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IMPACT

An Overview of Current Legal Events of Concern and Interest

From the Attorneys of Strauss & Troy, Cincinnati, Ohio, and Northern Kentucky *Winter 2000*

Basic Types of Bank Financing

By Stephanie A. Dill

Stephanie A. Dill

Almost every business — from the corner store to the multi-million dollar corporation — needs to borrow money at some point. The need for business financing can arise under a variety of circumstances, from the development of startup operations to a major expansion or the acquisition of another company.

So what type of financing is best for your company's particular needs? And how can you ensure that you receive the most favorable terms possible? This article highlights five basic types of bank financing — term loans, lines of credit, letters of credit, commercial mortgages, and syndication — and explains the valuable assistance that attorneys can offer as you obtain such financing.

Types of Financing

Term loans. With a term loan, the bank loans you a lump sum of money and specifies a length of time for you to repay the loan plus interest. The loan may be secured by collateral, such as the property to be purchased with the loan proceeds, or may be unsecured. Since term loans are among the easiest to obtain, they are the most common method of business financing.

Generally, term loans are intended to supplement a company's permanent capital. They may be used to cover routine operating expenses or to make specific capital improvements or equipment purchases. Banks generally require monthly or quarterly payments on term loans. Typically, loans with a longer term and less frequent payments carry a higher interest rate. Interest rates may be floating rates (which vary with the bank's prime rate) or may be fixed for the term of the loan. With a fixed rate loan, you can expect to pay a penalty if you repay the loan prior to its due date.

Lines of credit. Lines of credit, much like credit cards, establish a maximum amount of credit that you may borrow as needed, repay when you have excess cash, and then reborrow when the need arises again. When you reach your credit limit, you must make payments to reduce your debt before borrowing any more.

While they are useful in a number of different situations, lines of credit typically provide a steady cash flow for businesses with seasonal revenue or expense fluctuations. For example, a business that requires an inventory buildup for the Christmas season is a candidate for a seasonal line of credit. Funds borrowed to build up the inventory before the holidays can be repaid in January after the inventory has been converted into cash.

Like term loans, lines of credit may be secured or unsecured. Typically, the level of borrowing is limited to some percentage of your inventory, accounts receivable or other assets. The primary advantage of a line of credit is that you don't have to reapply for financing every time you need cash. Although lines of credit offer a lower interest rate than credit cards, interest is typically higher than on term loans.

Letters of credit. Like a line of credit, a letter of credit provides advance assurance that a certain amount of credit will be available to you in the future. However, with a letter of credit, the bank guarantees that it will pay *to a third party* the amounts that you owe that party. You are then responsible for repaying that amount plus interest. Banks provide many different types of letters of credit, and they generally can be tailored to meet your specific needs.

Commercial mortgages. Commercial mortgages are term loans secured by real estate. Businesses usually take out commercial mortgages to buy real property or construct or improve buildings. A mortgage typically is written as a percentage of the property's appraised value (generally 60-80 percent). Commercial mortgages are often written for a longer term than other term loans. In addition, a commercial mortgage has longer lead times and higher up-front costs than other forms of business financing due to the need for appraisals, title searches, title insurance, environmental site assessments, and so forth.

Commercial mortgages are not used solely to finance a new property purchase. You may also take out a second mortgage on existing property in which you have more than 20 percent equity. A second mortgage may be a good option if you have problems obtaining

IN THIS ISSUE

Basic Types of Bank Financing

The Employee Polygraph Protection Act: A Primer for Employers

Growth of On-line Sales Spurs Tax Debate

News of the Firm

other forms of credit or if you wish to consolidate debt. However, the interest rate on second mortgages will often be higher than on first mortgages.

Syndication. Syndication is a single loan — usually of millions of dollars — made by two or more lenders and administered by a common agent. Syndication allows companies to borrow sums that exceed amounts individual banks could lend to a single borrower. Typically, syndication is used to finance large corporate purchases and major mergers and acquisitions.

Due to the large dollar amounts, syndication is usually available only to the largest companies. The complexity of the application process for this type of financing is offset by the advantage of being able to finance large sums in a single transaction. Moreover, since the risk is spread out among different banks, the interest rate and other associated costs may be lower.

Why Do You Need an Attorney?

An attorney with experience in bank financing can offer several benefits. Banking attorneys typically have established relationships with banks and loan officers. Your attorney can help you find the right fit, thus enhancing the likelihood of a favorable working relationship. In addition, your attorney will help you anticipate a bank's requirements and prepare you for your meetings with the bank.

