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SETTLEPOU
ATTORNEYS ▪ COUNSELORS

3333 LEE PARKWAY, EIGHTH FLOOR, DALLAS, TEXAS 75219
TEL: (214) 520-3300, FAX: (214) 526-4145
WWW.SETTLEPOU.COM

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The New Franchise Tax: Crisis or Opportunity?

By Jeffrey J. Porter & Michael S. Byrd

In record time for the Texas Legislature, the Texas business tax was overhauled for reports due on or after January 1, 2008. Under a deadline imposed by the Texas Supreme Court to implement a school property tax rate reduction plan, House Bill 3 was moved through the Legislature quickly. The aftermath of the new franchise tax leaves more questions than answers for tax advisors and business and real estate attorneys. For example, the new tax is crafted such that a strong argument can be made that a limited liability partnership is not subject to the tax. Though the Legislature has already attempted to clarify its intent that limited liability partnerships are subject to the tax, even the clarification was made poorly and leaves practitioners scratching their heads as to how to counsel clients.

For perspective, the current franchise tax applies to limited liability companies and corporations. The tax is the greater of (1) 4.5% of adjusted federal taxable income plus officer and director compensation or (2) .25% of the company's adjusted net worth.

> "The Chinese use two brush strokes to write the word 'crisis.' One brush stroke stands for danger; the other for opportunity. In a crisis, be aware of the danger - but recognize the opportunity."
>
> **John F. Kennedy**
> *Speech in Indianapolis*
> *April 12, 1959*
> *35th President of the United States*
> *1961-1963 (1917 - 1963)*

On the other hand, the new tax applies generally to all filing entities with the Secretary of State. The broader scope will notably capture for the first time limited partnerships and entities providing professional services (i.e., doctors, lawyers, and accountants). While there is a higher level of complexity to arriving at the taxable amount, the new tax is based upon total revenue with an allowance to deduct either cost of goods sold or compensation. The taxable amount will usually be taxed at a rate of 1% (wholesale and retail sellers may be subject to .5%).

While there are certainly challenges to planning around this new law and the legislature probably will modify aspects of the new law in its next session, the potential crisis is that most entities will be impacted beginning January 1, 2007 (i.e., revenues from 2007 will be used to calculate 2008 franchise taxes).

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Attorneys:

- Bradford E. Adatto
- Sayuri Beltran
- Michael S. Byrd
- Scott J. Conrad
- Marsha L. Dekan
- Brian P. DeVoss
- J. Garth Fennegan
- Don Gwin
- Barry D. Johnson
- Katherine L. Killingsworth
- Norman H. Kinzy
- Oliver B. Krejs
- Bradley E. McLain
- Michael P. Menton
- Kelly J. Middleton
- Carl W. Morgan
- Jeff Mosteller
- David M. O'Dens
- Jeffrey J. Porter
- Robert L. Pou III
- Sharon Reuler
- John D. "Jay" Settle
- J. Allen Smith
- James M. Stanford
- Michael R. Steinmark
- Steven M. Thomas
- Daniel P. Tobin
- Cliff A. Wade
- C. Russell Woody

The New Franchise Tax: Crisis or Opportunity?

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Jeffrey J. Porter

Areas of Practice:

Acquisitions and Divestitures; Business Entity Creation; Commercial Leasing; Commercial Property Development; Resort and Golf; and Condominium Development

Michael S. Byrd

Areas of Practice:

Health Law; Private Business; Private Business - Technology; Private Business - Mergers and Acquisitions; Business Litigation; and Condemnation Law

However, there are also opportunities for tax and business model planning to minimize the impact of the new franchise tax. For example, the following are preliminary considerations that should be evaluated:

Entities investing in Texas real estate should evaluate whether it is appropriate to invest as a limited liability company rather than the traditional limited partnership.

Family limited partnerships ("FLPs") may be able to avoid the tax altogether if they meet the criteria to be a passive entity. It is important to evaluate the operations and investments of these FLPs to ascertain whether they will be subject to the tax (or whether adjustments can be made to avoid being subject to the tax).

