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Business Transactions

Don't Get Stuck – Avoiding Problems and Pitfalls When Selling a Franchise

By William A. Goldberg, Esq.

With the right location, lots of hard work, and a popular brand, owning a franchise can be a lucrative endeavor. Some franchise owners in Maryland and throughout the country have also tried to cash-in on their franchise ownership by selling their business soon after purchasing it. Much like “flipping” a condominium to cash in on ever-increasing value of land, some franchise owners have purchased underperforming businesses with the express goal of fixing them up, enhancing their value, and realizing a quick profit by turning around and selling it. While this may sound like a winning strategy, there are practical problems that may frustrate such a sale, and can leave a franchise owner “stuck” owning a franchise indefinitely that he or she planned to sell. At least two potential problems exist for the franchise owner hoping to “flip” his or her franchise business.

First, the franchisor, often a national or regional company which controls the right of the franchise owner to use their logo or brand name, almost always retains the right to disapprove of the would-be purchaser of the franchise business. For the national franchisor, it is crucial that the person or entity running

a local franchise has a demonstrated history of scrupulously maintaining the franchise’s corporate image and standards, as well as the experience to avoid running the business into the ground and thereby possibly damaging the brand in the eyes of consumers. Many franchise owners have struck tentative deals to sell their business, only to find out that the franchisor refuses to accept the transfer to the would-be buyer. While most contracts between franchisors and franchisees state that consent to sell the business (in technical jargon – “to assign the franchise agreement”) shall not be “unreasonably withheld,” not all contracts contain this operative language, and even if they do, it might require an expensive lawsuit to force the franchisor to “accept” the new owner. It is crucial for purchasers of a franchise who are contemplating selling their business to check that their contracts permit assignment of the franchise agreement and the conditions that must be met.

Second, the landlord of the real property on which the business is located also may be able to prevent the sale of a franchise business. Unless the franchise owner also owns the real estate on which his or her business resides,

the owner of that real estate will sometimes require that the national franchisor guaranty the rent payment if the franchise owner cannot make its payments (i.e. agree by contract that it will pay the rent if the franchise owner cannot). But the franchisor is under no obligation to do so. Thus, situations can arise in which a franchise owner seeks to sell his or her business, but the landlord will not accept the new owner without a guaranty from the national franchisor, which often will refuse to offer one. Unless the franchisor agrees, or the landlord relents, the franchise owner may not sell his or her business no matter how willing the buyer and seller are.

While a very rare occurrence, franchise owners should also be aware that their businesses could be vulnerable to what is known as “eminent domain.” Under the Constitution, the government (including state and local government) is permitted to permanently take land for public use, provided that it pays “just compensation” to the owner of the seized land. However unfair or inconvenient the government’s actions may be, the landowner is at least guaranteed some compensation for the loss of his or her land. In contrast, however, the question of whether the government is required to compensate a business owner whose business is located on land seized under eminent domain powers is less clear. One Maryland court has come out in favor of compensating a business owner for lost

(In this situation) unless the franchisor agrees, or the landlord relents, the franchise owner may not sell his or her business no matter how willing the buyer and seller are.

goodwill, while a District of Columbia court recently went the other way. The law is not settled on this issue, which promises further litigation as the courts attempt to reach a consensus on what property rights are compensable.

Thus, if a franchise owner does not own the real estate on which his or her business rests, and the real estate is taken by the government pursuant to its eminent domain powers, no matter how large the initial investment nor the amount of goodwill created, the business owner may or may not be compensated for these losses. While some Courts have begun to recognize that this rule can be extremely unfair to business owners who lose all of their investment and goodwill, and the trend is towards forcing the government to compensate business owners for these losses, a risk still exists that the state’s exercise of eminent domain will not result in compensation for the unfortunate business owner. Of course, to the extent that the business is movable, and loyal customers follow a business owner to a new location, the goodwill he

or she generated over the years will not be lost entirely. But for the franchise owner whose business success is linked to a certain location, eminent domain could threaten his or her livelihood.

In sum, a franchise owner looking to sell his or her business must beware of certain pitfalls that can arise. A careful review of the franchise contract will reveal what role the franchisor will play in determining whether or not the franchise can be sold. The landlord of the property on which the business resides may also have the authority to disallow a sale. Finally, state eminent domain law can have a significant effect on the compensation an owner receives should the property be taken. While purchasing a franchise to re-sell it can be very profitable, individuals who are contemplating doing so should be on the lookout for these issues.

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Business and Taxation

Could Your Company Benefit From an Audit Committee?

Increasingly, private companies are discovering the benefits of audit committees.

By Robin L. Dierbeck, Esq.