A banking attorney can be especially helpful in reviewing the required financing documents. Banks often use form documents to reduce the cost of the transaction. These forms typically have terms that are more favorable to the bank. Experienced banking attorneys can quickly identify the terms that are bad for you, recognize whether those terms are negotiable, and work with the bank to reach more favorable terms. Going forward, your attorney should assist you in remaining in compliance with your loan terms after the transaction is complete.

The Employee Polygraph Protection Act: A Primer for Employers

By Stuart C. Brinn

Stuart C. Brinn

Even if it hasn't happened to you yet, chances are good that some day you will be faced with the unenviable task of deciding whether an employee is lying. It could happen in any number of scenarios — from a theft investigation to simply hiring a new cashier. It's enough to make you wish you had a lie detector.

But before you decide to use one, you need to know about the Employee Polygraph Protection Act (EPPA). The EPPA is a little known federal law that prohibits most businesses from requiring current employees or job applicants to take lie detector tests. Let's look at some of the EPPA's highlights and how it could apply to you.

How the EPPA Works

With a few limited exceptions, the EPPA prohibits businesses from using lie detector tests for pre-employment screening or at any time during the course of employment. This is a very broad prohibition. For example, it says you can't:

- ➢ request, suggest, or cause an employee or job applicant to take a lie detector test;
- ➢ take any adverse action against an employee or applicant who refuses to take a lie detector test; or
- ➢ use, refer to, ask about, or take any adverse action based on a lie detector test that the employee or applicant may have taken for some other reason.

Investigation exception. The EPPA says private employers can ask — but not require — current employees to take a polygraph when investigating an economic loss or injury. This is the most widely applicable exception to the EPPA's general prohibition against lie detector tests. But you can only ask employees to take a polygraph if they had access to the property being investigated and you have a reasonable suspicion that they are responsible. You cannot ask all cashiers to submit to a lie detector test because they have access to the cash register.

You must have other evidence of guilt besides the polygraph results or refusal to take one, but that other evidence can be the same as the evidence that caused you to suspect the employee in the first place.

If you have other evidence, and the employee is employed at will, then you can take disciplinary action without the lie detector test.

Although theft of company property is the most obvious type of "economic loss" covered by this exception, it also covers such things as:

- ➢ theft of property belonging to someone else but for which your company is responsible (such as a messenger who steals the property he is supposed to be delivering);
- ➢ misappropriation of confidential information or trade secrets; and
- ➢ an employee's use of your business to commit a crime such as check-kiting or money laundering.

Exceptions for security and drug companies. Businesses that provide security services (such as armored trucks or building security) may require applicants for security positions to take a polygraph. Similarly, companies that manufacture, distribute, or dispense controlled substances may require polygraphs for employees and job applicants who have or will have access to drugs.

As in the case of the investigation of economic losses, you can't fire or discipline an employee solely because the employee refused to take or failed a polygraph — you must have some other evidence against the employee.

Note: The EPPA does not apply to federal, state, or local governments or to any political subdivision of a state or local government — they can legally require both prospective and current employees to take any type of lie detector test.

What Rights Do Employees Have?

The EPPA provides a number of procedural requirements for employers to follow both before and during a polygraph test. Some of the major restrictions include:

- ➢ You can't ask questions about certain personal matters such as religion, racial attitudes, union activity, or sexual behavior.
- ➢ You can't punish an employee for refusing to take a polygraph if she suffers from a medical or psychological condition that might cause doubt about the validity of test results.
- ➢ Before administering a polygraph, you must give employees 48 hours written notice of their rights under the EPPA, including specific information about the incident being investigated, why you suspect the employee was involved, a list of the specific questions that will be asked during the polygraph, and an explanation that they have the right to refuse to take the test or stop it at any time.

continued on page 5

News of the Firm

ATTORNEYS ON THE MOVE

James Heldman

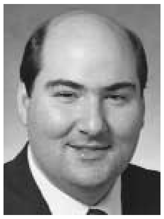
James Heldman, Chair of the Cincinnati Associates of Hebrew Union College, was one of three Chairpersons of the 17th Annual Hebrew Union College Tribute Dinner held on November 7, 1999, at the Hyatt Regency. An impressive 1,350 guests turned out as the Associates of Hebrew Union College-Jewish Institute of Religion (HUC-JIR) honored Richard A. Weiland as an exemplary model of civic and philanthropic leadership and achievement. The guest speaker was Nobel Peace Prize winner Elie Wiesel. The event raised a record-setting $1.8 million to benefit HUC-JIR and the Combined Generations of the Holocaust of Greater Cincinnati in the creation of a permanent endowed Center for Holocaust Education.

