An Illinois Law Firm

Getting Down to Business

Heyl Royster
Business & Commercial Litigation Newsletter

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Welcome Letter

Dear Friends,

I am happy to present our latest edition of *Getting Down to Business*, the Heyl Royster Business & Commercial Litigation Newsletter. This edition contains articles addressing four very different topics that demonstrate the wide scope of issues we address in representing our clients.

First, Mark Ludolph suggests answers to some of the major questions faced by businesses attempting to plan for their futures. In "Business Succession Planning 101," he recounts advice provided at an interesting roundtable discussion as to the development of a realistic and sustainable succession plan. Our second article, by Tyler Pratt, is a no-nonsense list of 10 essential take-aways from Illinois' new Limited Liability Company Act. Those considering formation of an LLC, as well as members of existing ones, should pay heed to the new rule, which takes effect on July 1, 2017. With warmer weather—and company-sponsored social events—on the way, Brad Keller's article, "Workers' Compensation for Employer-Sponsored Activities," is welcome advice. Through observations gleaned from Illinois court opinions, Brad provides insight into how social activities may be viewed as compensable under the Workers' Compensation Act. Our final article, by Mike Kokal, tackles the new and exciting topic of Blockchain technology. Not familiar with Blockchain? Fear not! Mike defines this concept and explains how it may well revolutionize how business transactions are conducted for generations to come.

We hope you enjoy this edition of *Getting Down to Business* and encourage you to contact us with questions or suggestions for future editions. We strive to provide news and free educational seminars on topics of interest to the business community. Our attorneys in Peoria, Champaign, Chicago, Edwardsville, Rockford, and Springfield protect the rights of businesses. If you need assistance, whether in business formation and governance, contract formation and enforcement, employment policy development and implementation, or litigation of disputes through trial, we look forward to speaking with you. For more information on our firm and our diverse areas of practice, please see www.heylroyster.com.

John Heil
Vice Chair of the Business & Commercial Litigation Practice Group, Editor

Business Succession Planning 101

By: Mark Ludolph, mludolph@heylroyster.com

This article was adapted from a roundtable discussion presented to the Peoria Chamber of Commerce by Mark Ludolph, Tim Kirk and Ken Davies from Heyl Royster and Mark Dalbey from CliftonLarsonAllen.

A well structured succession plan is critical for businesses that want to survive from generation-to-generation, while seeking to maximize value for the business. Creating an effective succession plan presents a series of specific challenges for closely-held and family owned businesses. Strategic planning, corporate and business organization structure, valuation, tax implications, estate planning, identifying talent, client relations, financing and transactional work all intersect during the succession process.

When should businesses begin succession planning?

There is an old Chinese proverb which states, "The best time to plant a tree was 20 years ago. The second best time is now." While there is no single correct answer for every business, it is important to provide the business with sufficient time to address all necessary considerations as well

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as sufficient time to overcome any unforeseen complications which may arise.

What are the necessary first steps in developing a succession plan?

Businesses need to identify their future objectives and incorporate the succession plan into the business's overall business plan. The first generation (Generation One) needs to determine how the business plan impacts his/her retirement or other financial goals. Obviously, Generation One wants to maximize their return on the value of the business. The second generation (Generation Two) needs to identify the long-term goals of the business and pursue a succession plan which allows the business to achieve those goals. It is vital that the acquisition of the business does not place insurmountable financial restrictions on the business which would prevent it from achieving its long-term goals. The business will want to coordinate these efforts with its accountants, attorneys, lenders and other consultants in order to assure that all necessary stakeholders' interests are protected.

What are potential elements of the plan?

While there is no "one-size-fits-all" approach to succession planning, there are a number of elements which are typically addressed. The Generation Two successors, either from inside or outside the organization, and their roles in the organization need to be identified. The role, if any, that Generation One will play in the ongoing operations needs to be clarified. A determination of the appropriate corporate structure for both the transfer and the ongoing business will need to be made. Ultimately, the necessary elements will need to be included in a buy/sell agreement which sets the price. The timeline for this agreement needs to provide sufficient flexibility for change due to unforeseen circumstances, but also provides sufficient structure to move the succession plan forward.

How should the business be transferred?