As a response to the Enron scandal, the Securities and Exchange Commission enacted the Sarbanes-Oxley Act of 2002. In addition to holding chief executive officers and chief financial officers directly responsible for the accuracy of financial statements, the Act is designed to improve the accountability of managers to shareholders by ensuring that financial statements are audited according to independent standards. As a result of this, publicly traded companies are now required to have audit committees.

While private companies are not held to the same requirements, more and more of them are discovering the benefits that audit committees can provide and are establishing them as well. This article takes a brief look at audit committees, and shows why having an independent financial review of the company's financial statements can help the Board of Directors meet its fiduciary duty and manage the company with ethics and integrity.

Why Form an Audit Committee?

Clearly, the first question that should be asked when contemplating the formation of an audit committee is how the

company could benefit from it. No law exists ordering private companies to form them, so why are so many companies putting forth the time and effort to do so? The answer lies in several distinct areas.

First, since audit committees should exist independently of the Board (for public companies, audit committees *must* be comprised of independent persons), they can offer a true "external perspective" of the company's financial reporting and control systems. Although they are formed by the Board, it is not recommended that members of the Board serve on the audit committee, so that any conclusions reached by the audit committee are arrived at from a thorough independent analysis, free of any potential influence by company officers or board members. Secondly, the analysis performed by the audit committee frequently provides the Board with knowledge and perspective regarding the company's financial health that would not ordinarily be available solely through an internal audit. Finally, audit committees provide a way for the committee and the Board to discuss complex or difficult issues within a structured environment, absent the influence of internal politics or pressures.

The Formation and Scope of Audit Committees

Once a company has decided to form an audit committee, it must then decide who will reside on it. Ideally, the audit committee should be comprised solely of independent persons, which typically disallows — either directly or indirectly — any director, executive officer, partner, member, principal or owner of the company. The Board should thus carefully select individuals with a variety of skill sets and backgrounds to serve on the audit committee.

The company's Board of Directors should also use its discretion to establish the scope of the audit committee, including determining what procedures should be followed, and providing guidance on the committee's functions.

The American Institute of Certified Public Accountants has a section on its website entitled the "Audit Committee Effectiveness Center"¹. While geared towards public companies, the Center provides advice relevant to all companies, including detailed explanations, functions and procedures for audit committees that will assist the Board in determining the scope of the audit committee.

The audit committee should take minutes at every meeting, which should then be submitted to the board and included in the company's minute book. What follows are suggested items that an audit committee should discuss and review in consultation with an independent auditor and management:

1. Inquiries about the current and/or unresolved issues or problems that have arisen in the financial, compliance, or operational control environment.
2. Recommendation of a firm or individual to be engaged as the company's independent auditor.
3. Review and approve the independent auditor's compensation and the terms of the auditor's engagement.
4. Review the result of each independent audit, the auditor's report, any related management letter and management's response to recommendations made by the independent auditor in connection with the audit.
5. Review the company's financial statements, any report or opinion rendered by the independent auditor in connection with those financial statements, and any dispute between management and the independent auditor that arose in connection with the preparation of the financial statements.
6. Consider the scope and plan of forthcoming external audits.
7. Consider the adequacy of the company's internal accounting controls.
8. Consider the appropriate accounting principles and practices to be used in the preparation of the company's financial statements.
9. Discuss the performance of key financial and operations officers.

To summarize, companies that utilize audit committees—even when not required to—will frequently find that the committee will help them better analyze and maintain their financial records, and help them manage their company more effectively and ethically. For more information, or if you have questions about the requirements, formation or function of audit committees, please contact our offices.

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1 <http://www.aicpa.org/audcommctr/homepage.htm>.



Eight Steps to Take to Make Mediation Successful

Awareness and preparation are key to increasing the likelihood of a successful mediation process

By Marc R. Engel, Esq.

As the use of mediation as a way to resolve disputes increases, the parties involved appear to have been lulled into a false sense of complacency. However, parties are free to engage in

mediation any time they choose, and the advantages to mediating a case early can be significant. This is regrettable, and often dangerous. Like most things in life, preparation usually is the

defining difference between success and failure, however those terms are measured. Here, then, are eight constructive steps which participants can take before arriving at mediation:

1. Decide When to Mediate.

Many lawyers and parties incorrectly believe that the only way they can mediate is if they are directed by a court to do so and that mediation can only occur at a single prescribed time. However, parties are free to engage in mediation any time they choose. Moreover, courts will often look favorably at requests to provide a judicially appointed mediator early in the case and often agree to stay litigation while mediation is pending.

2. Learn About Your Mediator.

Although it is true that mediators do not decide cases, they nevertheless arrive at mediations with their own views, perceptions and experiences. Certain mediators are simply better suited to handling certain types of cases and certain types of personalities than others. Successful participants in mediations understand this fact and establish their mediation strategy accordingly.