Steven Stuhlbarg

In December, **Steven Stuhlbarg** made continuing legal education presentations to the Southwestern Ohio Tax Institute and the Corporate Securities Law Institute on the subjects of Multi-Disciplinary Practice and the Unauthorized Practice of Law. Mr. Stuhlbarg chairs the Cincinnati Bar Association's Committee on the Unauthorized Practice of Law.

Marilyn Maag

Marilyn Maag will make a presentation at the Cincinnati Bar Association on drafting Wills and Trusts and avoiding Probate. This seminar is part of the "No Brown Bag" seminar series, presented by the Young Lawyers Section of the Cincinnati Bar Association.



Charles Ashdown

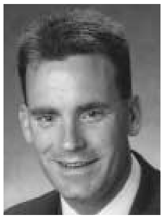
Charles Ashdown will conduct a portion of a seminar on Construction Contracting for Public Entities in Ohio, which is designed for administrators and managers of cities and other public entities involved in public works construction. Charles' topic will be the Bidding Process.

William Jacobs

William Jacobs is teaching a class in Corporate Finance at the University of Cincinnati College of Law.

Thomas Stachler

On February 25, 2000, **William Jacobs** and **Thomas Stachler** will teach at a one-day seminar for attorneys interested in maximizing their trial practice skills. The topic of the seminar is "The Fundamentals: Techniques for Success in Civil Litigation." Mr. Jacobs will speak on "Basic Considerations for Opening Statements" and "Ethical Considerations of the Client Perjury Rules." Mr. Stachler's topics will be "Direct Examination of Witnesses" and "Expert Witnesses."



August Janszen

August Janszen will be a lecturer/panel member at a seminar on Non-Competition Issues presented by Lorman Educational Services on April 26, 2000.

Paul Calico

On March 9-10, 2000, **Paul Calico** will speak at the 15th Annual Ohio seminar entitled "Personnel Law Update 2000" at the Westin Hotel. The program, sponsored by the Counsel on Education in Management, is for Human Resources managers, other management personnel, and their counsel. Mr. Calico's topic is entitled "Recruit and Retain Good Employees: Developing Proactive Policies and Procedures That Satisfy Your Employees, Management, and the Courts."

Employees' MAD ("Make A Difference") Team

Strauss & Troy is justifiably proud of our wonderful, *all volunteer* **MAD Team**, whose ambitious projects every year make quite an impact in Greater Cincinnati. The MAD Team was established in December 1993 and is comprised of employees from all levels of the firm. Funds are raised by our weekly casual Friday when we "pay up to dress down." Additional funds are raised by Firm-wide participation in in-house activities.

Our most recent project provided a joyful holiday for 31 children residing at the Diocesan Catholic Children's Home ("DCCH") in Ft. Mitchell, Kentucky. On December 16, the Team hosted a party for the children which included fun and games and a visit from Santa. Each child received $10 spending money and a bag full of homemade treats. On Christmas morning, each child awoke to find three "wish list" toys along with a new outfit, coat, hat and gloves, underwear, socks and shoes. The DCCH informed us that these were the only gifts the children received this Christmas, and that they were all very excited and happy with their gifts. We are all very proud at Strauss & Troy to have been able to make a difference this holiday season for the children at DCCH. On to our next project!!

continued from page 2

Generally, unless it's pursuant to a court order, you can't disclose polygraph results to anyone other than the employee. But if an employee admits during the test to committing a crime, you can tell a government agency such as the police.

Finally, don't even try to get around the EPPA by having the employee sign a release form before taking a lie detector test — that won't hold water. The Act specifically says employees can't waive their rights under it.

The EPPA contains many procedural, technical, and recordkeeping requirements too numerous to detail in this article. The DOL could fine you up to $10,000 for each mistake you make. The DOL counts each employee and each mistake as a separate violation. In addition, the wronged employee or applicant could sue you for lost wages and benefits, reinstatement or promotion, attorneys' fees, and costs. I recommend against using polygraph tests except for security and drug companies. If you want to use a polygraph and need help navigating the EPPA's complex requirements, feel free to contact Stu Brinn at Strauss & Troy.

