

BUSINESS LAW NOTES

[Part two in this series]

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BUYING A FRANCHISE

by M. Blen Gee, Jr.

If you have completed a thorough business analysis of a franchising opportunity, then you are ready to take the next step. What are the major legal issues concerning the franchise and how do they relate to what you have already learned? The Uniform Franchise Offering Circular (UFOC) is one of the major legal issues of concern to a prospective franchisee.

The Federal Trade Commission (FTC) requires certain specific disclosures by a franchisor prior to the sale a franchise. Approximately 18 states (but not North Carolina) have specific disclosure or registration requirements as well. The UFOC is a uniform disclosure document developed as an attempt to meet both federal and state disclosure requirements. A properly prepared UFOC will satisfy the FTC requirements and this is typically what is received by prospective franchisees.

Some of the key disclosures that are required are:

- The business experience

of the franchisor's officers and directors over the previous five years.

- The business experience of the franchisor
- Certain criminal convictions of officers or directors.
- Lawsuits and administrative proceedings against the Company that have resulted in a judgment or settlement.
- Bankruptcies of officers and directors.
- Initial and recurring fees.
- Any requirement that goods or services to be purchased from affiliated companies
- A description of leases, services and products that the franchisee must purchase.
- Limitations on customers, territory, or the goods and services that can be provided.
- Territorial protections.
- Financial information about the franchisor.
- Earnings claims, if any.

A thorough reading and understanding of the UFOC is essential. Discuss any and all questions you have about the UFOC with your business attorney or your accountant

[Next issue: The Franchise Agreement]

The Lighter Side of Employment Law: Being "Blonde" or "Southern" Is Not Protected by Title VII

Employment discrimination laws prohibit the termination of employees on protected characteristics. In two recent federal court decisions demonstrate, however, employees raised interesting issues. In one, a female employee sued her employer for "blonde" harassment; in another, the employee sued for harassment based on her southern accent.

The courts saw little humor and dismissed these cases.

Our law firm has provided exceptional legal services to clients throughout the state and the U.S. for more than 45 years. A full-service firm founded in 1955, we have built a reputation for helping clients solve difficult problems with sound counsel, sophisticated analysis and superior performance.

A hallmark of our firm is personalized client service. Recognizing that each of our clients has a unique set of issues, objectives and needs, our firm is committed to individualized attention and works as an integrated team to respond to our clients' needs. We serve diverse clients, including Fortune 500 companies, government agencies, professional associations, closely held corporations, limited liability companies, partnerships and individuals.

“One size/entity does not fit all businesses”

FAQ'S REGARDING CHOICE OF BUSINESS ENTITIES

By F. Stephen Glass

In recent years, North Carolina has revamped its corporations, partnerships and limited partnerships statutes and added a statute permitting formation of limited liability companies (or "LLCs"). The main objectives of a prospective business owner are to choose an entity that will “shield” the owner from personal exposure to the business liabilities and obtain favorable tax treatment. With several available choices, what is the best entity to use? There are significant tax and non-tax distinctions among the available entity choices. Your selection should be made in light of your company's circumstances (one size/entity does not fit all!).

The following are some “frequently asked questions” regarding choice of business entities:

What is the difference between an S and a C corporation?

A corporation will be treated as a C corp unless it qualifies for and makes a timely election as an S corp in order to achieve "pass-through" tax treatment. Thus, owners of an S corp will be taxed only once – at the personal income tax level – while owners of a C corp face dual level taxation – once when the corporation pays tax on its income, and again when income is distributed to the owner, where the owner's income is taxed. The protective shield against business liabilities is the same for both kinds of corporations.

With the drop in individual income tax rates does it make sense to organize my business as a C corp?

Prior to 2001, the top marginal rate for individuals was 39.6% and the top marginal rate for C corps was 35%, so it was frequently advantageous to organize a business as a C corp (other factors excluded from this consideration). As a result of the 2001 tax act, the 39.6% bracket is gradually reduced so that it will be 35% by 2006. There are still some attributes of a C corporation that are attractive, such as the availability of tax-advantaged fringe benefits for owners of the business and the 50% capital gains exclusion potentially available under IRC §1202. The reduction in individual tax rates, however, makes entities that offer pass-through taxation more attractive than ever.

Why do the venture capital providers prefer funding C corps?

