MJM LAW, LLC

SUMMER 2011 NEWSLETTER

Dear Valued Clients:

As is always true, legal information and decisions have both current and future effect. I hope you will find the following information and developments both interesting and helpful. I look forward to answering any questions you may have and to serving your legal needs.

FRANCHISING YOUR BUSINESS

Background: You have a small successful business and you believe that it could be replicated with equal success. How can you do this?

One traditional means of doing this would be to open more company stores on your own, but doing so obviously would take lots of capital and time, and you can only be stretched so far and still feel in control of what could be distant additional locations.

Franchising is a time-tested alternative for expansion that, at least over the long run, should involve less of your own time and money. If all goes well--and the odds of that are certainly enhanced by getting good professional advice at each step in the process--you can expand using someone else's money, you can reduce your risks because the franchisee(s) (you are the franchisor) will take on most of the responsibilities and risks that come with opening new stores, and you may be able to expand more rapidly than if you go it alone.

Franchising entails opening additional outlets by selling franchise rights to independent investors who will use your name and operating system. The franchisee will pay you an initial franchise fee in exchange for the rights to open and operate a business under the franchise trademark, for training in how to operate the business, and for any other startup services. Once a franchise is up and running, the franchisee will usually also pay you a periodic royalty fee,

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700 Wells Fargo Financial Plaza, 7900 Xerxes Avenue S, Minneapolis, MN 55431 mjmc@mjmlawllc.com

generally 4% to 10% of the sales, for continued support, training, and other services. A critical attribute from the franchisor's vantage point is that the franchisee must provide the capital required to start the business and must assume practically all of the risks of success or failure.

Questions You Should Ask

Before taking the plunge into franchising, however, you should be able to answer the following questions in the affirmative; otherwise, making the best of your single location makes the most sense.

- Will your business, however well it may have done in its original location, be well received in the broader marketplace?
- Does your business have a special, unique quality that will appeal to the "new" public that will be introduced to the business for the first time?
- Is your business concept, including processes that will have to be taught to the franchisees, one that can be easily duplicated elsewhere?
- Will your business idea sell well to potential franchisees?

Ingredients For Success

You need more than an appealing business idea for a franchising plan to be successful. Here are some of the other necessary ingredients: First, you need a proven, i.e., profitable, prototype upon which the new franchises can be modeled. Second, you should have a comprehensive set of written procedures, based on how the prototype is run, that will serve as a valuable training manual for new franchisees. Third, you should have a protected trademark that will identify in the marketplace the niche that you have created for the franchises (it can take some time and expense, but it is worth the trouble). Fourth, perhaps with the help of an

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experienced consultant, you should create marketing materials and a marketing plan for use in securing new franchisees. In the same vein, whoever actually sells the franchises must be aware of the strict regulations on such sales.

Finally, and crucially, you will need a Franchise Disclosure Document (FDD) that must be prepared in accordance with the regulations in the states where the franchises will operate and that must be approved by the state agencies that regulate franchises. A typical FDD will include an outline of the offering, information on the history and résumés of the principal franchisor officers, a report on the financial preparations for the franchising, and copies of the actual franchise agreement that will be used.

Conclusion: Devising and implementing a plan for franchising a business is in some respects a daunting prospect. On the other hand, if you had what it takes to establish a successful business in the first place, those same qualities, plus advice from experienced professionals, may allow you to cast a much wider net for your business through the franchising process. After all, practically all of the most well-known franchises spread out from a single, original location. (Think Dairy Queen, Starbucks, Mrs. Fields Cookies, …)

DELETING COMPANY E-MAIL

Background: A company is experiencing substantial financial difficulty and the President/CEO is suspected of covering up the difficulties and funneling money to himself. The company abruptly shuts down and is placed in receivership.

The receiver sued the former executive for a variety of actions taken in connection with the collapse of the company, including improper deletion of e-mails. Among the receiver's claims was an assertion that when the former CEO deleted the e-mails it was to cover up

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misconduct, which violated the federal Computer Fraud and Abuse Act (CFAA). One of the executive's defenses was that the CFAA only makes it illegal to "*damage"* computers, and that the mere deletion of e-mails could not reasonably be regarded as inflicting such damage. The federal district court hearing the case disagreed. It ruled that to require physical harm, or even some lesser injury, to a computer for there to be "damage" would be to ignore the expansive language that Congress used in drafting the CFAA. The judge pointed out that the law defined "damage" as "any impairment to the integrity or availability of data, a program, a system, or information." Given that definition, the court concluded that even the commonplace act of deletion of data from the company computers impaired the "availability" of computerized data, thereby constituting "damage" within the meaning of the CFAA.