There are a number of options available to effectuate the transfer. A sale of the stock may be the simplest. A sale of assets may be more advantageous under certain circumstances. A gift or bequest may be an option, but can be complicated by probate issues. Any sale would involve financing. Third-party financing will necessitate the involvement of a lender early in the process. The lender will likely have a role not only in financing the sale, but also in providing financing to the business for its ongoing operations. Self-financing may also be an option, but will require informed buy-in from both Generation One and Generation Two on the structure of the financing agreement. The tax implications for the transfer will vary depending on the form of the transfer and may make certain options more favorable than others.

Ultimately, succession plans are as varied as the businesses who require them. It is vital that any business pursuing a succession plan consult with its professionals (accountants, attorneys, consultants, etc.) in order to develop a plan which achieves its goals while successfully balancing the sometimes disparate interests of Generation One and Generation Two. The team at Heyl Royster can help you develop a succession plan or review and advise you on an existing succession plan.

Mark Ludolph is Co-chair of Heyl Royster's Business and Commercial Litigation Practice. He focuses his practice in commercial litigation and represents commercial lenders, financial institutions and other creditors in enforcing secured and unsecured claims in the state and federal courts.

10 Things Limited Liability Companies Should Know about the New Limited Liability Company Act

By: Tyler Pratt, tpratt@heylroyster.com

The Illinois Limited Liability Company Act (Act) recently underwent a significant overhaul. Although Public Act 99-0637 does not take effect until July 1, 2017, the magnitude of the changes warrant an early review and both well-established LLCs and those still being conceived should take time to contemplate the impact of the revisions. Here are 10 of the most substantial changes.

1. **Oral and implied operating agreements are now recognized.**

Previously, oral and implied operating agreements were not explicitly recognized by the Act. The best practice is still to have a written operating agreement. This revision may not always protect members, since courts may not always find that an oral operating agreement exists, but it gives those who have failed to draft an operating agreement an alternative avenue for asserting their rights.

2. **LLCs are now member-managed unless the operating agreement specifies otherwise.**

Both member-managed and manager-managed LLCs are still recognized, but unless the operating agreement expressly provides that an LLC is manager-managed, or that the management of the company is vested in its managers, the default is to treat the LLC as member-managed.

3. **The Act clarifies the procedures when a member wants to inspect and copy records.**

Under the Act, a company shall furnish information concerning the company's activities, financial condition, or other circumstances of the company's business necessary to properly exercise a member's rights under the operating agreement or the Act upon member demand. If the company knows, however, that the member already knows the information, the company does not need to honor the demand. Under the Act, when a written demand is made, the company shall provide the information within 10 days after receiving it. If the company cannot comply with the deadline, it must provide a description of the information the company will provide and state the time and location in which it will be provided. If the demand is denied, the company must do so in writing. The company may still charge the person reasonable costs of copying. The Act also clarifies that a member or dissociated member can exercise these rights. Whenever a dispute arises concerning the reasonableness of a restriction or designation, the company bears the burden of proving reasonableness. A transferee is not entitled to inspect records.

4. **A member is no longer an agent of the LLC solely by reason of being a member.**

This new requirement does not prevent or restrict a member from acting as the LLC's agent, but limits the impact. Previously, each member was an agent of the LLC for purposes of the company's business. Additionally, an LLC may deliver to the Secretary of State a statement of authority which identifies the member or manager of the company authorized to execute instruments transferring real property or other transactions on behalf of the company.

5. **Except for the duty of care, fiduciary duties can be eliminated and altered.**

The operating agreement may now eliminate or reduce a member's fiduciary duties. Previously, the LLC Act did not allow the operating agreement to eliminate or reduce a member's fiduciary duties. That provision has been removed, allowing a member's fiduciary duties to be eliminated or reduced. The operating agreement may not, however, eliminate or reduce the obligation of good faith and fair dealing and it may not restrict or eliminate the duty of care. The operating agreement can establish the standards by which a member's duties or rights are to be measured. The elimination of any other fiduciary duties must be clear and unambiguous within the operating agreement. The operating agreement may not authorize intentional misconduct or a knowing violation of the law. The operating agreement may identify specific types or categories of activities that do not violate any fiduciary duty and may specify the method by which a specific act or transaction that would otherwise violate the duty of loyalty may be authorized or ratified after full disclosure of all material facts.