Combined reporting is required for affiliated businesses that are engaged in a unitary business. The business model of affiliated entities should be evaluated to determine whether the entities are subject to combined reporting and, if so, whether there is a way to restructure and avoid this requirement.

Businesses should evaluate whether their existing model minimizes federal income taxes and payroll taxes. Whether by reorganizing the business model or re-characterizing the flow of money, there may be opportunities to minimize these other taxes (and thus minimize the impact of the new franchise tax).

Some businesses, whether through inefficient planning or otherwise, may have been paying significant franchise taxes under the current franchise tax. With proper planning, the new law may offer opportunities to actually reduce their future franchise tax obligations.

Because the impact of an entity's tax liabilities are largely predicated on (1) the business model and (2) the characterization of the flow of money, it is important that both the tax advisors and business attorneys work together in designing a tax efficient business model.

If you would like to evaluate your business model and develop a tax planning strategy with your tax advisors, please contact Jeff Porter, Chair of our Real Estate Section, for real estate entities at jporter@settlepou.com or Michael Byrd, Chair of our Business Counsel Services Section, for other business entities at mbyrd@settlepou.com. Both Jeff and Michael may also be reached at (214) 520-3300 and additional information may be obtained at www.settlepou.com .

Some businesses, whether through inefficient planning or otherwise, may have been paying significant franchise taxes under the current franchise tax. With proper planning, the new law may offer opportunities to actually reduce their future franchise tax obligations.

Eminent Domain Negotiations: Can the Government Force One Property Owner to Negotiate with Another?

By J. Allen Smith & Michael R. Steinmark

It has become common practice for government agencies in Texas to farm out to third parties the government's duty to make offers to all property owners in eminent domain cases. While concerns with this practice, including its legality, will be left for another article, this article will address a related practice that is equally troublesome—the frequent attempts by those government agency designees to force property owners to do the government's job.

Specifically, government agencies' third-party representatives are seeking to negotiate pre-condemnation purchase of a parcel by determining the value of the dominant estate and offering that sum to the dominant estate owner only. That offer is made on the assertion that it is the dominant owner's responsibility to dispose of all other real property interests in the parcel, and that offers need not be made by the condemning authority to the owners of those other interests. The government agencies support this practice. The law, however, does not.

Under Texas condemnation law, a condemning authority must make a bona fide offer to each owner of a real property interest in the parcel to be taken as a prerequisite to instituting condemnation proceedings under the Texas Property Code. "Owners" in this context include landowners (i.e., fee owners), lessees, and easement owners, among others. If the condemning authority makes a bona fide offer to one of several owners but is unable to agree on a price for the purchase of that owner's interest, negotiations with other owners are deemed futile, and the condemning authority may institute condemnation proceedings without making offers to the other owners.

But if negotiations with the first owner do not prove futile: i.e., if the first owner accepts the sum offered, the condemning authority must go on to make offers to all other owners until either all of the owners have agreed on prices for their interests, or negotiations have become futile. This duty to negotiate with other owners accrues to the condemning authority alone, and not to any owner. The condemning authority has no right to force one owner to negotiate with the other owners on behalf of the government. That is the government's job, not the owner's.

The government has a superpower. It can do what no one else can do — take property against the owner's will. But the 5th Amendment to the U.S. Constitution, Article I § 17 of the Texas Constitution, and the Texas Property Code, both separately and collectively, place protections on this power for the benefit of the property owners. When taking property, the government must ensure it adequately compensates all of the owners of that property for their loss, including both the owner of the dominant interest and the owners of all other interests. A government agency cannot absolve itself of this duty by attempting to shift its obligations to one of the property owners.

If you have any questions or comments regarding eminent domain negotiations, please feel free to contact J. Allen Smith of SettlePou at asmith@settlepou.com or at (214) 520-3300.