3. Analyze Your Case Early and Often.

Many cases do not settle at mediation because lawyers and their clients have not diligently and thoroughly analyzed the strengths and weaknesses of their cases before mediation. This analysis should include, among other things, assessing the possible claims and the likelihood of success of each of these claims; evaluating the categories and amounts of likely damages; interviewing key witnesses; calculating the litigation costs for each stage of the case; and gauging the public relations consequences

and lost opportunity costs if the matter does not settle.

4. Prepare an Effective and Persuasive Mediation Statement.

Mediation statements are confidential documents that provide the mediator with a roadmap of the case; summarize the issues in dispute; realistically assesses the parties' best and worst case scenarios; and suggest at least one plausible resolution of the matter. Even if the mediation is not immediately successful, the mediation statement can serve as the foundation for subsequent settlement discussions.

5. Consider a Conference Call with the Mediator Before the Mediation.

Counsel and/or their parties can request that the mediator participate in a pre-mediation telephone conversation (which can occur either with counsel only, or with counsel and their clients present). During this conversation, the parties may wish to bring to the mediator's attention any intervening information which would be helpful to a party's case and to the possible resolution of the matter. In addition, the mediator can seek to clarify any open issues that may exist in the mediation

statements and get a better sense of what is really dividing the parties.

6. Decide Who Will Attend and Who Will Speak at the Mediation.

One of the issues that is often overlooked in connection with the preparation for mediation is deciding who will attend the mediation. Having the actual decision maker attend the mediation on behalf of a company can provide a number of advantages. It can communicate to the opposing party that the company is prepared to stand behind the individual, and it can serve to personalize the company.

An equally challenging issue is deciding who will speak at the mediation. An opening statement can serve not only to frame the substantive issues, but also to set the overall tone for the mediation session. Acknowledging that the parties will never agree upon what actually transpired in connection with a particular dispute can often provide an atmosphere where candid discussions can take place. It is the attorneys' role, however, to counsel their clients to be careful about so called "admissions" as well as how to address potentially sensitive issues.

Although it is true that mediators do not decide cases, they nevertheless arrive at mediations with their own views, perceptions and experiences.

7. Master Mediation Etiquette.

It is important that participants conduct themselves professionally and respectfully at all times. Parties should be encouraged to shake the hand of their opponent as well as the hand of the opposing counsel, not interrupt another individual when he/she is speaking, and to avoid sighs and other body language which communicates disgust or disapproval.

8. Be Prepared to Close the Deal.

Attorneys should consider preparing a checklist of terms that they would expect to see

included in a settlement agreement or, better still, a rough draft of an actual settlement agreement. This exercise will force the parties to think critically about what they want to achieve in a settlement. Those who do this are much more likely to avoid the circumstance of "buyer's remorse," which can prevent the culmination of an otherwise reasonable and acceptable deal.

In summary, the participants who are most successful in mediation are the ones who have prepared wisely and effec-

tively. The mediation process should be treated with great care and attention. Parties and counsel who carefully prepare for mediation can reasonably expect to see the results of their labors in the form of mutually agreeable resolutions which save thousands of dollars of litigation costs, prevent lost opportunities, and preserve relationships.

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Lerch, Early & Brewer News and Notes



The firm congratulates **Michael D. Smith** and **Shannon N. Mandel**,

both of whom recently passed the Maryland Bar Exam and accepted associate positions with the firm.



Mr. Smith, who joined the firm's Commercial Lending and Real Estate Transactions groups as a paralegal in 2001, represents financial institutions in a wide variety of commercial lending transactions. He received his J.D. in 2005 from the American University Washington College of Law, and is admitted to practice in Maryland.

Ms. Mandel joined the firm's Commercial Lending

Group as a paralegal in 2004, and focuses her practice on the representation of financial institutions in government-guaranteed lending transactions. She is admitted to practice in Maryland, and received her J.D. from the American University Washington College of Law in 1999.

Lerch, Early & Brewer also welcomes **Amy Williams**, who recently joined the firm as a legal assistant in the Litigation Group. Regretfully, the firm announces the departures of **Faye Edwards**, who worked as a legal assistant, and **Robin Bortnick**, who worked as a paralegal.

The firm wishes to congratulate **Steve Robins** and **Jeff VanGrack**, both of whom were recently selected as final-

ists as one of "Washington's Top Lawyers" by the Washington Business Journal. Mr. Robins was one of four attorneys in the Washington region selected in the area of Zoning and Land Use. Mr. VanGrack, Co-chair of the firm's Community Associations Group, was one of three attorneys selected in the area of Real Estate Litigation.

Congratulations are also in order for **Marc Engel**, who was selected as one of 35 members of the "Greater Washington Legal Elite" by Washington SmartCEO magazine. Mr. Engel is a principal in the firm's Employment and Litigation groups.

