

Impact

An Overview of Current Legal Events of Concern and Interest

Winter 2006

Is Your Investment Fiduciary Diversified for Risk, or Just Return?

by William K. Flynn



All financial professionals (e.g., stockbrokers, investment managers, bankers, financial planners, insurance agents), have a legal duty to exercise a degree of care, skill and competence expected of a reasonable person under the same or similar circumstances (i.e., a reasonable insurance agent, accountant, etc.). When a customer suffers financial harm because a provider fails the reasonable care test, the law provides a remedy in the form of a cause of action for “negligence.”

A fiduciary has duties that exceed reasonable care. Investment fiduciaries can include, for example, any of the millions of people who are the investment committees of retirement plans, trustees of testamentary or inter-vivos trusts, directors of charitable foundations, or private investment managers. Fiduciary status is determined on a case-by-case basis but, generally, if someone is paid to exercise his or her judgment to buy or sell securities, or to invest other assets without discussing it with you first, the chances are high that you are dealing with an investment fiduciary.

In addition to the duty of care, fiduciaries assume the highest duties of good faith, candor, and undivided loyalty to their customers. “Good faith” means that a fiduciary’s conduct is judged objectively. Stated another way, the fact that advisors subjectively believe they are making good investment decisions is no defense if their research methods fall short of prevailing industry standards. “Candor” means full disclosure and honesty “in fact.” It makes no difference if fiduciaries honestly believe what they report. If the facts are wrong, the fiduciary is wrong. “Undivided loyalty” means no conflict of interest with the customer. Potential conflicts lurk around every corner of today’s investment environment with any incentive-based revenue stream (i.e., sales commissions).

An investment fiduciary’s duty of care incorporates a duty of “prudent” investment. Certain fiduciaries, such as ERISA managers or private trustees, are governed by statutory standards of prudence. The touchstone of contemporary prudent fiduciary investing is reflected in the Restatement 3d of Trusts and codified by the Uniform

Prudent Investor Act (the “Act”), which has been adopted by 42 states (including Ohio). These rules make clear that a fiduciary is judged by his or her methodology rather than performance. For instance, does the fiduciary follow a defined investment process, other than simply trying to maximize returns? Is the process supported by a written investment policy statement taking into consideration the purposes, duration, beneficiaries, distribution requirements and other particular circumstances (e.g., tax consequences) of a portfolio? Complaints most often arise in reaction to investment returns that appear less than satisfactory. An objective evaluation of the fiduciary’s responsibility should, however, focus on whether there is a disciplined decision-making process relating to a fact-specific investment policy statement.

Both the Act and the Restatement reflect the pervasive influence of Modern Portfolio Theory on fiduciary investing. A cornerstone of portfolio theory holds that because uncertainty is the central factor at work in financial markets, a portfolio must be properly diversified to minimize risk. Proper (or “rational”) diversification of a stock portfolio, for example, means avoiding a concentration in companies that have a high “covariance” to each other (i.e., stocks that move closely together relative to changes in the market), in favor of stocks that are diversified across asset class and market sectors.

Some investment fiduciaries stubbornly insist that so long as a portfolio holds a certain number of different stocks, then it is well-positioned to increase returns and, therefore, “diversified.” The portfolio might be diversified, but under portfolio theory, that kind of diversification is more likely to increase, rather than minimize, the risk of loss. For example, many “professionals” believed strongly that a stock portfolio was diversified in 1999 and 2000 if it held 15 or 25 different technology or Internet-related stocks. The painful reality is that these portfolios were unnecessarily exposed to the risk of catastrophic loss, as virtually all stocks in these categories fell off the table together. True diversification for risk, on the other hand, would have consisted of a portfolio invested across all market components, thereby minimizing the risk of a complete portfolio meltdown.

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Sexennial Property Valuation Reassessments: Valuation Appeals

by Andrew M. Shott and Franklin A. Klaine, Jr.

The value of all property in Hamilton County is reassessed every six years. The real estate tax bills mailed to Hamilton County residents in January 2006 reflect this “sexennial property valuation reassessment.”