J. Allen Smith

Michael R. Steinmark

Meet Your Lawyers:

H. Norman Kinzy

H. Norman Kinzy

Areas of Practice:

Aviation; First-Party Insurance Claims; Insurance Coverage Litigation; Insurance Subrogation; Third-Party Liability Claims; and Business Litigation

Hometown:
Dallas, Texas
College:
Texas Tech
Law School:
University of Texas - Austin
Family:
Wife, Polly; son, Christopher; and daughter, Claire

Personal Favorites

Food:
Seafood
Drink:
Tea; Propel
Hobby:
Collecting antique edged weapons
TV Show:
Fox News; 24
Old Movie:
Midway; old WWII movies
Recent Movie:
Shakespeare In Love
Book:
FDR's Secret War; Decker
Music:
Andrew Lloyd Weber
Vacation:
Egypt
Sport:
Jogging; hunting
Sports Team:
Dallas Cowboys

What do you consider as the most important qualities of a good lawyer?
Competence and integrity.

Meet Your Legal Support Team:

Deborah Offenhauser

Deborah Offenhauser

Position:
Legal Assistant
Hometown:
Houston
Education:
Stephens College
Columbia, Missouri
Family:
Daughters, Christa and Kimberly; four sisters and two brothers

Personal Favorites

Food:
Mexican
Drink:
"Ritas"
Hobby:
Interior Decorating; Gardening; Dogs and Horses
TV Show:
Design on a Dime
Old Movie:
The Ghost and Mrs. Muir
Recent Movie:
An Unfinished Life
Book:
To Kill a Mockingbird
Music:
Country
Vacation:
Blue Lake Ranch, Colorado
Sport:
Football
Sports Team:
Dallas Cowboys

A native, lifetime Houstonian, Deborah "moved up" to the Big D when she joined Barry Johnson's foreclosure team in 2004. Deborah enjoys spending time with her girls and traveling to Colorado and Austin and eagerly awaits the birth of her first grandchild.

Physicians' Compliance Plans: A Means for Combating Fraud and Abuse and Increasing Reimbursements

By Bradford E. Adatto

Recent Federal Initiatives

In May of 2006, an osteopath practicing in Texas was sentenced to ten years in prison and ordered to pay $47.9 million in restitution for health care fraud for signing preprinted prescriptions for $250 per prescription. In July of 2006, pursuant to a whistleblower action, a hospice provider paid $12.9 million to settle allegations that the company submitted false claims to Medicare over a four-year period. Also in July of 2006, Tenet agreed to pay more than $900 million to resolve false claims allegations involving Tenet's billing practices, which included billing for services and supplies that were not provided.

In addition to these recent fraud and abuse announcements, the federal government has issued a new ruling on restrictions on joint ventures and reimbursements. In March of 2006, the Department of Health and Human Services Office of Inspector General ("OIG") issued Advisory Opinion No. 06-02, which found a durable medical equipment ("DME") manufacturer's proposed business venture with a physician problematic, even though one of the programs would only involve non-federal program patients. In April of 2006, the Center for Medicare and Medicaid Services ("CMS") proposed sweeping reform to the Hospital Inpatient Prospective Payment System ("Inpatient PPS"), which will significantly impact the reimbursements of physician-owned specialty hospitals. Also in April of 2006, the OIG issued its first "Open Letter" since 2001 to health care providers, announcing a new initiative to promote the use of the Provider's Self-Disclosed Protocol to resolve civil monetary penalty ("CMP") liability under the physician self-referred law and the Anti-Kickback statute for financial arrangements between hospitals and physicians. Finally, starting in January of 2007, diagnostic and therapeutic nuclear medicine services and supplies will be considered designated health services ("DHS") under Stark law. Thus, joint ventures or similar investment vehicles for imaging centers that were developed around positron emission tomography ("PET") services must now meet an applicable Stark exception to ensure compliance.

These recent announcements and rulings demonstrate that the federal government has refocused itself on limiting the types of business ventures that a physician may participate within, the amount of reimbursements a physician can expect to be paid, and how a physician is to disclose conduct that may be subject to CMP liability. Further, these recent initiatives indicate that providers ranging from solo practitioner physicians to large hospitals are being prosecuted for regulatory violations.