6. **The operating agreement may provide for remedies and consequences for a member's failure to make contributions.**

The Act now allows an operating agreement to specify the consequences for a member's failure to make required contributions. Those consequences include, without limitation: the loss of voting rights, the loss of the right to participate in the management or operating of the LLC, liquidated damages, the reduction or dilution of a member's proportionate interest, the subordination of the member's rights to receive distributions, a forced sale of the member's interest, the adjustment of the interest rates for non-defaulting members, and the fixing of the value of a defaulting member's interest by an appraisal or other formula.

7. **A creditor's charging order now constitutes a lien on distributional interests and transfer of distributional interests.**

A charging order by a creditor now constitutes a lien on the judgment debtor's distributional interest and requires the LLC to pay over the debtor's distributional interest to the creditor. No other rights, however, are granted to the creditor. Consequently, the Act also provides that the transfer of a distributional interest alone does not require dissolution.

8. **Dissolution is not always necessary.**

The Act now specifically provides that a court may order a buyout of an applicant's membership interest when the applicant has petitioned for relief due to alleged illegal, oppressive, or fraudulent conduct by the LLC's managers or controlling members. Additionally, even if there are no members, an LLC may now continue to exist, so long as the legal representative of the last remaining member files an agreement to continue the LLC within one year after the event that caused the dissociation of the last member. In that instance, the legal representative is admitted as a member and the company will not be dissolved until a future event of dissolution occurs.

9. **Dissociation does not relieve or discharge a member's obligations.**

Under the Act, a person's dissociation alone does not discharge the person from any debt, obligation, or other liability owed to the company which the member incurred while a member.

10. **The Act now provides a detailed procedure for converting and domesticating an LLC.**

The Act now provides the procedures for conversion and domestication. When a company is converted, it changes its structure either from a non-LLC to an LLC or vice versa. Domestication on the other hand occurs when an LLC established under another state's law becomes an LLC under Ilinois' laws and vice versa. In general, conversion and domestication are permitted so long as the applicable statutes permit such action and not prohibited by the laws of the U.S., Illinois, or other governing states.

Conclusion

Preparing and amending operating agreements is a very complex process and can result in unintended consequences if not done properly. The new ability to have an oral and implied operating agreement complicates this situation. It is important to consult with counsel to assure that your rights are protected and that your operating agreement functions in the manner desired.

Tyler Pratt concentrates his practice in the area of civil litigation, including: professional liability, tort litigation, Professional Regulation/Licensure, truck and commercial transportation litigation, estate litigation, and estate planning, including powers of attorney, probate administration, and wills.During law school, Tyler worked as an extern for Federal Judge Rudolph T. Randa in Milwaukee, Wisconsin, the U.S. Attorney's Office in Hammond, Indiana, and the City of South Bend.

WORKERS' COMPENSATION FOR EMPLOYER-SPONSORED ACTIVITIES

By: Brad Keller, bkeller@heylroyster.com

Summer is a popular time for businesses to sponsor employee sports teams or host company picnics or events. Accidental injuries are always a possibility with such activities. It is important for businesses to be aware that, depending on the circumstances of the activity, there is a possibility of workers' compensation liability for an injury to an employee that occurs during such an activity.

General Rule

Section 11 of the Workers' Compensation Act provides the rule for whether an injury at a company event is compensable. Section 11 states: "[a]ccidental injuries incurred while participating in voluntary recreational programs including but not limited to athletic events, parties and picnics do not arise out of and in the course of the employment even though the employer pays some or all of the cost thereof." Thus, the rule that determines the compensability of such an injury is whether participation on the team or in the event is voluntary.

Despite the relatively clear language of Section 11, there are numerous cases in Illinois interpreting whether participation on a team or attendance at an event is voluntary. Below are seven cases that provide examples of Illinois courts' analysis of this issue.