Valuation changes are based on inspections and the actual re-appraisal of each parcel of real estate. This re-appraisal tracks sales, market trends, and other unique factors that impact value. Generally a re-appraisal results in increased valuation. This does not mean that the taxpayer will have a proportionately higher tax bill, but the increases can be significant, especially when properties have been historically undervalued in certain neighborhoods.

Also, beginning with the real property tax bills for the first half of 2005, which are due and payable January 31, 2006, the ten percent (10%) rollback/tax credit of real property taxes will be eliminated for property that is primarily used or intended to be used in a “business activity.” In a nutshell, the term “business activity” means all uses of real property except for farming and occupying/leasing/holding property with a one-, two-, or three-family dwelling. The elimination of this rollback effectively increases taxes on business activity property by 11.1% or more.

Property owners and school boards have powerful tools available to ensure that property valuations are accurate and fair. Ohio law permits property owners and school districts to appeal assessment valuations to the County Board of Revision by filing a property valuation complaint between January 1 and March 31 of any calendar year. There is a limit of one valuation appeal per parcel during any three-year assessment period unless certain conditions are met, such as a sale of the property, casualty, substantial improvement, or a reduction or increase in occupancy by 15% or more.

Many property owners typically file tax complaints in re-appraisal years, and we anticipate that this will hold true in 2006. It has been our experience that a well-prepared tax complaint and presentation to the Board of Revision is essential to obtaining a valuation change.

We wish we could recommend that taxpayers file their own tax complaints. However, the rules and requirements for filing such complaints can be confusing and fraught with procedural requirements, which if not properly followed, can result in the dismissal of the valuation challenge. Due to the statutory limitation on filing such complaints, a dismissal generally precludes the filing of another valuation complaint for three more years — three years in which the higher taxes must be paid. Where property is owned by a trust, partnership, or other legal entity, the Ohio Supreme Court has held that tax complaints must be filed by attorneys. If non-lawyers (such as officers of a corporation that owns property) attempt to file a valuation complaint, the Supreme Court has held that they are engaging in the unauthorized practice of law, and the complaints are subject to dismissal. The moral of this story is clear: When in doubt, engage an attorney with property valuation expertise to assist with the preparation and filing of the complaint and the presentation of the appeal.



Andrew M. Shott



Franklin A. Klaine, Jr.

When considering a valuation appeal, property owners should not evaluate the merits of their case by focusing solely on the increased valuation and higher tax bill. The owner must ask the same questions the County Board of Revision will ask at the hearing: What is the property worth on the open market? What do similar properties in comparable locations sell for? For business property, what value results from dividing a stabilized net operating income by a market-derived capitalization rate? For properties acquired within two years from the relevant tax date (January 1, 2005 for tax bills issued in 2006) what was the sale price? For newly built improvements, what was the construction cost? The answers to these questions will indicate whether a valuation complaint stands a reasonable chance of success.

Property owners who file valuation complaints must be prepared to present probative evidence from credible sources at the valuation hearing before the Board of Revision. Although owners are free to testify on their own behalf, the testimony of qualified appraisers carries the most weight. Appraisal reports to be introduced at a hearing in Hamilton County must be submitted to the Board of Revision no less than ten days before the hearing. If you feel the Auditor's tax valuation for your property is wrong, we recommend that you contact a qualified appraiser as soon as possible to review the County's valuation and to give you a clear idea as to what he or she feels would be an appropriate valuation. We also can assist in advising you as to whether or not to file a tax complaint, valuation strategies, and all aspects of tax valuation issues.

Strauss & Troy has represented owners and school districts in property valuation cases involving office, industrial, retail, apartment, and residential property as well as special-use properties before County Boards of Revision, in state court, the State Board of Tax Appeals, and the Supreme Court of Ohio. Andy Shott, Frank Klaine, Michael Ruh, and Bill Williamson can assist owners in evaluating potential valuation reduction claims and guide owners through the complicated valuation appeal process.

