6 Most Devastating Dangers Facing Today's Business Franchisees & Licensees!™

Warning: Creditors, Franchisors and Licensors Using Bankruptcy Courts to Eject Founders, Owners & Controlling Shareholders!
You're Fired, Without Pay! Fired From My Own Company?

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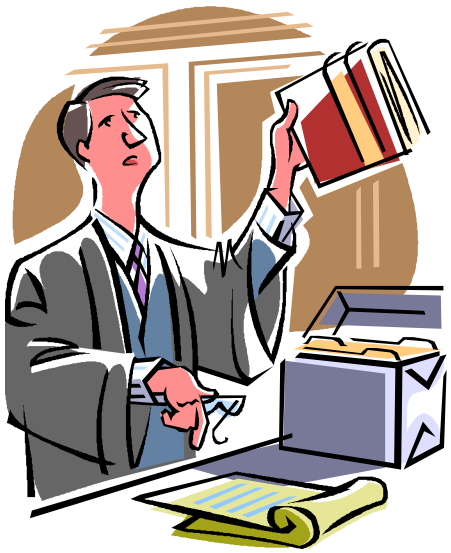

The List:

The 6 Most Devastating Dangers Facing the Small Business Owner™

1. Lack of Proper Bargaining or Negotiating Position
2. Lack of Proper Entity Formation
3. Lack of Proper Employment Agreements
4. Lack of Proper Buy-Out Agreements; Operating, Organizational, or Equity & Profits Interest Agreements
5. Lack of Proper Use of Insurance, Financial & Pension Products (Buy Sell, Life, Disability, Key Man, Income Replacement, Pensions, etc.)
6. Lack of Proper Asset Protection Facing Risks & Costs of Litigation

The Explanation:

1. Lack of Proper Bargaining or Negotiating Position

Lack of proper bargaining or negotiating position often results in vulnerability to legal, business and hidden contingent liability. The small business owner (licensee and franchisee) often suffers from a lack of bargaining position which results in the inability to effectively negotiate proper agreements, leases, and ventures. Also, too often the small business owner must form his entity and business, and operate on a shoe-string budget.

However, the small business owner must seek the most beneficial *positioning* at all opportunities. For example, currently, many retail, office or industrial tenants are suffering from the recession and can't afford their operating expenses. The landlords are also suffering. As such, today's business owner must understand that the time to re-negotiate with the landlord is now, and that there are several benefits waiting for the tenant in such a negotiation. The tenant should seek to lower the cost of its lease in terms of monthly payments, as well as pass-through (CAM) common charges. This can be done in various ways, but the point is it must be attempted, usually through an attorney, broker, or advisor, and then properly documented.

Licensors, or certain franchisors are motivated to take control (and ownership) of potentially successful territories or stores, especially in troubled times when valuations are at its lowest, in order to realize profitable (company) operations when the economy returns, without loss of profits to the licensee or franchisee.

2. Lack of Proper Entity Formation

All too often the client wants to save legal fees by self-forming, or paying for a bare-bones entity formation, without an appropriate employment and buy-out agreement. The client fails to appreciate that not-all-entity-formations are created equally. Sometimes you get exactly, and only, what you pay for.

My Little Story About Corporate Jack & Diane!

To illustrate the key points in this article, let's use my little story about corporate Jack and Diane, starting their own business, going from rags to riches, back to rags. Licensors, or certain franchisors are motivated to take control (and ownership) of potentially successful territories or stores, especially in troubled times when valuations are at its lowest, in order to realize profitable (company) operations when the economy returns, without loss of profits to the licensee or franchisee.

Jack and Diane, the client, consult an attorney about forming an entity to start up a new business. The client barks at the price and decides to do it themselves, or instructs the attorney (or CPA) to form a bare-bones entity. Maybe the client either decided not to pay

for certain key operating agreements or the attorney, CPA, or online portal, simply failed to advise the client of this option, and the risks concomitant in this decision.
In any event, the client gets their new entity, no-frills. They start operating their business, and despite the odds, they start to succeed, succeed, and succeed. After a few years, they now have gross revenues in the mid-tens of millions of dollars. This scenario will apply to the average franchisee or licensee business making far less, as well.

Being self made, they hire the minimum qualified personnel to run the executive offices. As a result the company runs afoul of certain tax requirements, license or franchisee arrangements, but manages to continue growing exponentially. Then some event occurs which changes the direction of this growth plan. Let's assume, that one buys the other partner out and fails to adequately plan the cash flow requirements of such a deal, or fails to plan for the contingency that the franchisor or licensor, may decide to make an end-run around this client's rapid success-train and take back this successful going concern, either based on *'the bigger corporate greed doctrine,'* or because this client has violated terms of the arrangement (that the franchisor/licensor says simply cannot be cured).

Warning: creditors, franchisors, and licensors are using the bankruptcy court to eject founders, owners & controlling shareholders – without pay, or equity or profits-interest buy-out compensation!

