

BUSINESS LAW NOTES

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Business Succession Planning: PART THREE

ANATOMY OF A BUY-SELL AGREEMENT

By F. Stephen Glass

Because a company is a legal entity separate from the individual owners, it is advisable for partners of a partnership, shareholders of closely held companies and members of limited liability companies to enter into a buy-sell agreement to regulate the relationships with each other and the company. This agreement should be adopted by the business entity early in its formative stage when feelings and attitudes are in harmony. If a buy-sell agreement is not in place when a dispute arises among the owners, it may be impossible for the various factions to carry on the company's business.

Some of the provisions of a typical buy-sell agreement include:

- The business owners agree to control the transfer of ownership and to waive or modify their rights as owners that are provided under North Carolina law.
- Each owner agrees that the restricted shares are "for investment only", that the restricted membership shares have not been registered with the Securities Exchange Commission (SEC), and that the restricted ownership shares will not be sold or otherwise transferred in a way that will require SEC approval or action.
- The ownership certificates shall contain an appropriate "Transfer Restricted" clause.
- If an owner decides to sell any or all ownership, and receives an offer from an outside party, that owner must first make the same offer to sell the shares to the business entity.
- If the business entity does not accept the offer to purchase all the ownership interests offered, it must notify the other owners that the ownership interests are available for purchase. Each owner may choose to buy some or all of the ownership interests offered. If the owners want to buy more of the ownership interests than are available, the available shares shall be divided among them in proportion to the shares they already own.
- Any shares not purchased by the company or the other owners may then be purchased by the outsider. The outside purchaser buys subject to all of the provisions of the buy-sell agreement.
- A valuation formula, such as book value, multiple of earnings, etc. is often set up in the agreement. Another method for establishing the value or sale price of the shares is by utilizing third-party appraisal.
- If an owner dies, becomes permanently disabled or legally incapacitated ["triggering events"], the company would buy that owner's shares at the per-share value established each year by the company's owners. In the event of death or permanent disability, payment could be made by an insurance policy purchased by the company for each owner.
- If an owner's former spouse receives any of the company ownership pursuant to a divorce, such an event becomes a "triggering event." The terms of the agreement can keep the business "in the family."



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FRANCHISING – FTC STUDIES RULE CHANGES

By M. Blen Gee, Jr.

The Franchise Rule promulgated by the Federal Trade Commission (FTC) in 1979 requires detailed disclosures by a franchisor to prospective franchisees. It is probably the single most important law or regulation affecting franchising in the United States. The rule has not been amended since 1986, but the FTC staff has issued a lengthy report suggesting changes to the rule. Significant proposed changes are listed below:

Proposed Changes:

- Written disclosures would have to be made at least 14 calendar days before paying money to the franchisor or signing a binding agreement.
- Electronic disclosures would be specifically permitted.
- Disclosure of a franchise broker would no longer be required.
- Disclosures made in the Uniform Franchise Offering Circular (UFOC) could not be superceded by the franchise agreement. This is a significant proposed change.
- Disclosure of prior litigation would be expanded.
- Use of plain English in disclosures would be required.
- Revised disclosures of the franchisor's plans to operate a competing system for similar goods or services would be required. This is a significant proposed change.

No timetable has been set for acting on the staff's recommendations.

HIDDEN RISKS IN EQUIPMENT LEASES

By M. Blen Gee, Jr.

Businesses frequently lease equipment without the slightest thought about the legal risks involved in the transaction. In the vast majority of cases, the lease does not become a problem. However, occasionally a business dispute arises and the lessee suddenly finds that the documents he signed and the law are stacked against him.

The statute governing equipment leases in North Carolina, and in many other states, is Article 2A of the Uniform Commercial Code. At least one commentator believes that the drafting of Article 2A was dominated by the leasing industry and that this has produced a statute drastically lopsided in favor of lessors. Here are some of the problems in a typical commercial lease of equipment:

- If you default under the lease, the lessor may repossess your leased equipment **without any notice to you whatsoever!**
- The lessor may repossess your equipment and simply hold it, but still require you to pay the full rent.
- As an alternative to repossession, the lessor can disable your equipment. You would continue to be liable for rent but would not be able to use the equipment.
- If you are buying used equipment, a UCC search will disclose the existence a lien on this equipment. However, a UCC search may not reveal the existence of a valid lease. You may believe that you have purchased a piece of equipment only to find out that the seller had no authority to sell it and you do not actually own it. (Most commercial leasing companies file a UCC financing statement with the appropriate Secretary of State, even though they are not required to. Therefore, in most cases you can learn about the existence the lease with an appropriate UCC search.)
- Frequently, a lease will be governed by the law of another state; if that state has not adopted the most recent revisions to Article 2A, you may be subjected to some very onerous provisions. If the lease provides that it is governed by North Carolina law, this is cold comfort since the North Carolina version of Article 2A is almost as bad.
- In real estate leases and virtually every other contract

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BUSINESS TAX LAW

IRS Allows More Flexibility in Flexible Spending Accounts

By F. Stephen Glass

The IRS Notice 2005—42 will benefit employees who participate in flexible spending account plans (FSAs). FSAs are accounts, usually funded by voluntary annual employee contributions under a "cafeteria plan", which employees can use to pay health or dependent care expenses on a pre—tax basis. For example, an employee could use a health FSA to pay, on a pre—tax basis, deductibles, co—payments and other health expenses that are not paid by the employee's health insurance.