Make A Difference (MAD) Team Update

Strauss & Troy's “MAD Team” has been very busy, working on three different projects over the holiday season. In one project, team members delivered blankets, gloves, and hats to the Center for Respite Care, Inc. In its second project, the team bought new toys for the Marine Toys for Tots Foundation. Finally, the Team “adopted” five single-mother families from the Inner City Youth Opportunities. Strauss & Troy employees purchased and delivered “wish list” items to ICYO's facilities, where Team members met the families, had a pizza party, and made crafts. At the end of the evening, the children had their pictures taken with Santa and received goody bags. This was not only an unforgettable holiday season for the recipients of the gifts, but for Strauss & Troy employees as well.

Upcoming Project: In conjunction with Cincinnati Public Schools, the MAD Team is again sponsoring a literacy project in which Taft Information Technology High School students will write an essay on “What ‘Adversity’ Means to Me.” The authors of the top 25 essays will attend an exhibit at The Center for Holocaust Humanity Education at Hebrew Union College. They will also be recognized at an awards luncheon at Strauss & Troy where additional prizes will be awarded, including a grand-prize to the student whose essay is selected as the best.

Attorneys on the Move



Guy Taft



Tim Theissen

Strauss & Troy is pleased to announce that **Guy Taft, Tim Theissen, Diane Schneiderman, and Philomena Ashdown** were named "Leading Lawyers" by *Cincy Business Magazine*. No more than two attorneys were selected in 30 areas of practice.



Diane Schneiderman



Philomena Ashdown

Tom Rink was elected to his second term as Mayor of the Village of Indian Hill and his fifth term on the Village Council.

Jim Heldman is teaching an 8th grade social studies class at his alma mater, Walnut Hills High School, as a part of the Junior

Achievement Program. Mr. Heldman also played in two events including the Men's Open Tournament of *The Midwesterns* Platform Tennis Tournament, which was held in Cincinnati in January. Strauss & Troy was once again a corporate sponsor of the event, which benefited The Children's Home of Cincinnati, a non-profit agency providing care and guidance for children and their families in the areas of adoption, early childhood education, and mental health.

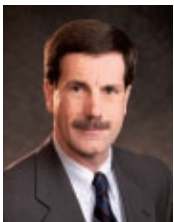


Tom Rink



Jim Heldman

Paul Calico was the featured speaker at the January luncheon of the Cincinnati Commercial Industrial Association, making a presentation on *Litigation and Alternative Dispute Resolution*. He is on the faculty of an upcoming seminar entitled *Building a Foundation for Managing Complex Construction Law Issues in Ohio*, sponsored by the National Business Institute. Mr. Calico is also speaking on *Avoiding, Resolving and Litigating Contract Disputes in Ohio*, at a seminar sponsored by Lorman Education Services.



Paul Calico

Claudia Allen authored an article on Roth 401(k)s for the *Biz Women* section of the *Business Courier*. In March, she will speak on the *Top 10 Ways Employers Benefit from Retirement Plans* at a seminar sponsored by Lorman Education Services. Additionally, Ms. Allen will again serve as an Adjunct Professor of Law at the University of Cincinnati during the spring semester, teaching a course on Employee Benefits.



Claudia Allen



Charles Ashdown

Charles Ashdown was on the faculty of a seminar sponsored by the Ohio State Bar Association, speaking on *Identity Theft and Real Estate Fraud* at the Real Property Institute in Columbus.



Tom Stachler

Tom Stachler recently lectured at a National Business Institute seminar entitled *Civil Trial from Start to Finish: A Practical Approach to Trying a Civil Case in Ohio*. His presentations focused on the jury-selection process and ethical considerations for civil trial attorneys.



Gus Janszen

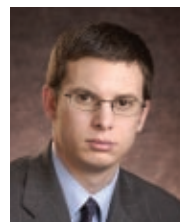
Gus Janszen was appointed to the Evendale Recreation Commission by Mayor Donald Apking.