Well, let's not forget, that 'the bigger corporate greed doctrine' comes with *'bigger corporate lawyers,'* and a much *bigger war-chest*. Maybe just maybe, they have experience getting around *their* nuevo-riche. They have probably done it before, many times. Well, the big-guy (or gal) usually has.

Consider, if the client, made certain financial decisions that jeopardized, even potentially, the ability of this entity to pay its bills as they became due. The creditors, franchisors, licensors, and agency principals might have some rights. The state corporate and civil codes have laws that protect the creditors, but the federal bankruptcy laws are even more potent. Federal bankruptcy laws interpreting state property or employment rights can be a two-edged-sword for the unwary.

If this client's situation is put into the jurisdiction of the federal bankruptcy court ("BK Court"), watch out, the freight-train is-a-coming. The BK Court has its mandates. It must look out for the creditors – not the owners, necessarily. Let's image that the 'bigger corporate lawyers' (or the BK version of them) get the BK Court to replace the client as the person-in-charge (or Responsible Officer or Person ("RP")), by in part, accusing the client of wrongdoing: yes, stealing money, falsifying invoices and the like; yes even before any due process or investigation. Well, the judge might have to put an RP in charge of the client's entity (business). When the client gets to work the next day, the new RP, hands the client the Pink-Slip – and says your services are no longer needed; and by the way, there will be no further compensation as well. You're Fired - Without Pay! Please get off the property.

Now you say, that can't happen to the founder, the owner, the President, the Director and the controlling Shareholder of his/her (own) company. Wrong, it can happen, and it does!

The client sits back and collects his thoughts for the moment, scratches his head and does his best James Dean. ***How could this happen?***

3. Lack of Proper Employment Agreements

> A. Failure to have a written or provable employment agreement requiring "cause" for termination can come back to ruin your client!

If the new RP wants to fire the client, he/she should first review any employment agreements with the client and this company. What's that: there are none? Or are there? Well then, the law in many states, certainly for example, California, allows a person without an employment agreement to the contrary, **to be fired for any reason**, ***without cause***. This is a matter of state law determination. The client in California would be considered an *at-will employee*, and as such could be terminated at any time.[1] The RP found no written employment or buy sell agreement. Hence, the RP (and BK Judge) had every right to say You're Fired - Without Pay.

Employment for an indefinite term is presumed to be at-will (Cal. Lab. Code 2922; Foley v. Interactive Data Corp., 47 Cal 3d 654, 677). This presumption may be rebutted by a **contract, express or implied**, that limits the employer's right to terminate. Id. "The board's removal of a person from office has no effect on whatever rights that person may have under contract of employment with the corporation… [Corps C Section 312 (b) creates "at-will" presumption which can be **overcome by terms of express or implied contract].**[2] {emphasis added}

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[1] California statutory law provides generally that an employment relationship having no specified term may be terminated at the will of either party on notice to the other. Cal. Lab. Code §2922. These exceptions include (i) public policy; (ii) state and federal statutes (e.g., the California Fair Employment and Housing Act prohibits termination based on race, sex, etc.); (iii) implied contract …to create an implied contract that employee can only be terminated for good cause); Foley v. Interactive Data Corp., 47 Cal.3d 654 (1988); and Pugh v. See's Candies, Inc., 116 Cal. App. 3d 311 (1981); and (iv) the covenant of good faith and fair dealing (one cannot terminate an employee in bad faith in order to deny the employee some benefit of the employment bargain). For the many exceptions to the at-will rule, see 4 Wilcox, California Employment Law, §60.02 (2000). In the absence of any termination clause, termination would be subject nominally to Labor Code section 2922 (termination "at will") if the Agreement provides for an indefinite term or to section 2924 ("willful breach of duty, . . . habitual neglect, . . . or continued incapacity to perform . . . .") if the Agreement is for a specified term. Either standard may be varied contractually. Employment nominally "at will" can also be altered by implied contract.

[2] [Corps C Section 312 (b) creates "at-will" presumption which can be overcome by terms of express or implied contract] 6:267 TRG CORPORATIONS *Current through Stats 2005, ch. 728* **§ 312.** (b) Except as otherwise provided by the articles or bylaws, officers shall be chosen by the board and serve at the pleasure of the board, **subject to the rights, if any, of an officer under any contract of employment**. Any officer may resign at any time upon written notice to the corporation without prejudice to the rights, if any, of the corporation under any contract to which the officer is a party. [emphasis added]

The Evidence

Why didn't the client have a "provable" 'for cause' employment agreement again? That's right, he/she didn't want to pay for it. A simple 'for cause' employment agreement would have saved the day.[3] Or did the client tell his counsel he had no contract, express or implied, or did his counsel fail to offer evidence of the client's implied contract for-cause? Had the client had the minimum written evidence of a for-cause employment agreement, the client would still be in the driver's seat of his own company, or fully compensated during the litigation, as opposed to - out in the cold.

4. Lack of Proper Buy-Out Agreements; Operating, Organizational, or Equity & Profits Interest Agreements

> B. Failure to have a written or provable buy-out agreement requiring a substantial buy out valuation in the event the client is fired or terminated from employment, or enjoined from working in his/her own company, can leave the client penniless!

