

BUSINESS LAW NOTES

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Business Succession Planning: PART ONE

GOT AN EXIT STRATEGY??

By F. Stephen Glass

Did you know that, statistically, fewer than one-third of all family owned businesses survive into the second generation and about 12% will still be viable into the third generation?

The leading cause of this failing rate of succession is the failure of the business owner(s) to design a proper business succession plan.

A business succession plan ("BSP") is a documented road map for business owners, heirs and successors to follow in the event of the death, disability or retirement of the business owners. It can also be used to facilitate the orderly sale of the business for fair value. The plan can include a program for the distribution of business interests and other assets, debt retirement schedules, life and disability insurance, buy-sell agreements, and, importantly, the establishment of the value of the business.

The starting point for a BSP is to clearly establish your exit goals and objectives — what you want your BSP to accomplish for you. Some key considerations are:

- Is there someone capable of running the business when you exit?
- How much control of the business do you want to maintain when you exit?
- Are there key employees who should be retained?
- Are there sufficient assets to pay the estate tax upon your death to allow the business to be retained in the family?
- How much money do you need from the business to reach your financial goals?

Your BSP should be flexible and comprehensive enough to permit you to handle the following occurrences without destroying your business:

- Your partner decides to move to Tahiti for an early retirement and wants his share of the business assets NOW. Do you have a buy-sell agreement in place that will enable the purchase of his business interest without bankrupting your business (and you)?
- A key manager becomes disabled and most likely will not return to work.
- Your partner gets a divorce and the spouse gets his/her interest in YOUR company.
- One of your children has worked his/her way up in the businesses. The other(s) haven't, but how will you treat each of them equitably upon your exit?

Your BSP should protect your goals regardless of the situation that might arise. Do you have an exit strategy that will protect your goals and allow you to maximize your financial goals upon your exit? *[next issue: buy-sell agreements for your business]*

BUSINESS LAW NOTES

Slavery in the 21st Century

FRANCHISEE LIABILITY FOR FUTURE ROYALTIES

by M. Blen Gee, Jr.

A few years ago, you purchased an up-and-coming franchise and signed a 20-year franchise agreement. But now things are not going well. It seems like every time you turn around, the franchisor is changing the rules and the franchise has become less and less profitable. You start looking for a buyer, but because the franchise system has deteriorated so much, no one is interested. Finally, in desperation, you decide to cut your losses and just quit. You tell your landlord you are leaving. He says "No problem," he can lease the space easily and he will let you out of your lease at minimal cost.

Then you write your franchisor that you are just not making any money, you are about to lose everything you have and you are going to terminate your franchise. You get a hot letter back from the franchisor's Washington D.C. legal counsel telling you that, if you terminate prematurely, you will be liable for all the future royalties on the 15 years remaining in your franchise agreement. That amounts to several hundred thousand dollars!

In a panic, you run to your lawyer. He flips to Item 17 of your UFOC (Uniform Franchise Offering Circular) and under the heading "Termination by You" in big, bold, black, ugly letters is the word "NONE"! The lawyer heaves a sigh and tells you "Yes, you probably will owe all that money if you try to terminate your franchise agreement."

Typically, a franchisor does not give its franchisees a "no-fault" right for them to terminate. On the contrary, there appears to be an increasing trend by franchisors to try to collect future royalties from terminated franchisees. Most courts that have addressed the issue have ruled in favor the franchisor! No wonder many franchisees feel like they are slaves to their franchisor.

If you are a prospective franchisee, you should closely examine Item 17 of the UFOC and the termination provision of the proposed franchise agreement to find out your rights to terminate the franchise. If there is no right for a no-fault termination, you should propose to the franchisor to attach a rider to the franchise agreement giving you the right to terminate on reasonable notice. A form for such a rider is attached below. If the franchisor refuses to attach a rider, you should seriously consider not buying the franchise. This is especially true if the franchise agreement is for a long term, such as 10, 15, or 20 years and the franchisor is not one of the well established (and well regarded) franchisors. If Item 3 of the UFOC indicates that the franchisor has had a great deal of litigation, you should be even more wary.

* * * * *

RIDER TO
FRANCHISE AGREEMENT

This Rider to _____ Franchise Agreement ("Franchise Agreement") is made between _____ (Franchisor) and the undersigned franchisee ("Franchisee"), effective the ____ day of _____, 20__.

Notwithstanding anything to the contrary set forth in the Franchise Agreement, Franchisee shall have the right, without cause, to terminate the Franchise Agreement upon ninety (90) days prior written notice to Franchisor.

FRANCHISOR
By: _____
Title: _____

FRANCHISEE
By: _____
Title: _____

LLC MANAGERS' DUTY OF LOYALTY AND CARE

By F. Stephen Glass

North Carolina LLC statutes require that an LLC manager must discharge his duties as manager in good faith, with the care an ordinary prudent person in a like position would exercise under similar circumstances, and in the manner the manager reasonably believes to be in the best interests of the LLC. LLC managers have essentially the same duties of loyalty and care as to directors of a corporation.