Representative Cases

***Gooden v. Industrial Comm'n*, 366 Ill. App. 3d 1064 (1st Dist. 2006) – Injury Not Compensable**

An employee was injured while playing volleyball at a company picnic. Employees had the option of working a half-day and attending the picnic or working a full day and not attending. Attendance was encouraged, but was not mandatory. Employees attending were paid their full salary. The employee's injury was not compensable because his participation was voluntary. The court relied on the fact that the employer had not ordered or assigned him to attend the picnic. Additionally, the picnic was merely an alternative to the normal work day, with non-attending employees not facing the prospect of losing a personal day or pay.

***Pickett v. Industrial Comm'n*, 252 Ill. App. 3d 355 (1st Dist. 1993) – Injury Not Compensable**

A sheriff injured his knee while playing basketball on his department's basketball team. The sheriff admitted that he voluntarily played on the team. The facts showed that the department exerted a lot of control over the team, with another sheriff in charge of the team and the department providing the uniforms. The department also paid regular salary for any games that occurred during working hours. Despite these facts, the injury was not compensable because the sheriff's participation was completely voluntary. The court explained that an employer's control was not, of itself, sufficient to support compensability independent of proof of an employer's assignment or direction to participate in the activity.

***Kozak v. Industrial Comm'n*, 219 Ill. App. 3d 629 (1st Dist. 1991) – Injury Not Compensable**

An employee died of a heart attack while playing in a tournament to determine a team from his company to play in a national corporate tennis tournament. A fellow employee was in charge of organizing the tournament. The employer agreed to pay the fees and expenses for the national tournament qualifiers and agreed it would not deduct any wages or salary for the time spent there. However, both parties agreed that the participation was voluntary. On this basis, the injury was not compensable.

***Outdoor v. Illinois Workers' Compensation Comm'n*, 2013 IL App (1st) 121418WC-U – Not Compensable**

An employee was injured at a bowling charity event hosted by her employer. Participation in the event was not mandatory, but was highly encouraged. The employer closed the office early for those who chose to participate in the event and did not deduct pay for attendees. The employer paid for the bowling shoes and lane rental. Those who did not attend were not penalized in any way. The court found that the injury was not compensable because the event was merely an alternative to the employees' regular workday. From these facts, it found the employer had not ordered attendance.

***Auto-Trol Technology Corp. v. Industrial Comm'n*, 189 Ill. App. 3d 1065 (1st Dist. 1989) – Injury Compensable**

An employee was injured while riding a motorcycle provided for use by the host of a company party. The event was designed to bring together two departments that had issues between them. The employee had asked a manager if he needed to attend and was told that it "would serve his career very well if he attended." There were a lot of business discussions at the event. This injury was found to be compensable. The court found that there was a clear business emphasis to the event and that attendance was mandatory, despite the fact that the manager had not told the employee that he was required to attend.

***Law Offices of William W. Schooley v. Industrial Comm'n*, 151 Ill. App. 3d 1069 (5th Dist. 1987) – Injury Compensable**

A law clerk was injured while playing on a softball team sponsored by his employer. The law clerk claimed that his duties at work included managing the team. He was allowed to use firm resources to handle business for the team and was allowed to leave work early for practice without any reduction in pay. The clerk's employer would attend games and would buy beverages for the team following the game at a tavern, where he received several referrals. The court determined this was a compensable injury. The court found that the clerk's participation was more than "mere cooperation" given that he was directed to manage the team and did not lose pay for his time spent managing.

***Woodrum v. Industrial Comm'n*, 336 Ill. App. 3d 561 (4th Dist. 2003) – Injury Compensable**

Woodrum was injured while playing basketball at a company event hosted by his employer. The event was held on a work day. Employees could attend the picnic and be paid, take a vacation/personal day and be paid, or do neither and not be paid. The court determined the injury was compensable, explaining that by forcing employees to choose between attending the company picnic or giving up a benefit, the employer had essentially ordered attendance.

Conclusion

Despite the relatively clear rule provided in Section 11, the issue of whether an employee's participation in an employer-sponsored activity or event could expose an employer to workers' compensation liability can be a difficult, fact-intensive question to analyze. If your company has any questions regarding its company-sponsored events, it is recommended that legal counsel be contacted.