For start-up businesses generating losses, a flow-through entity such as an LLC or an S corp, generally provides tax benefits that make it preferable to a C corp. A profitable C corp may distribute after-tax earnings to shareholders as dividends. In computing their tax liability, however, shareholders must generally include C corp distributions in income, and cannot use C corp losses as deductions. Since LLCs can have multiple classes of equity interests and it is possible to fashion an LLC membership interest comparable to convertible preferred stock, one might think that the LLC form would be attractive to investors. Nonetheless, venture capital providers generally make conversion to a C corp a condition for providing funding. One reason is the nonrecognition treatment available to C corps for mergers and other kinds of reorganizations under IRC §368. This nonrecognition treatment is not available to LLCs or S corps -- or to corps that have converted to C corps in anticipation of a reorganization. A second reason is the 50% capital gains exclusion under IRC §1202 that is available only to C corps. The venture capital providers seem willing to sacrifice short term tax benefits in hopes of maximizing the after-tax return to investors when a liquidity event occurs. The preference for C corps also appears to be driven by non-tax reasons. Investors are familiar with the structure of corps, and they find it easier to get deals closed and manage their investments if all their portfolio companies are organized as corps.

[To be continued in next issue. Steve Glass may be contacted at sglass@jhvgmlaw.com or 919.743.2200]

YOUR GOODS DELIVERED TO BANKRUPT CUSTOMERS? WHAT SHOULD YOU DO??

By Jean Winborne Boyles and M. Blen Gee, Jr.

You have just shipped off several thousand dollars worth of merchandise to a customer on 30 days net credit terms and a few days later you learn that the customer is on the verge of filing bankruptcy. Is there anything that you can do? Surprisingly, yes, but *INSTANT ACTION IS REQUIRED!*

Under § 2-707 of the Uniform Commercial Code and § 546 of the United States Bankruptcy Code, you can demand in writing immediate return of the goods that you have just shipped. You must do this within 10 DAYS after your customer RECEIVES the goods.

If you make a timely and proper demand for reclamation of your goods, you may be able to substantially increase your recovery in bankruptcy. You may actually be allowed to repossess your goods. More likely, however, you will be granted a “lien” on debtor assets equal to the value of your goods or an “administrative priority.” In either case you will probably receive close to the full value of your goods. If you delay ten days after delivery of the goods to your creditor before you make your demand, you can expect to receive little or nothing in the bankruptcy proceeding since you will then be considered an unsecured creditor.

Here are the things that you need to do:

- Send a letter to your customer. Use the form below as a guide.
- The goods that you want to reclaim should be carefully identified.
- Use multiple methods of communication (i.e., fax, overnight service, certified mail, and e-mail.) Your demand for reclamation is probably effective as of the time that you send it rather than when the customer receives it. However, the case law is not clear and you should not take chances.
- If the customer has more than one address (for example local office and corporate office) send it to multiple addresses.
- Carefully retain documentation of the giving of notice (i.e., fax cover sheet, return-receipt for certified mail, overnight delivery service documentation.) Some overnight delivery services will give you documentation of receipt similar to certified mail.
- You will want to contact a lawyer to make sure that you’ve done everything right and to pursue collection. However, if you cannot speak to your lawyer immediately, you should not wait before sending your notice.

***INSTANT ACTION IS REQUIRED* when you have just shipped merchandise to a customer who learn is about to file bankruptcy!!!**



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F. Stephen Glass is the author of *The Legal Handbook for North Carolina Businesses*, and *Your Estate Planning Handbook and Limited Liability Companies in North Carolina—2004 Update*. His practice is concentrated in the areas of business, employment and corporate law, business litigation, business succession planning and estate planning. He serves on the Cary board of Capital Bank.

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PROTECTING YOUR COMPANY FROM E-MAIL AND INTERNET ABUSE

By F. Stephen Glass

While e-mail and the internet are great resources for an employer, they are not without their problems. Employees in many companies spend an inordinate amount of time browsing the internet for non-business use and/or use the company's e-mail in an inappropriate manner. An employee has no right of privacy in the use of the company's electronic resources. Protecting your company's systems from abuse and misuse raises both practical and legal issues.

Employer's Right to Monitor. An employer's risk is significantly reduced to the extent that:

- The employer's policy is specifically spelled out that its employees e-mail and web-site activities are subject to inspection by the employer, and
- Any inappropriate e-mail or website activity by employees would be cause for termination.

The employer's right to monitor these electronic resources and prohibiting their misuse or abuse should be included in the company's Employee Handbook.

Employers interested in creating or updating an employee handbook may contact Johnson, Hearn, Vinegar, Gee and Mercer, PLLC, at the address given above.

An employee has no right of privacy using the company's e-mail or internet on company time.