In discharging these duties, a manager is entitled to rely on information, opinions, reports, or statements, including, but not limited to, financial statements or other financial data, if prepared or presented by one or more employees of the LLC whom the manager reasonably believes to be reliable and competent in the matters presented; legal counsel, CPAs, or other

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SMALL BUSINESS TAX LAW

By F. Stephen Glass

The U.S. Tax Court has ruled that the owner of a closely held S corp qualified for capital gain treatment when he sold his stock via installment sale to his son and two unrelated employees. The redemption was complete and the seller had no prohibited continuing interest in the S corp even though (1) the redemption agreements carried extensive cross-default and cross collateralization provisions, (2) the seller and his wife leased a building they owned personal to the S corp, and (3) the owner's spouse continued to be an employee and received fringe benefits including health insurance coverage. However, the health insurance provided to the spouse who remained as an employee was taxable to her since she was treated as a 2% shareholder.



Although the taxpayers prevailed on the major points of their contention regarding capital gains treatment, the case points up the hazards of retaining too many ties after a stock redemption. The IRS is watching!

LLC MANAGERS' DUTY OF LOYALTY AND CARE

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persons on matters the manager reasonably believes are within the person's professional or expert competence; or a committee of managers of which the manager is not a member if the manager reasonably believes the committee merits confidence.

A manager is not acting in good faith if the manager has actual knowledge concerning the matter in question that makes this reliance unwarranted.

An LLC manager is not liable for any action taken as a manager, or any failure to take any action, if the manager performs the duties of his office in compliance with the North Carolina LLC statute requiring a duty of loyalty and due care.

New Law Adds Obligations for Employers with Employees in Military Service

By F. Stephen Glass

On December 10, 2004, the President signed into law the Veterans Benefits Improvement Act which amends the Uniformed Services Employment and Reemployment Rights Act (known as "USERRA") in two ways that have significance to employers whose employees have been called to active duty military service.

Continued Health Plan Coverage Must be Offered for 24 Months

USERRA contains a requirement that eligible employees who are called to military service must be allowed to continue health coverage for themselves and their covered dependents under the employer's plans, at the employee's expense. In the past, this requirement applied for up to 18 months, which corresponded to the COBRA continuation period. The new law extends that period from 18 months to 24 months. ("Health plans" for this purpose include all of your plans that are subject to the COBRA requirements, including medical, dental and vision plans.)



Notice of USERRA Rights and Duties The new law also adds a requirement that each employer must provide to employees entering military service covered by USERRA a notice "of the rights, benefits, and obligations of such persons and such employers" under USERRA. This requirement can be met by posting a notice in the locations where you customarily place notices to employees. The notice requirement is effective March 10, 2005.



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F. Stephen Glass is the author of *The Legal Handbook for North Carolina Businesses; Your Estate Planning and Administration Handbook; Limited Liability Companies Update 2004 (Formation and Operation; State LLC Law Issues; LLC Tax Issues; LLC Securities Law Issues; Special Uses of LLCs); Contract Preparation: Drafting Complete and Unambiguous Contracts; North Carolina Family Limited Partnership Update.; Wrongful Discharge*. His practice is concentrated in the areas of business, employment and corporate law, business succession planning and estate planning. He serves on the Cary board of Capital Bank.

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North Carolina Retaliatory Employment Discrimination Act

By F. Stephen Glass

The North Carolina's Retaliatory Employment Discharge Act ("REDA") defines retaliatory action to mean "the discharge, suspension, demotion, retaliatory relocation of an employee, or other adverse employment action taken against an employee in the terms, conditions, privileges, and benefits of employment."

The REDA prohibits any person from discriminating or taking "any retaliatory action against an employee because the employee in good faith does or threatens to" file a "claim or complaint, initiate any inquiry, investigation, inspection, proceeding or other action, or testify or provide information to any person with respect to exercising rights under certain worker protection laws.

An employee who claims discrimination in violation of REDA may file a complaint with the Commissioner of Labor within 180 days of the alleged violation. The Commissioner will investigate and attempt to resolve the matter through informal, confidential methods. As part of the investigation, the Commissioner may issue subpoenas. The Commissioner must make a determination within 90 days of receiving the complaint. If the matter is not resolved, the Commissioner will either bring suit or issue a right-to-sue letter to the employee. The following remedies are available in a civil action: injunction; reinstatement to the same or an equivalent position; reinstatement of full fringe benefits and seniority rights; compensation for economic losses such as lost wages; automatic treble damages for economic losses if the court determines the violation was willful.

Note: The North Carolina statute explicitly provides that an employer is not guilty of violating the law if the employer can prove that the unfavorable action would have been taken even if the employee had not engaged in a protected activity.