The most notable disadvantage of FSAs has been the "use it or lose it" rule, which provided that an employee would forfeit any unused amount left in a FSA at the end of the plan year. Thus, the "use it or lose it" rule required that employees carefully plan how much they would contribute to FSAs for a plan year, because they would lose any "over—contribution" benefits.

The IRS amendment to the "use it or lose it" rule provides that an FSA plan may give employees a two and a half (2 ½) month grace period after the end of each plan year during which the unused portion of their FSAs can be used to pay qualifying expenses.

Employers must amend their FSA plan document before the end of the plan year to take advantage of this new rule.

HIDDEN RISKS IN EQUIPMENT LEASES

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- situation, there is a duty for the injured party to "mitigate damages." This means the injured party must make reasonable efforts to limit his losses. The duty of a lessor of equipment to mitigate damages, on the other hand, is very limited. In fact, many commentators argue that there is no meaningful duty to mitigate damages at all.
- If the lessor decides to sell the repossessed equipment, he may do so and must give you "an appropriate credit" against the amount owed. However, unlike other UCC provisions, there does not appear to be any requirement that the goods be sold in a commercially reasonable way.
- When the lessor is a financial institution, the lessor gives no warranties. The supplier's warranties to the financial institution pass through to you. However, the lessor has no incentive to negotiate strong warranties. Therefore, you should carefully negotiate with the supplier yourself.
- Article 2A gives the lessor the opportunity by agreement to further limit rights of the lessee. For this reason, the "boilerplate" of the lease should be read carefully.
- A common area of abuse is a "liquidated damages" clause. Such provisions can give the lessor a windfall in the event of a default.
- Typically, at the end of the lease term, you are required to ship the equipment back to the lessor. While you may have leased the equipment locally, you may find that you are required to ship the equipment to some far away location.
- Commercial leases typically cannot be canceled early. Because you are leasing, you do not own the equipment and cannot sell it. Assignment of the lease to someone else is subject to the lessor's consent. In practical terms, a lessee can sometimes find himself with a piece of equipment that he no longer needs, he cannot sell, and that he cannot return to the lessor.

Commentators on Article 2A frequently refer to the standard commercial lease as a "hell or high water" lease. That is to say, you are probably stuck with your lease, come hell or high water. Unless there are strong advantages to a particular lease, a decision to purchase the equipment might be a better move.



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CALCULATING LEAVE TIME UNDER THE FAMILY & MEDICAL LEAVE ACT

By: Frank X. Trainor, III

Private sector employers who employ 50 or more employees and certain employees are subject to the federal Family & Medical Leave Act ("FMLA") which entitles employees to a total of 12 work weeks of leave during any **12-month period**. However, many employers have had difficulty in calculating when a "12-month period" begins and ends.

There are four ways in which an employer may calculate the 12-month period:

- (1) the calendar year;
- (2) any 12-month "leave year" such as a fiscal year or the employee's "anniversary" date;
- (3) the 12-month period measured forward from the date any employee's first FMLA leave begins;
- (4) a "rolling" 12-month period measured backward from the date an employee uses any FMLA leave.

Any of the four methodologies is acceptable to the Department of Labor. However, an employer must choose one methodology and stick with it. **Otherwise, the federal government will apply the methodology most advantageous to the employee on a case by case basis.** Check your employee handbook and see if the FMLA section specifies the type of 12-month period utilized by your company. If it does not, now is a perfect opportunity to change your handbook and/or circulate a memorandum to your employees informing them of how the 12-month period will be calculated.

There are advantages and disadvantages to each of the four methodologies. Generally speaking, employers use the 12-month "rolling" period as method of calculating leave time. Utilizing such a rolling period places some administrative burdens on the employer, but will help to alleviate the danger of having the employee take unreasonably long periods of time for FMLA leave. If a fixed year, such as a calendar year, is chosen by the employer, then the FMLA leave time is easily calculated. However, it can lead to results that are not advantageous to the employer. For example, if a calendar year is utilized, the employee may take the last 12 weeks of one calendar year and follow that with the first 12 weeks of the next calendar year. An employee will have effectively taken a 24 week leave time. This may be a situation that your company wishes to avoid. If you choose to change your methodology, employees must be given 60-days notice prior to the implementation of that new policy.