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In conjunction with its second anniversary in March 2005, Parsons Farnell & Grein, LLP is pleased to issue this newsletter to clients and friends. Serving our clients during our first two years has been our greatest reward. We hope you find this newsletter both interesting and informative. We anticipate issuing additional installments on a regular basis.

*Parsons Farnell & Grein LLP is a boutique firm specializing in helping Northwest businesses and their leaders. Our law practice concentrates on general business litigation, policyholder insurance disputes, construction litigation, business formation, business and real estate transactions, estate planning, probate, and tax planning/litigation.*

## EXPECTING THE UNEXPECTED: Appropriate Insurance Coverage For Your Business

Michael Farnell & Justin Leonard



Proper insurance coverage provides security from unforeseen losses and lawsuits. As your business changes over time given the ever changing landscape of the business market, how do you know if your insurance policies still meet your needs? A regular review of your insurance policies will help protect you against unexpected exposure during an already difficult time of loss.

Any coverage analysis begins by focusing on four general principles. These principles can also be useful before a loss or third-party claim arises. As a preliminary test

of your coverage, ask yourself whether the following questions apply to your situation:

### 1. The Insured.

Is each person and/or business that could be involved in a foreseeable loss or claim listed as an insured in the policy declarations or otherwise included in the policy's definition of "insured?"

### 2. The Subject Matter.

Is the subject matter to be protected, such as certain property, business locations, or business activities, listed on the policy declaration form or described elsewhere in the policy?

### 3. The Peril or Claim.

If your coverage only protects against certain losses or third-party claims, does your policy cover the perils or third-party claims that one would predict in your line of business?

### 4. The Exclusions.

Do the specific exclusions in the policy preclude coverage of these predicted perils or third-party claims?

Although not every loss or claim can be predicted, reviewing and updating proper coverage on a regular basis can go a long way to avoiding the dreaded denial letter. Nevertheless, even when your insurer denies coverage, you may still have a strong claim under your policy. Insurance carriers benefit from retaining your money as long as possible and commonly dispute coverage for as long as they can. If this happens, we can help you assess the strength of your claim. Otherwise, we urge you to act now and check your coverage – as doctors of insurance law, we know that prevention can be the best medicine.

## Getting Paid: How to Protect Your Lien Rights on a Tenant's Construction Project

John Parsons



In Oregon, a contractor doing work for a tenant, as in comparison to the owner, should take steps to ensure that the owner is aware of the work being undertaken by the tenant. When entering into a construction agreement, the contractor should, if possible, seek the contractual participation of the owner. Short of that, the contractor should deliver to the owner a Notice of Right to a Lien, irrespective of whether delivery of such notice would otherwise appear to be required. Completing and delivering this notice will require confirming the address of the property where the construction will occur, as well as obtaining the name and address of the owner.

If a contractor does work for a tenant but fails to put the owner on notice, the contractor may not be in a position, in the event of non-payment by the tenant, to secure payment by filing and foreclosing on a construction lien on the underlying real property. ORS 87.030 provides in relevant part that “[e]very improvement . . . constructed upon lands with the knowledge of the owner shall be deemed constructed at the instance of the owner, and the interest owned shall be subject to any lien perfected pursuant to the provisions [of this chapter].” In other words, if an owner is NOT aware of the construction, the construction is NOT deemed to have been constructed at the owner's instance and is NOT subject to any lien perfected under this chapter!

Further, even if the owner is put on notice by way of a Notice of Right to a Lien, the owner can, under ORS 87.030, post written notice in some

conspicuous place on the land or improvement that the owner will not be held responsible. For purposes of this article, the primary impact of this provision is that if you do not have the participation of the owner of the land and improvement, your lien rights may be undermined.

As a result, the contractor should not only deliver notice of the construction to the owner, but should thereafter monitor the property closely to confirm that no notice of non-responsibility is posted. If such a notice is posted, the contractor should immediately take measures to ensure the capacity of the tenant to pay for the improvements.

We recently litigated a case where the contractor did work for a subtenant. The subtenant failed to pay both the contractor and its landlord (the original tenant). Consequently, a construction lien was recorded, and a lawsuit was filed. If the contractor has a direct or contract claim against the tenant, it may have other forms of leverage in addition to pursuing its lien rights. On the other hand, if the contractor is a subcontractor, it might only have claims against the general contractor and its lien rights. As a general proposition, in pursuing its lien rights, the contractor can only step into the shoes of the tenant, or in this case the subtenant. Under this scenario, foreclosing the lien may provide the contractor with an opportunity to become a tenant. In our case, because of the eviction, the subtenant's interest in resolution was significantly reduced, as it had little to gain by paying on the lien. As a result, the key to securing some form of payment was the ability to pursue the lien claim against the underlying real property. Yet, in order to do so, the owner needed to have responsibility for the work under ORS 87.030. In our case, the owner had leased the property to a national franchise, who then several years later sublet the

property to the delinquent subtenant. Thus, the subtenant and tenant were each aware of the lease, but whether the owner was aware became the critical question.