Charlie Melville spoke to a select group of attorneys specializing in the representation of manufacturer's representatives at the MANA (Manufacturer's Agents National Association) Attorney Forum in Chicago. The topics included commission protection legislation, the latest trends in contracts, and related issues. It was an honor to be selected for this presentation; the magazine *Agency Sales* recently concluded that, "there are only a couple of dozen attorneys in the United States and Canada who truly understand the rep-principal partnership."



Charlie Melville

Jason Tonne was appointed by the Colerain Township Board of Trustees to serve on the Colerain Township Board of Zoning Appeals beginning in 2006.



Jason Tonne

News of the Firm

Strauss & Troy is pleased to announce the election of three new Shareholders, effective January 1, 2006:

Mike Stoner is a member of the firm's Real Estate Department, and practices primarily in the area of commercial real estate law, including development,



Mike Stoner



Joe Braun



Stephanie Dill



Ryan Hall

lending, sales, leasing, and zoning. **Joe Braun** is a member of the Strauss & Troy Litigation and Dispute Resolution Department, with an emphasis in commercial litigation and business law, municipal law, and constitutional law. **Stephanie Dill** is a member of Strauss & Troy's Real Estate Development & Finance Group as well as the Corporate, Securities & Business Law Group and practices in all areas of commercial real estate and corporate/business law.

Strauss & Troy also welcomes its newest Associate, **Ryan Hall**. Mr. Hall received his B.A. in Economics and Political Science from Rice University in Houston, Texas, and his J.D. from Notre Dame Law School, where he served as the President of the Black Law Students Association and a Recruiter in the Admissions Office. Mr. Hall works in our Cincinnati office and practices in the areas of corporate law, commercial litigation, and general business law.

Client Spotlight



Years ago, a typical template for an executive job description read: “20 years of industry experience, proven sales leader and motivator, experience with M&A and tenure at a multinational company.”

Times have changed, and executive demands have never been higher. Market complexity, competitor drive, global scale, government regulation, and the speed of communication are pulling today’s executives apart. Pick up your favorite business magazine and you’ll read about the latest executive to retire under board pressure, jump ship, or be fired.

These challenges are calling for a new breed of executive leadership. Today’s executives need depth, not just breadth. They need to know how to think strategically, make high-risk, high-reward decisions, and steer a business through those changes – all in a business climate where velocity is a given, not the exception.

Today’s New Executive: The CXO

In response, a new executive is taking the helm of today’s best businesses – the CXO. He or she comes to the table with years of operational executive experience, has the unique ability to immediately integrate into a company, and has an arsenal of resources at his or her disposal to remedy the most complex business pains.

Who is this Superman of the C-suite saving corporate America? It’s not one person but a cadre of executive leaders working together to address corporate pains — called executive-leadership consultants.

Today’s highest performance organizations are searching for executive professionals to serve as strategic counselors actively engaged in leading the achievement of results. These leaders help validate and assess business issues, objectively challenge the existing strategy when necessary, and execute action steps quickly and efficiently to achieve results.

Customized Leadership

Flexibility, particularly for the mid-market, is critical. The ability to customize your team at the executive level can make or break your business. Some companies are opting for one professional for each stage in the business lifecycle. Instead of hiring one, two, or three executives full-time, paying bonuses, options, and a platinum salary, you can find the right executive for the right time for only that time. It guarantees your business gets the right executive for the job and saves the sweat of overwhelming overhead.

With executive turnover, liability, and shareholder pressure in the news, thousands of former executives see these newfound engagements as the best of both worlds. Because they are independent, they can provide the objective counsel the business needs without worrying about losing their job. They are also serving the best businesses for a shorter timeframe with a cadre of fellow executives available to supplement, back-up, or complement their expertise.

Results-Driven

These engagements are bringing organizations what they need – business velocity. Speed matters in today’s marketplace, and the best companies in America are searching for battle-tested, executive professionals that bring objectivity, leadership, judgment, wisdom and ultimately results – and they’re finding them in executive-leadership consultants, a very different breed of professionals than the big consulting houses.