As a result, these initiatives are squeezing the already tight reimbursement market and the types of business ventures that physicians may enter into, and have once again propelled the need for physicians to strongly consider customizing compliance programs for their practices.

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Bradford E. Adatto

Areas of Practice:

Health Law - Compliance; Peer Review and Credentialing; Asset Protection Planning; Private Business - Mergers and Acquisitions

Physicians' Compliance Plans: A Means for Combating Fraud and Abuse and Increasing Reimbursements ...Continued from page 5

Your Compliance Plan

The medical industry has been bombarded over the last few years with compliance guidelines issued by the OIG through the Department of Health and Human Services ("DHHS"). In the healthcare industry, an effective compliance program can (1) reduce fraud and abuse, (2) improve quality of care, and (3) reduce the costs of healthcare. A compliance plan is not just about proper coding for medical procedures. A compliance plan details policies and procedures, regularly educates and trains employees, and audits and reviews corporate business practices. A compliance program should be customized to the industry and size of the business. Complex multiple page compliance programs for a two-person practice would not be effective. Buying a generic compliance manual that sits on a shelf is also not effective.

Most importantly, a compliance plan can help avoid or mitigate legal action and civil and criminal penalties. In the medical industry, a compliance plan will reveal billing errors and other questionable practices while helping with reimbursements. A compliance plan will also help minimize the risk of being subjected to *qui tam* suits (also called whistleblower actions) by designing proper channels for employees to disclose billing and compliance errors to the medical practice prior to filing suit on the government's behalf. In addition, if necessary, the compliance plan will provide the proper protocol for the medical provider to disclose to the federal government. Each compliance plan should be tailored to the scope and needs of each medical provider's practice.

To better understand how a compliance plan could work for you, feel free to contact Michael S. Byrd (mbyrd@settlepou.com) or Bradford E. Adatto (badatto@settlepou.com) of SettlePou at (214) 520-3300.

Cliff A. Wade

Areas of Practice:

Commercial Bankruptcy; SBA Liquidation, Asset Recovery, Lender Liability, and Loan Workouts and Restructuring

Commercial Bankruptcy: Protecting a Lender's Collateral Rights at the Beginning of a Chapter 11 Bankruptcy Case

By Cliff A. Wade

A borrower has decided it can't make it without the protection of the Federal courts and, with or without warning, files a Chapter 11 bankruptcy to attempt a business reorganization through the bankruptcy process. The lender is secured by the borrower's inventory and accounts receivable. The loan payments stop, and the lender's rights to pursue collection are automatically stayed pending further court order. What is the first issue the lender should address?

After a bankruptcy is filed, the proceeds of a lender's collateral are called "cash collateral," and are defined in Section 363 of the Bankruptcy Code. The bankrupt debtor may not use cash collateral without the lender's consent or a court order authorizing its use. 11 U.S.C. 363(c)(2).

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Commercial Bankruptcy: Protecting a Lender's Collateral Rights at the Beginning of a Chapter 11 Bankruptcy Case ...Continued from page 6

Common examples of cash collateral are monies or accounts derived from a debtor's sale of inventory, collections on accounts receivable, and lease payments on the lender's real property collateral. The issues with use of the cash collateral arise in the beginning of a bankruptcy when a bankrupt debtor is cash poor and needs to use the cash collateral to pay expenses necessary to stay in business.

To illustrate–a Chapter 11 debtor files a cash collateral motion with the bankruptcy court, often on the first day of the bankruptcy case, so that the debtor can make payroll, buy additional inventory, pay ongoing utility bills, pay insurance premiums, and pay other expenses necessary to stay in business. On the same day, the court enters an interim order (often good for 15 days) and sets a follow-up hearing at the expiration of the interim order so that the debtor can give sufficient notice to all interested parties of the hearing date and provide opportunity to object and appear at the hearing. The interim order will likely include a budget for the debtor's use of cash collateral during the 15-day interim period. The debtor will then notify its secured lender of the motion and press for an agreement for the use of the cash collateral.