The former CEO was unable to have the case against him dismissed but it remained for a jury to decide if he had, in fact, both deleted the e-mails and done so without authorization. On those points, an examination of the defendant's e-mail box on the server was enough to allow a jury to find that he had deleted the e-mails in question (the e-mail box had been reduced in size by about 98%) and that he had no authorization to do so based upon his "breach" of his "duty of loyalty" to his employer. The jury's decision adopted the receiver's argument that, although the CEO previously may have had broad authority to deal with his company e-mails as he wished that authority vanished once he feared or knew claims would made against him of misconduct and disloyalty.

REAL ESTATE PURCHASES AND SALES

Background: A couple is purchasing a home and has questions regarding the closing process and certain financial calculations made by the loan servicing company. The couple

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makes written requests for information but they are reported to credit bureaus as being delinquent on their mortgage payment obligations.

The Real Estate Settlement Procedures Act (RESPA) is a federal consumer protection law passed in 1974 that regulates real estate settlement (closing of the sale), including the servicing of loans and the assignment of those loans. RESPA places a number of duties on lenders and loan servicers, including requirements that borrowers be given notice by both a seller ("transferor") and a buyer ("transferee") when their loan is transferred to a new lender or servicer, and that loan servicers respond promptly to borrowers' written requests for information.

It takes a "qualified written request" to trigger the loan servicer's duties under RESPA to acknowledge and respond. RESPA defines a "qualified written request" as written correspondence from the borrower or his or her agent that requests information or states reasons for the borrower's belief that the account is in error. The written request must also include the name and account number of the borrower or must enable the servicer to identify the borrower.

Within 60 days after receiving a qualified written request, the servicer must take one of three actions: (1) Make appropriate corrections to the borrower's account and notify the borrower in writing of the corrections; (2) Investigate the borrower's account and provide the borrower with a written clarification as to why the servicer believes the borrower's account to be correct; or (3) Investigate the borrower's account and provide either the requested information or an explanation as to why the requested information is unavailable. The servicer must also provide a name and telephone number of a representative of the servicer who can assist the borrower. During the 60-day period, a servicer may not provide information to any consumer reporting agency regarding any claimed overdue payment of the borrowers.

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The borrowers sued the two mortgage companies involved in their home purchase for violation of RESPA and claimed that as a result they had been denied home equity lines of credit, a small business loan, and had suffered emotional distress.

In the culmination of what the court described as "maddening troubles" that the couple encountered with the mortgage companies a federal appellate court ruled that the borrowers' claims under RESPA for damages could proceed to a trial on the merits. Two of the five different letters sent by the borrowers were ruled to be qualified written requests. As to both letters, the borrowers contended that one of the mortgage servicers violated RESPA by reporting their account as delinquent to credit bureaus within the 60-day window after the letters were received. As to one of the letters, the servicer also was alleged to have failed to investigate properly or to take corrective action.

The borrowers withstood an argument by the mortgage servicers that the borrowers had not raised "triable" (valid) issues on actual damages allegedly sustained as a result of the RESPA violations. The court rejected this claim by the mortgage servicers and ruled that a jury must decide if the couple had, in fact, suffered the damages they claimed.

NEW GIFT TAX BREAK

Having a net worth of $1 million, or maybe even $2 million, is certainly not what it used to be. By some estimates, between 5 and 6 million American households have a net worth of at least $2 million today. This means that there are considerably more people today than just a few years ago who should consider how best to shield their money from the IRS and pass it on to their heirs. One such strategy that just became more attractive due to new federal legislation is the making of gifts during one's lifetime.

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Among the significant pieces of the new federal tax law that was passed in December, 2010, were very substantial, albeit temporary, increases in the lifetime gift tax exemptions for individuals and couples. For 2011 and 2012, these exemptions have increased five-fold, from $1 million to $5 million for individuals, and from $2 million to $10 million for couples. There will be no gift tax imposed on gifts that do not exceed those totals. The same law reduces the tax rate for gifts above the exemptions to 35% from the previous of 55%, thereby benefiting those individuals wealthy enough to make gifts that exceed the foregoing exemption levels.