In today’s business world there isn’t a template job description to find the right executive to guide your business. Instead, you can and should search for the perfect solution for your business at that time. It will ensure your business gets the right fit at the right time without sacrificing results.

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Tatum, LLC is the largest and fastest-growing executive services and consulting firm in the United States, helping companies in transition to accelerate business success and create more value.™ Through more than 30 offices nationwide, Tatum’s 500+ executive partners and principals provide strategic and operating leadership in finance and information technology.

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Are Roth 401(k) Deferrals in Your Future?

by Claudia G. Allen

Tax code provisions permitting “Roth 401(k) deferrals” became effective January 1, 2006. This change permits 401(k) plans to offer participants an alternative way to save. Roth 401(k) deferrals work the same way as contributions to Roth IRAs: contributions are made in after-tax dollars, but earnings are never taxed if they are received in a “qualified distribution.” Since higher wage earners are foreclosed from using Roth IRAs by a limit on income (\$110,000 for single filers and \$160,000 for married filing jointly), many individuals have not seriously considered the impact of this Roth-type of saving plan. However, the Roth IRA income limit does not apply to Roth 401(k) deferrals, so all plan participants are able to take advantage of this savings opportunity. Offering a Roth 401(k) feature is **not** a legal requirement, and many plan sponsors are taking a “wait-and-see” attitude before adding it to their plans. If your employer makes a Roth 401(k) available, this overview may help you decide if you should consider participating in a Roth 401(k).



While the Roth 401(k) rules are simple, deciding whether to use them is much more difficult. The ultimate monetary consequences of designating a salary deferral as a Roth 401(k) depends on some factors that are necessarily unknown at the time you must make the decision, such as the future tax rates and your own personal tax bracket at the time of future distributions. In the early years of employment, an employee may be in a very low tax bracket and thus making a Roth 401(k) contribution would have a minimal tax burden. By making Roth 401(k) contributions with after-tax dollars, employees can do retirement planning without reserving funds for paying taxes upon distribution (since distributions are tax-free).

In general, the longer an employee keeps funds in a Roth plan, the greater the tax savings. However, this is not always the case. If your current tax bracket is higher than your tax bracket at the time of distribution, making regular (non-Roth) 401(k) deferrals would be better since you would pay taxes at the time of distribution at your lower rate. (It is impossible, however, to know what the future tax rates may be.) Conversely, if you think your tax bracket will be higher at the time of distribution, the Roth deferrals may be a better choice.

For 2006, employees may contribute up to \$15,000 as salary deferrals into a 401(k) Plan. Participants age 50 and over may contribute an additional \$5,000 catch-up contribution. You can contribute both Roth 401(k) and “pre-tax” 401(k) dollars, as long as total contributions do not exceed the maximum. The designation of contributions as “Roth” or “pre-tax” is irrevocable. It is important to remember that Roth 401(k) deferrals are made with after-tax dollars. That means, in order to make the maximum deferral of \$15,000, you will have to also pay approximately \$3,000 to \$6,000 in taxes on that amount (depending on your tax bracket).

Because Roth 401(k) deferrals are treated in the same manner as pre-tax deferrals, the same distribution restrictions apply. Funds in 401(k) accounts are restricted and may not be withdrawn before age 59½ (if in-service withdrawals are permitted) or upon death, disability, or termination of employment. Thus, for a Roth 401(k) distribution to be “qualified” (thereby avoiding taxation on the earnings), funds in a Roth 401(k) account may only be distributed after the participant attains age 59½, becomes disabled,

or dies. In addition, the distribution must be made after the end of the five-year period beginning with the calendar year in which the participant first made a Roth deferral. This means that if an employee’s first Roth 401(k) contribution is in 2006, the five-year rule will be satisfied for all Roth 401(k) contributions as of January 1, 2011 — even for contributions made in 2007 through 2010. If a distribution from a participant’s Roth 401(k) account is not “qualified,” the earnings are taxable. They may also be subject to a 10% premature distribution penalty tax.