Growth of On-line Sales Spurs Tax Debate

By Marshall K. Dosker

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As of September 1999, more than 112 million North Americans were using the Internet. That's up from 58 million in 1997 and 35 million in 1996. On-line retail sales were expected to exceed $20 billion in 1999 and $184 billion by 2003 — and *total* Web-related revenues were projected at $150 billion for 1999 and more than $3.2 trillion by 2003.

Whether states should be able to collect taxes on purchases their residents make over the Internet is a matter of intense debate — one that shows no signs of an easy resolution. Congress has said that it doesn't intend to impose federal taxes on electronic commerce. But state and local governments are eager to collect taxes from Internet sales.

Current Law

Currently, most on-line sales are not taxed. That's because in 1992 the U.S. Supreme Court held that states can not compel out-of-state companies (like mail order and Internet retailers) to collect sales taxes from their residents unless the companies have a *physical* presence in the state. Although consumers are supposed to pay taxes (i.e., a Use Tax) directly to their local and state governments on mail order and Internet purchases, most jurisdictions simply don't have the resources to enforce that requirement.

The Court explained that only Congress has the power to legislate whether, when, and to what extent states may require out-of-state companies to collect sales taxes from their residents.

Taking the Court at its word, Congress passed the Internet Tax Freedom Act of 1998, which:

- ➢ placed a moratorium on state and local governments imposing new taxes on certain Internet transactions for three years; and
- ➢ established an advisory commission to review and make recommendations on Internet taxation issues.

The moratorium — which will expire in October 2001 unless Congress extends it or makes it permanent — is aimed at preventing state and local governments from applying "multiple" and "discriminatory" taxes on electronic commerce.

The moratorium on *multiple* taxes covers situations in which the same transaction may be taxed by more than one state or local government. The moratorium on *discriminatory* taxes prohibits state and local governments from taxing Internet sales when they wouldn't tax similar sales through more traditional means, such as telephone or mail order. For example, if Ohio required bookstores located in the state to collect sales tax but didn't require out-of-state mail order catalogs to do so, the state can't require out-of-state Internet businesses to collect sales tax from Ohio residents either.

The Pros and Cons of Internet Sales Taxes

The main arguments for imposing sales taxes on Internet sales are offered by traditional retail businesses and state and local governments. Traditional retailers say requiring them but not their on-line competition to collect sales taxes places them at an enormous disadvantage. State and local governments warn that, as on-line sales skyrocket, they will lose an ever-increasing amount of tax revenues, harming their ability to provide basic services.

At the other end of the spectrum, pro-business advocates argue that:

- ➢ Any taxation of Internet purchases will unnecessarily stymie the industry's growth, resulting in more lost revenue opportunities than lost tax revenues from Internet sales.
- ➢ State and local governments have overestimated the amount of revenue lost to untaxed Internet sales, and the economy is thriving in large part *because* of electronic commerce.
- ➢ There are almost 7,500 individual taxing jurisdictions in this country. Requiring Internet retailers to figure out what taxes are owed by every consumer in every jurisdiction on every sale will cripple on-line businesses — and the industry and economy in general.

There's even a bill proposing to permanently prohibit *all* taxation of on-line sales — even when the on-line company has a physical presence in the state where the consumer lives.

Somewhere in the middle are proposals to simplify the tax system itself with the goal of leveling the playing field for *all* forms of commerce. Some of the basic reforms being proposed include each state having one tax rate for all purchases made by its residents regardless of where they live or where they bought the goods and having all states use the same tax forms, filing dates, and exemptions.

The Advisory Commission

As mentioned, Congress created an Advisory Commission on Electronic Commerce to recommend a course of action on taxing e-commerce. The Commission has held a number of public meetings to consider the arguments for and against Internet taxes. When it last met in mid-December, the Commission was sharply divided on the issues.

Although it has another public meeting scheduled for March, the Commission's members didn't expect to resolve their differences on the issues by then. The Commission's final report to Congress is due in April.

Certain states, including Kentucky, do not certify specialties of legal practice. Certain states, including Ohio, do not provide for recognition as a specialist in any area or field of law, except for patent, trademark or admiralty. IMPACT is published quarterly to provide information of general interest and not to provide legal advice concerning any specific situation. If you wish additional or more specific information, please contact one of the attorneys at Strauss & Troy.

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