Well even if the client failed to have a provable or written for cause employment agreement, the new RP who did exercise the legal option to terminate the client, would have to satisfy the terms required in the employment agreement, and related agreements (Buy-Out Agreement, Profit's Interest Agreement, etc.) "Buy-Out" agreement should not mean "Bye-You're Out" agreement.

Small business owners need to have buy-sell agreements that supply the mandate of buy-out, and valuation of same, whether it be *book value, fair market value, some fixed minimum, or some other valuation method, and or compensation, profits interests or equity payments due the key-man if employment ceases.* Small business founders and owners need to plant a poison-pill in their buy out agreements, coordinated with their employment agreement. A poison-pill could be a steep price to pay for an intruder. That's right, beware of the contingency of an intruder of a private company. A poison pill

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[3] ASSUME IT ALL OR REJECT IT! If Jack had an employment or buyout contract 'for cause', he had a duty to offer such evidence to the court for a determination of whether to the estate would 'assume or reject' the contract in BK. If the court allowed it to be 'assumed', the court is required to assume all the terms and conditions of the contract (for cause) not just certain terms, conditions or provisions. Raima UK Ltd. v. Centura Software Corp. (In re Centura Software C..., 281 B.R. 660. "Section 365 provides for the assumption or rejection of executory contracts or leases in existence at the commencement of a bankruptcy case. Lawrence P. King et al., Collier on Bankruptcy P365.01 pp. 365-17 (15th ed. Rev. 2002). If the trustee or debtor-in-possession assumes a contract, it is not interrupted and the contracting parties' rights are undisturbed. Id. Assumption of executory contract under **11 USCS § 365 requires debtor to accept its burdens as well as permitting debtor to profit from its benefits.** In re University Medical Center (1992, CA3 Pa) 973 F2d 1065; "Bankruptcy law provides a federal machinery for enforcing creditors' rights but the rights themselves are created by state law."; *In re Christensen*, 95 Bankr. 886, 890 (Bankr.D.N.J.1988); *In re Skelly*, 38 Bankr. 1000, 1001 (D.Del.1984) ("The nature of a creditor's property rights in bankruptcy is **defined by state law,** not federal law.") (citation omitted)."

is the very thing the big boys (and gals) use at the public company level. Why shouldn't the small business person take heed.

Operating, Organizational, or Equity & Profits Interest Agreements

Agreements should rarely stand-alone. Proper business formation and planning should include the coordination and integration of the entity operating agreement, the organizational agreements, by-laws, and any equity and or economic or profits interest agreements along with the employment agreements. Each can bear upon or condition the rights of the other.

5. Lack of Proper Use of Insurance, Financial & Pension Products (Buy Sell, Life, Disability, Income Replacement, Pensions, etc.)

Proper estate, business, and asset protection devices are often funded with insurance or annuity products for purposes of supplying the necessary liquidity. Life insurance is often used to fund the Irrevocable Life Insurance Trust (ILIT), the Key Man Employment Agreement and the Buy-Sell Agreement (or other appropriate agreement). Disability and replacement income insurance is often used to supply liquidity on the occurrences of those events. Certain pensions and retirement trusts are often used as vehicles to supply income and assets necessary for retirement and afford asset protection over creditors and lawsuits. For more information on insurance, pension and annuity products commonly used in estate, business and asset protection planning, see the article: 13 Secrets of the Rich or Informed™ (www.preferredprofessionalpublishing.com).

6. Lack of Proper Asset Protection Facing Risks & Costs of Litigation

When litigation comes calling, it's often a high risk game of poker. Generally, half win and half lose. So the goal should be to avoid having all of eggs-in-one-basket; especially if that basket is not protected from creditors and lawsuits. The cost of litigation, the stress of litigation and the uninsured judgment from litigation can ruin empires. Proper planning is a must.

All of the above issues combined, coordinated and integrated are the beginnings of a proper estate, business and asset protection plan. Proper entity selection, along with the proper documentation for employment, equity or profit interests, and buy-out of each, must be reconciled with proper estate and asset planning. Living trusts primarily used to avoid probate and centralize estate asset and debt distribution and liability, generally are not a device that will protect assets from creditors or lawsuits. Certain irrevocable trusts, including certain retirement trusts, as well as certain pensions, will add protection from creditors. Certain insurance and annuity products will add protection and liquidity needed for a properly resilient estate, business, and asset protection plan. For more information on the commonly used estate, business and asset protection devices, see the article: 13 Secrets of the Rich or Informed™ (www.preferredprofessionalpublishing.com).

Conclusion

Well then, Diane then leaves Jack; but is this just a little story about corporate Jack and Diane, two American kids doing the best they can, or could they have done better (with proper guidance)? When termination or *enjoindre* comes, retribution or redress for same should be waiting – with teeth.

Business Owners: Remember; don't unwittingly be penny wise and pound foolish!

Advisors: You may have a ***duty to warn clients*** to review their entity structure for legal risk and litigation analysis, including a contingency analysis.

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