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THE COMING BLOCKCHAIN DISRUPTION: TRUST WITHOUT THE "MIDDLE-MAN"

By: Mike Kokal, mkokal@heylroyster.com

Business and trade run best when there is trust, certainty, and transparency surrounding transactions. When humans traded in hunter gatherer economies or small villages, trust was enforced by social constraints or reputation. You knew who you were dealing with. When trade expanded outside villages and grew more complex, institutions developed. These institutions functioned as "neutral authorities" in which both parties to the transaction had some degree of confidence. In other words, you may not trust the person you were trading with, but you did trust that if they did not fulfil their obligation, a government, police, legal system or other "middle-man" might step in and enforce the trade. Indeed, the late Nobel laureate economist Douglass C. North wrote that these "institutions" were specifically created "to create order and reduce uncertainty in exchange." Now, with the promise of Blockchain technology, we have the potential to enforce trust in business—without the "middle-man."

What exactly is a Blockchain? At its core the Blockchain is a peer-to-peer decentralized database that stores a registry of assets and transactions. Think of it like "triple entry accounting." In traditional double entry accounting, the seller enters a debit in their accounting ledger for cash received, while the buyer books a credit for cash spent for the same transaction. Each party maintains separate books, but placed side by side, the bookkeeping entries of both parties should line up. In a Blockchain, rather than the parties generating entries in separate records, the details of transaction get automatically coded into blocks of data that are cryptographically linked together with other transactions and secured over a network. The linked chain of data blocks forms an incorruptible record of all the transactions that can be replicated on every computer that uses the network. On the Blockchain, you can store not only the debits and credits of the transaction, but other information such as history of ownership and location, title, contracts, real world objects—and even personal information.

Perhaps the most currently used Blockchain technology is the virtual currency Bitcoin. However, according to a 2016 research report from Credit Suisse, there is an "increasingly consensus view" that it is Blockchain, not Bitcoin, which may disrupt institutions like law, banking, real estate, accounting, media, and intellectual property because of its three key properties: "disintermediation of trust, immutable record, and smart contracts."

"Disintermediation of Trust"—Blockchain technology provides a more efficient and secure transaction not possible before the internet. Take the example of land title. Currently, county recorders and title companies are necessary to verify and record property data with brokers, escrow companies, appraisers, notaries and other middlemen involved in verifying a process that can be slow and tedious. With a Blockchain protocol in place, instead of a paper title, a digital title could be created—a cryptographically secure token that can be transferred as quickly and cheaply as an email. A unique and cryptographically secure "digital ownership certificate" could be created that would be virtually impossible to replicate or forge, making selling or advertising properties you don't own almost impossible-and if you think that this is the stuff of the future, think again, because a number of countries including the Republic of Georgia, Ghana, and Honduras are already experimenting with it.

"Immutable Record"—Going back to our accounting example, because the entries in a Blockchain are distributed and cryptographically sealed, falsifying them, destroying them, altering them or concealing them is practically impossible. Instead you have a detailed audit trail without the need of a third party auditor.

"Smart Contracts"—Blockchains could allow programmers to write code creating binding contracts between individuals that are self-executing without the need of third party enforcement. The classic example envisioned by Nick Szabo was a leased car, recorded as a smart-contract on a Blockchain. If the lease payment were missed, the contract could automatically revoke the digital right to use the car. Purchase contracts could be programmed to release funds only when the goods are received in a satisfactory condition. Smart cars could automatically release funds for parking meters, not to mention for parking violations. The possibilities are limitless and depend on the coder's ability to reify legal principles into self-executing algorithms.

Perhaps, the most salient promise of Blockchain technology is the potential to return humanity back to the trust and transparency of transactions based on reputation-not mediated by third parties whose interests may not be congruent with our own. We currently purchase products-not the story behind the products. We buy our clothes from chains where people work in conditions that may be abhorrent to our sensibilities if our purchase was not mediated and kept at a distance by an opaque scheme of "middle-men." With Blockchain, you could see the whole transaction and supply chain history of how a product came to be. If you drink a cup of coffee, you can start tracing from the farmer who actually harvested the coffee beans to the person who ground it-you can see the fully story behind everything you buy. And likewise, they may be able to see us.

(For Further information on Blockchains, please see the article Mike published on the same subject in the January 2017, Springfield Business Journal)

Mike Kokal has wide-ranging trial experience in professional liability, products liability, commercial litigation, and intellectual property. He is a licensed attorney with the United States Patent and Trademark Office.

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