Alison Rind, a principal in the firm's Commercial Lending and Real Estate Transactions

groups, was recently honored by the Montgomery County Bar Foundation as the "Committee Chair of the Year" at the annual "Law Day" celebration luncheon. She received the award due to her efforts as co-chair of the Bar Association's Fall Outing Committee.



At the Montgomery County Chamber's Annual Banquet on June 21, **Steve Robins** was honored with the Chairman's Award for his work on the Chamber's Board of Directors. In addition to being a member of the Chamber's Board, Steve was Chair of the Chamber during 2003-04. On May 11, Mr. Robins was also the recipient of an award from the Montgomery County Department of Corrections in recognition of his efforts for the past five years as Chair of the Montgomery County Public Safety Awards program.



Patrick O'Neil, an associate in our Land Use and Zoning group, was recently elected to the

Board of Directors of the Greater Bethesda-Chevy Chase Chamber of Commerce. Patrick will help guide and direct the initiatives of the Chamber, where he also serves as the Chair of the Parking and Transportation Committee. Additionally, Patrick also recently joined the advisory board of Bethesda Transportation Solutions, an

organization that acts as a resource to promote alternative transportation methods to commuters and employers in Bethesda's business district.

Several Lerch, Early & Brewer attorneys have been on the speaking circuit recently: **Deborah Webb**, a principal in our firm's Family Law Group, presented a seminar at the Rita Rosenkrantz Pro Bono Family Law training on Marital Settlement Agreements and Ethics. Additionally, on May 18, Ms. Webb spoke on custody and related issues at the Montgomery County Women's Commission. **Sigrid Haines**, Chair of our firm's Health Care Group, recently presented a seminar at Suburban Hospital entitled "Don't Get In Trouble: A Lawyer's Perspective." **Jeffrey VanGrack** and **Jason Fisher**, Co-chairs of our Community Associations Group, presented a seminar in May for association board members and managers entitled "Covenant and Rule Enforcement and Maryland Legislative Update." Finally, on September 19, **Marc Engel** will be speaking to the Northern Virginia Chapter of the National Association of Women Business Owners at their "Smart Growth Workshop" on the topic of "Human Resources Best Practices."

The firm has announced that Joseph Braun, a senior at Northwest High School (Germantown), was the recipient of its 2006 Annual Scholarship Award. The scholarship is awarded to the Northwest football player with the highest

cumulative grade point average, and who has been a member of the football program throughout all four years of the student's high school career. **Jeffrey VanGrack** and **Paul Alpuche** coordinated the award with the school. Both Mr. VanGrack and Mr. Alpuche serve as volunteer coaches for the Northwest football team.

On July 15, a group of Lerch, Early & Brewer attorneys and staff members, along with their family members, spent an evening serving dinner at the Shepherd's Table soup kitchen. Shepherd's Table, located in downtown Silver Spring, provides meals and assistance to the less fortunate citizens of Montgomery County and elsewhere throughout the region. The firm is planning another evening of service at Shepherd's Table later this year.

On Saturday, September 9, **Benjamin Harris**, Director of Marketing for the firm, wed Christina Barry at a ceremony at the Washington National Cathedral.

Congratulations are in order for several Lerch, Early & Brewer attorneys and staff members who have all recently become proud parents: **Kristin Hall** gave birth to twins Kate and Lindsay in July. **Jeremy Tucker** is now a father after the birth of his first child, Maxwell, in May, and **Fran Castillo** celebrated the birth of her son, Roberto Andres, also in May.

The information in this Newsletter is not intended to render legal, accounting or other professional advice and should not be acted upon without first consulting an attorney or other professional.

Six Lerch, Early & Brewer Attorneys among "Best Lawyers in America"



Lerch, Early & Brewer, Chtd. is proud to announce that six attorneys in the firm were recently selected as among the "Best Lawyers in America®" by South Carolina-based Woodward/ White Inc. The selections are based entirely upon surveys conducted with over 24,000 attorneys across the country.

The six Lerch, Early & Brewer attorneys selected to the Best Lawyers® list include:

- Robert G. Brewer, Jr., a principal in the firm's Land Use and Zoning and Health Care groups;
- Eric M. Core, Co-chair of the firm's Estate Planning and Probate Group;
- Harry W. Lerch, a principal in the firm's Land Use and Zoning Group;
- Stanley J. Reed, Chair of the firm's Litigation Group;
- Deborah E. Reiser, Chair of the firm's Family Law Group; and
- Steven A. Robins, a principal in the firm's Land Use and Zoning Group.

Several of the attorneys listed have been included in previous editions of Best Lawyers®. Mr. Brewer has been included since 1991, Mr. Lerch since 1999, and Ms. Reiser and Mr. Core since 2002. The Best Lawyers® list is a nationally-known and respected source which has been featured in the Washington Post, New York Times and Corporate Counsel magazine, as well as over 50 "best lawyers" features in regional newspapers and magazines across the country.

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