Assuming the owner claims to have no knowledge of the construction, there are any number of potential avenues to address the problem. For example, a contractor may be in a position to assert that the tenant is the common law or statutory agent of the owner or assert a third party beneficiary claim. However, as a contractor, the clearest way to protect the viability of your lien and to secure payment from the real property is to have a valid construction lien that can be enforced against the owner and not just the tenant. Again, this usually can be accomplished if you know the owner (1) is apprized of the construction because it received your Notice of Right to a Lien, sent registered or certified as required by ORS 87.018, and (2) has not posted a notice of non-responsibility. If such a notice is posted, you can immediately address the need for payment with the tenant before you proceed further.

## Can Your Business Play Favorites When It Comes to Creditors?

Emily Robertson



As a general rule, businesses can give particular creditors preferential treatment. Of course, other legal principles augment this rule, including a rule called the “trust fund doctrine,” which imposes a fiduciary duty on officers and directors of insolvent businesses to hold any business assets in trust for creditors. Under this rule, a business cannot give particular creditors preferential treatment. Fortunately, this restriction arises only when the

insolvent business has closed its doors or is operating with a view towards cessation of operation.

If a business' liabilities outweigh its assets or if the business cannot pay its bills when they become due, then that business is legally insolvent. It is not uncommon for businesses to be legally insolvent at some point in their life cycle. Nonetheless, many businesses are able to rebound to financial stability, a result encouraged by allowing insolvent but operational businesses to treat certain creditors with preference because specialized treatment may be the only way to obtain additional lines of credit. Accordingly, an insolvent but operational business could grant one of its creditors a security interest in existing assets to facilitate a new business loan.

However, once an insolvent business closes its doors or begins operating with a view towards its cessation, it can no longer give such preferential treatment, and is deemed to hold the remaining business assets in trust for all its creditors.

### **Recent Caselaw Threatens Family Partnership/LLC Estate and Gift Tax Benefit**

**Mark Golding**



For several years, estate planners have advised clients to use family limited liability companies or family limited partnerships (collectively, "FLLCs") to plan for the succession of family businesses and investments, to consolidate management of assets, to diversify portfolios and to reduce estate and gift taxes. The estate and gift tax savings derive from discounts applied in valuing FLLC membership interests and from the removal of any post-gift appreciation in the FLLC membership interests from the

donor's estate. These savings can be enhanced by making the gifts over several years to best use the annual gift tax exclusion, currently \$11,000 per donee per year.

Two recent cases may restrict the availability of these benefits. In *Estate of Strangi v. Commissioner*, Mr. Strangi transferred virtually all of his assets into an investment FLLC shortly before his death. Strangi's attorney-in-fact held control over the FLLC's distributions to owners and the FLLC's dissolution required the unanimous consent of Strangi and his four children. The FLLC's distributions tracked the specific cash-flow needs of Strangi and his estate.

After Mr. Strangi's death, the Tax Court disallowed all discounts on Mr. Strangi's FLLC interests and treated him as if he had retained the contributed assets personally until his death. The primary rationale was that Strangi treated the FLLC assets as if he personally owned them, available for his use as needed, and not as assets of a separate business entity with multiple owners. As a secondary basis, however, the Court indicated that, where the FLLC is not an operating business and does not have significant non-family owners, the donor's retention of control (even as only one of several decision-makers) over the FLLC's distributions or dissolution may be enough to subject the full value of the donor's FLLC contributions, without discounts, to estate taxes. This decision is troubling both as to the breadth of its reach and its dismissal of Supreme Court authority to the contrary.

In *Hackl v. Commissioner*, the Hackls formed an FLLC and gifted membership interest to their 21 children and grandchildren. The Hackls then claimed the annual gift tax exclusion on the gifts. Under

the FLLC's operating agreement, Mr. Hackl, as manager, controlled distributions and retained veto power over the other members' ability to cash out their interest. As a start-up company, there was no cash flow to make distributions for several years. Even though the gifts were absolute transfers of equity interests, both the Tax Court and the Seventh Circuit held that the gifts did not qualify for the annual exclusion because they were not gifts of "present interests," as required by the Internal Revenue Code. The courts' analysis was that the Hackls' control over distributions and cash-out rights, combined with the lack of distributions for several years, resulted in the donees receiving no substantial present economic benefit from their FLLC membership interest. Although the *Hackl* decision is troubling, it appears to lay down potential strategies to qualify for the annual exclusions where proper planning is employed.

In light of *Hackl* and *Strangi*, FLLC owners and their advisors should review their FLLCs to plan for any changes necessary to counter the effects of these decisions.

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