Last year Congress also raised the exemption for federal estate taxes to $5 million and lowered the estate tax rate to 35% for 2011 and 2012, so that, *taken together, the new federal estate and gift tax rates are more favorable for taxpayers than they have been for approximately 80 years.*

This is an area of law for which sophisticated professional help is especially appropriate, but there are some general considerations to bear in mind when devising a plan for gift-giving. For example, making a tax-free gift now—not in 2013--makes good sense, especially for assets that are appreciating rapidly, so that future appreciation can be shielded from taxes. It is conceivable that Congress in the future could “claw back” gifts that are greater than the exemption at the time the donor dies, but, even in that event, any income or appreciation occurring after the gift date should be tax-exempt.

Other considerations for giving are more emotional than legal. Financial considerations aside, it may be a high priority for you to make sure that assets with sentimental value are preserved for future descendants, such as by putting them into a trust. Gifting decisions may also involve weighing some remorse over parting with assets that took a long time to acquire against

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the desire to improve the lives of those receiving the gifts. (Unless, of course, you fear the recipient(s) will squander the assets, in which case a "spendthrift trust" controlling the assets could prevent such squandering.)

Conclusion: In any case, if your analysis of the foregoing considerations results in favor of making major gifts, now is the time to make them.

SOCIAL MEDIA IN THE WORKPLACE

The prevalence of social media, including postings that are meant for employment-related topics in particular, has led to an increase in litigation between employees and employers. The scenarios leading the parties to the courtroom are as varied as the people themselves.one might imagine. A company fires a worker over her criticisms of the boss that she posted on Facebook. Repeated attempts by a manager to "friend" a female employee on Facebook eventually leads to allegations of sexual harassment. A disappointed job applicant sues when a job offer is retracted after a hiring manager turns up something about the applicant on Twitter that the manager finds disturbing.

In addition to scenarios in which a worker loses his or her job because of something appearing in social media, litigation may ensue against an employer if its supervisory officials go *too far*[1] in digging for dirt by this means. For example, two restaurant workers recently settled their claims against their former employer for a monetary payment after having sued the employer for gaining access to postings on a password-protected MySpace page set up as a chat group *for employees only*. What was found on the page eventually led to the workers' termination. The case was settled after a jury found that the employer had violated the federal

[1] How far is "too far?" Only judges and juries can determine that but if you are not sure, consult counsel.

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Stored Communications Act (SCA) of 1986.

The jury found that the employees' managers had violated the SCA by knowingly accessing the chat group on MySpace *without authorization from the involved employees*. Although a fellow employee had provided her log-in information to one of the company's managers, she had not authorized access to the chat group by any of the company's managers. She also felt that she had been coerced into giving her password to her manager, as she felt that she would have been in trouble if she had not done so.

Using the employee's password, the company's managers accessed the chat group on several occasions, although it was clear on the website that the chat group was intended to be private and accessible only to invited members. Finally, the managers continued to access the chat group even after realizing that the employee had reservations about having provided her log-in information.

<u>Conclusion:</u> Since e-mail first came on the scene many years ago countless cases have arisen over what was or was not appropriate when employees used their company-provided computers for sending e-mails. One time-proved beneficial action for employers as well as employees regarding e-mail use has been the creation by employers of a clear written policy on the subject (which can range from no use to liberal use) followed by informing and training the employees. Similarly, an employer's best protection against potential liability stemming from social media use by employees may be to establish a policy for social media use like that for e-mail use, i.e., clearly spelling out the ground rules for use of social media.

FDIC INSURANCE UPDATE

In July, 2010, Congress enacted legislation that raised the standard maximum deposit

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insurance amount (SMDIA) to $250,000. The law made permanent a previous temporary increase of the federally-insured amount to $250,000 from the former maximum limit of $100,000. The new permanent maximum limit should especially benefit consumers who do or can afford to have more than $100,000 in their financial institution beginning in 2014, when the temporary hike in the maximum limit had been scheduled to expire.

It is important to know that the SMDIA does not limit the new insured amount to a single account in a single institution. Rather, the SMDIA applies per depositor, per insured depository institution, for each account ownership category. For example, a person's single account will be insured up to the new permanent maximum amount of $250,000 but so will his or her share of *all joint accounts,* as well as any other of his or her accounts *in other ownership categories*.

Another 2010 legislative change (this one effective December 31, 2010) creates a new *temporary* insurance category that will fully insure all funds, regardless of the dollar amount, *but only in checking accounts that pay no interest to the account holder.* An example of a possible application of this new insurance is an account in which an individual who has just sold a home temporarily places the large proceeds from the sale in that account, understanding that no interest will be earned. However, absent Congressional action, this change is temporary and will expire at the end of 2012.

This newsletter is not intended to provide legal advice on specific subjects but rather to provide news and analysis of legal issues and developments. You should always consult with legal counsel before taking action on any matter described in this newsletter.

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