or knowingly assisting a fraudulent act perpetrated by a client.

16.

ПРЕАМУЛА: ОТВЕТСТВЕННОСТЬ ЮРИСТА

[1] Юрист, как член юридической профессии, является представителем клиента, содержащим правовой системы и общественным гражданином, несущим особую ответственность за качество правосудия.

[2] Как представитель, клиентом юрист осуществляет деловую функцию. Как консультант юрист предоставляет клиенту информацию о возможных правах и обязательствах клиента и объясняет их правовые последствия. Как адвокат юрист участвует в осуществлении позиции клиента согласно правовой системе справедливости и суда. Как посредник юрист действует, рассматривая правовые вопросы клиента, и предоставляет отчет о них клиенту или другим.

[3] Помимо и представительскими функциями юрист может служить в качестве нейтральной третьей стороны, непредвзятой роли, помогающей сторонам разрешить спор или другой вопрос. Источники из этой Прямой применяются соответственно к третьему, четвертому, пятому или шестому и качеству нейтральной третьей стороны. См. напр., Правила 1.12 и 2.4. Вдобавок, имеются Правила, которые применяются к юристам, которые не занимаются юридической практикой или представительскими услугами, даже когда они занимаются непрофессиональной деятельностью. Например, юристы, оказывающие медицинскую и юридическую помощь, подлежат дисциплинарной ответственности за обман, мошенничество, ложность или введение в заблуждение. См. Правила 8.4.

[4] Во всех профессиональных функциях юристу следует быть компетентным, независимым и честным. Юристу следует поддерживать связь с клиентом, откровенно и предвзято. Юристу следует хранить конфиденциальность информации, относящейся к представителю клиента, кроме того, когда раскрытие требуется или разрешено Национальной Профессиональной Палатой или другим законом.

[5] Поведение юриста должно соответствовать требованиям закона, и в профессиональной службе клиенту, и в делах юриста и профессиональных интересах. Юристу должно возмещать судопроизводство только в исключительных и не обоснованных или изнурительных случаях. Юристу должно демонстрировать уважение правовой системы и тем, кто служит ей, включая судей, других юристов и должностных лиц. Нередко в тех, кто это делается должно верить, когда исполняются обязанности юриста, также должно верить является стандарта судебного процесса.

[6] Как общественный гражданин юрист должен стремиться и усердно соблюдать закон, доступ и правовые системы, управление правосудия и качества услуг, предоставляемых гражданам и правовой системы. Как член юридической профессии юрист должен развивать навыки закона по применению его профессиональной для клиента, работать по развитию и реформе закона и работать для улучшения правосудия. Помимо юрист должен осознавать влияние профессии на общество и веру и веру закона и системы правосудия, так как правовые учреждения и конституционной демократии зависят от уважения и поддержки народа, чтобы сохранить их власть. Юристу должно быть внимательным и открытым, существующим и отстраненным правосудия, а также в уважении факту, что люди и не имеют достатков, а также со стороны правовые системы не в состоянии позволить себе соответствующую правовую помощь. Следовательно, все юристы должны поддерживать профессиональные навыки и системы, и поддерживать общественные интересы для обеспечения равного доступа к правовой системе правосудия для всех тех, кто имеет экономическое или социальное барьеров не могут позволить себе, или обеспечивать соответствующую профессиональную консультацию. Юристу должно поддерживать людей в сфере правосудия и достижения этих целей и должен помогать коллегам адвокатов регулировать собой в интересах общества.

1

**Operational and Transitional
Issues for LLCs or Tax Topics
Business Lawyers Can Master**

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28 May 2010

What is §83(b)?

- Transfer of Property
- Transferred for as Compensation for Services
- Subject to Substantial Risk of Forfeiture
 - Think: called “vesting.”

Rules of the Road

- Affirmative Election to the IRS
- Election must be filed in 30 days from the receipt of the property
- Must declare a value for the property received –the fair market value
 - If a carried interest – likely to be zero or low
- Pay tax in year of election on amount declared as value – if not ever vest, pay tax and no property

Why make a §83(b) election?

- Locks in the basis for the property received
- Shifts potential compensation income (ordinary rates) to capital gains
- If no election, ordinary income is recognized in the amount of the fair market value of the property on the date the property is vested (no longer subject to substantial risk of forfeiture)

Liquidation of the LLC

- If sell the LLC interest, all capital gain
- If sell assets, rules on distributions from partnerships apply – hold this thought
- Good scenario: Make election, distribution on liquidation, no tax to extent of basis, and rest of tax takes on character as held by the LLC
- Less good scenario: No election, vests – all ordinary income
 - Many vesting provisions occur on the sale of the LLC, which without an election, means ordinary income

Conversion of an LLC to a C Corp

- Why? – to merge the LLC into a publicly traded corporation
- Problematic because of tax rules on tax free incorporations under §351

Distribution Rules for LLCs

- Tax on distributions in excess of basis in LLC interest
- Converse: No tax to the extent that you have basis in your LLC interest
- After basis, tax on the remainder of the distribution
- Nature of the tax depends on the nature of the asset held by the LLC

Three Ways to change to a C Corp

- **Interest over** – Exchange LLC interests for stock
- **Assets over** – exchange assets for stock, distribute the stock in liquidation of the LLC
- **Assets up** – LLC may liquidate, owners contribute the assets to the corporation in exchange for stock
- **Conversions:** treated as “Assets Over”

Conversion and §351

- Convert LLC by contributing all assets in exchange for stock, qualified as a tax free formation of a C corp
- §351 requires solely in exchange for stock
- §351 requires 80% control of the stock by the transferors – former LLC members

Exceptions to Tax-Free Transfer

- Debt in excess of Tax Basis
- Investment Companies
- Stock for Services

Conversion in Anticipation of a Merger

- No tax free merger provisions for LLCs
- If merge an LLC, you are subject to liquidation of LLC and Distribution of FMV of Assets to members
- That's why we set out distribution rules as First!

Convert to a C Corp

- Convert to a C Corp and do tax free merger between C Corps!
- Pesky Rules

§351 Not Applicable if:

- Not a bona fide business purpose
- Agreement in place to complete a merger
- If fail these tests, the merger is taxable

Acquiror Issues in this Analysis

- If merger is tax free, no step up in basis
- SEC disclosure issues about tax treatment if tax-free
 - How old and cold?
 - Effects of lower basis

Considerations

- If must convert prior to deal, must analyze using §351 exceptions to figure cost of conversion
- Unless S election is possible, must determine to give up pass through tax status without firm deal