Roth 401(k) deferrals are subject to the same required minimum distribution rules as apply to other amounts in the retirement plan. However, participants may be able to avoid initiation of distributions at age 70½ (or if later, after the participant retires) by rolling them into a Roth IRA. Distributions from Roth IRAs are not subject to the minimum distribution rules and can be postponed beyond age 70½. When Roth 401(k) dollars are converted to Roth IRA dollars, they are subject to all the rules of Roth IRAs, including one that may be a detriment to some participants. Whether or not the five-year period has been met within the Roth 401(k) account, when deferrals are rolled into a Roth IRA, the five-year period from the first contribution to the Roth IRA determines if a distribution is qualified. For many, this means that another five-year period is required before funds can be withdrawn tax-free.

The Roth 401(k) provisions are contained in the Economic Growth & Tax Relief Reconciliation Act of 2001 (commonly called EGTRRA), which contains a “sunset” rule under which all provisions expire on December 31, 2010. Some commentators have cautioned that if the tax provisions excluding Roth distributions from taxable income disappear, the benefits of the Roth 401(k) will be gone as well. However, it is more likely that even if the ability to make contributions in the future is curtailed, the tax treatment for amounts already contributed will be preserved. Even with the uncertainties, this feature may be an important alternative for employee retirement savings.

Claudia Allen is a partner in the Cincinnati office, specializing in employment law and employee benefits. Ms. Allen also teaches a seminar on employee benefits at the University of Cincinnati Law School.

Our Community— Our Commitment

SPONSORSHIPS

Since the time of our last newsletter, Strauss & Troy has continued to sponsor a variety of deserving causes as a part of our tradition of sharing our gifts and talents with others. We are proud to have supported the following programs and events in fulfillment of our continuing commitment to the Greater Cincinnati and Northern Kentucky communities:

- American Bar Association/Young Lawyers Division
- Children’s Home of Cincinnati
- Cincinnati Bar Association
- Hebrew Union College
- Just the Beginning Foundation
- The Merlot Group, LLC
- Pleasant Run Farms Flames Soccer Team
- WNKU 98.7 FM
- Yavneh Day School

Is Your Investment Fiduciary Diversified for Risk, or Just Return? *continued*

The significance of these principles for trustees and other fiduciaries is that the duty to diversify for risk, rather than for returns, is not merely good practice; it is mandatory. This lesson is illustrated by a recent decision from the Ohio First District Court of Appeals in *Wood v. US Bank*. In that case, the trustee bank had taken on management of an existing trust investment portfolio weighted heavily in the common stock of the bank. Everyone involved agreed that the trust grantor favored the bank's stock as an investment which had created substantial wealth for the grantor during his life. The grantor liked the stock so much, he drafted the trust instrument to say specifically that the bank trustee had the discretion to hold shares of its own stock, if the trustee believed it to be appropriate. When the stock's price declined substantially and the investment performance of the trust was challenged by the trust beneficiaries, the bank trustee argued that this language overcame any statutory duty to diversify the portfolio. The Court of Appeals disagreed, instructing that the duty to diversify for risk can be overcome only by "specific language authorizing or directing the trustee to retain in a specific investment a larger percentage of the trust assets than would be normally prudent." The court concluded that language merely

giving a trustee discretion to retain a particular asset does not rise to the level of a specific instruction that will overcome the duty to diversify. The court thus makes clear that the duty under the Act to diversify to minimize risk is not just sound portfolio management, but mandatory.

The significance of this decision for investment fiduciaries other than trustees is that courts often look to judicial interpretations of prudence under the Act and the Restatement when evaluating industry best practices and investment behavior in other contexts. Therefore, investment fiduciaries who ignore modern portfolio principles of rational risk diversification, do so at their own risk.

Mr. Flynn concentrates his practice in representing customers and financial providers in investment-related matters, including securities arbitrations and business disputes. He is a charter member of the Public Investor Arbitration Bar Association (PIABA), a national association of attorneys committed to representing public investors in disputes with brokers or other financial advisors.

The rules of the Supreme Court of Kentucky require the following statement in any material of this type: "THIS IS AN ADVERTISEMENT."
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