This is the lender's first opportunity in a bankruptcy case to set the course of the proceedings with respect to the secured lender's rights. At this early stage of the case, the critical terms of a cash collateral order will include a budget for the debtor's operations during the bankruptcy case and post-petition liens on the debtor's assets. Without these provisions, the lender's liens will not attach to the debtor's post-petition inventory and other asset purchases, even if the purchases are made with the lender's cash collateral. The lender can also take this opportunity to negotiate for several other provisions to further secure and protect the lender's rights in the proceedings. For instance, the lender may negotiate the following provisions:

- Adequate protection payments or additional collateral. Depending on the lender's collateral, a potential decrease in its value resulting from use of its cash collateral during the case may justify such payments or additional collateral.
- Agreement to the balance of the indebtedness and treatment of the lender's claim as fully secured in debtor's plan of reorganization, with a valid and enforceable security interest.
- Case deadlines for filing and confirming debtor's plan of reorganization.
- Access to collateral and debtor's books and records for inspection or appraisals.
- Additional financial reporting beyond that required by the Bankruptcy Rules and Code.
- Insurance on the lender's collateral.
- Conditioning of the automatic stay to terminate if the debtor defaults under the order.
- Other agreements to assist the lender in evaluating the debtor's business operations and protecting the lender's collateral.

Bankruptcy courts are reluctant to deny a debtor's request for use of cash collateral since such denial will usually result in a debtor's business being shut down and conversion of the case to a Chapter 7 liquidation bankruptcy. But if a debtor files a bankruptcy case in bad faith, or takes some other egregious action, a lender is justified in opposing the debtor's motion for use of cash collateral.

Chapter 11 proceedings move quickly in the first several weeks of the case. Thus, it is imperative that a secured lender seek immediate legal advice in order to fully protect its position.

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For more information, contact Cliff A. Wade of SettlePou at (214) 520-3300 or cwade@settlepou.com.

Recent Insurance Cases of Note

By H. Norman Kinzy

During the past three months, the following cases have been decided by the Texas Supreme Court which are of interest to the insurance industry.

- Insurance - prompt payment of claims

In *Minnesota Life Insurance Co. v. Vasquez*, 49 TSCJ 484 (Tex. April 7, 2006), the Supreme Court held that a mortgage life insurer was not liable for delaying payment under a mortgage insurance policy while it demanded hospital records in order to fully explain the death certificates. In this case, the policy provided coverage if "death results directly and independently of all other causes… from an accidental injury."

The medical examiner's certificate and the death certificate both stated that the cause of death was "an accident" in which the deceased struck his head, but also listed the cause of death as "seizure disorder with encephalopathy followed by blunt force trauma to the head."

Because of the wording of these latter two documents, the Supreme Court held that it was "not reasonably clear" that coverage existed under the policy for the death of the insured and stated that:

"We agree that when coverage is not reasonably clear, an insurer cannot sit on its hands or draw out an investigation to keep things that way. Under the Insurance Code, an insurer that fails to pay claims promptly must pay for actual damages it causes as a result. But payments beyond that cannot be based on negligence or hindsight; there must be evidence that the insurer was actually aware that it was handling the claim in a way that was false, deceptive, or unfair. [absent such evidence…,] the lower courts erred in awarding extra-contractual damages." *(Bracketed material added.)*

- Non-Subscriber Workers Compensation - Plaintiff's Burden

In *The Kroger Co. v. Billy Elwood*, 49 TSCJ 623 (Tex. May 12, 2006), the Supreme Court dealt with a non-subscriber workers compensation case wherein an employee sued his employer for injuries received when a customer shut her vehicle door on the employee's hand as he was transferring items from a grocery cart to the customer's vehicle. Despite a jury verdict in favor of the clerk, the Supreme Court reversed, holding that the employee had failed to prove a duty and negligence on the part of the employer, as is required in non-subscriber cases. The court ruled that although an employer has a duty to use ordinary care in providing a safe work place, which can include a duty to warn of hazards, an employer "owes no duty to warn of hazards that are commonly known or already appreciated by the employee," and the employer has "no duty to provide equipment or assistance that is unnecessary to the job's safe performance."

- Commercial General Liability Policy Coverage - For "Additional Insured"

In *Evanston Insurance Company v. Atofina PetroChemical Inc.*, 49 TSCJ 589 (Tex. May 5, 2006), the Supreme Court dealt with the scope of insurance coverage that was provided to a third party "additional insured" under a "following form" excess insurance policy, where the primary CGL policy excluded coverage for the sole negligence of additional insured.

The Court held that despite the language of a separate contractual indemnity agreement between the additional insured and the policies' named insured, that the policy language in the excess policy excluded coverage for the additional insured's sole negligence.

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Recent Insurance Cases of Note ...Continued from page 8

- Malicious Prosecution/ Intentional Infliction of Emotional Distress

In *Kroger Texas Limited Partnership, et al. v. Suberu*, 49 TSCJ 592 (Tex. May 5, 2006), the Supreme Court recognized that a private citizen has no duty to investigate a suspect's alibi or explanation before reporting a crime, and that in a malicious prosecution case resulting from suspected shoplifting, the alleged shoplifter/civil plaintiff has the burden "to produce evidence that the motives, grounds, beliefs, or other information upon which [the defendant] acted demonstrate that it did not reasonably believe [the plaintiff] was guilty of shoplifting." *(Bracketed material added.)*

The Supreme Court further held that although the alleged shoplifter/civil plaintiff undoubtedly suffered embarrassment and emotional distress, that no cause of action was available for intentional infliction of emotional distress, absent evidence that the defendant "intentionally subjected her to such distress, knowing that she was innocent."

- Legal Malpractice - Claims Against Estate Planners

In *Belt v. Oppenheimer, Blend, Harrison & Tate, Inc*. 49 TSCJ 598 (Tex. May 5, 2006), the Supreme Court revisited the issue of legal malpractice in the area of estate planning, despite its earlier decision that beneficiaries cannot sue a decedent's estate planning attorney because of lack of privity. In Belt, the Supreme Court held that "legal malpractice claims alleging pure economic loss survive in favor of a deceased client's estate, because such claims are necessarily limited to recovery for property damage," and that the estate's personal representative, as opposed to a beneficiary of the estate, has a cause of action against an estate planning attorney for legal malpractice to recover damage suffered by the estate.

- Recreational Use Statute - Liability of Landowners and State of Texas

In *The State of Texas v. Shumake*, 49 TSCJ 769 (Tex. June 23, 2006), the Supreme Court considered the effect of our recreational use statute on a premises liability claim against the State, interpreting both Texas Tort Claims Act with the Recreational Use Statute. The court held that although the Recreational Use Statute provides that a landowner, who allows the recreational use of his land, does not assure that the premises are safe for that purpose, nor owe to the user a greater degree of care than is owed to a trespasser on the premises, that nonetheless such a landowner, including the State (despite the doctrine of sovereign immunity) can be liable to a recreational user where the landowner or the State "has been grossly negligent or has acted with malicious intent or in bad faith."

The Court hastened to add that their decision does not "hold, or even imply, that a landowner may be grossly negligent for failing to warn of the inherent dangers of nature," but nonetheless held that where a landowner permits recreational use of his land to a third person, if that landowner has knowledge of an uncommon, hidden peril or danger on the land that is not inherent in the use to which the land is put that would not be reasonably discovered or avoided by a trespasser, the landowner's failure to warn or guard against such a danger could amount to willful, wanton, or malicious inaction, or gross negligence, thus generating liability despite the otherwise protective provisions of the recreational use statute.

For more information, contact H. Norman Kinzy or Oliver Krejs of SettlePou at (214) 520-3300 or at nkinzy@settlepou.com or okrejs@settlepou.com.