

G R e v i e w

DOING BUSINESS WITH CHINA

By David R. Brown

On August 19th, Gould & Ratner welcomed over 100 clients and friends to a seminar entitled *Doing Business with China: Guidelines for U.S. Companies and Entrepreneurs*, at Chicago's Standard Club. The program, moderated by Fredric D. Tannenbaum, sought to bring together experts on doing business with Chinese concerns and individuals united by a common interest working with this ever more important player on the world stage.

Three distinguished guests with in-depth knowledge of the Chinese business and legal worlds, and equally importantly, their intersections with their U.S. counterparts, presented useful information and answered a barrage of questions from the audience.

Scott Y. Guan, of Yao Liang Law Office (Shanghai and Beijing), explained the legal do's and don'ts of doing business in China, reducing the sometimes intimidating alphabet soup of state agencies and regulations into immediately accessible concepts. Following his presentation, Scott fielded questions from the audience on topics ranging from joint ventures to land ownership to repatriation of Chinese market earnings.

Anita Y. Tang, of Chicago-based Royal Roots Global, Inc., a management and investment consultancy, shared her unique bi-cultural experience working with both U.S. and

Chinese firms. Her lively anecdotes entertained while providing very useful insights into how to further cooperation and understanding between Chinese and American businesspeople.

Jeffrey White, of Wells Fargo HSBC Trade Bank, addressed cross-border financing issues, and highlighted the recent opening of China's capital markets and the challenges lying ahead for China and foreign investors. He also discussed the nascent Chinese commercial banking system and the respective roles of state-owned and private sector banks in the Chinese economy.

As the three speakers addressed their specific areas of expertise, a recurring theme emerged: Recent years have seen a dramatic increase in the attractiveness of the Chinese market for trade and investment, but the legal and financial framework remains a work in progress. Nonetheless, with capable advisors, an appreciation for the unique challenges of doing business in China, and a flexible approach, the Chinese market offers great potential for growth.

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A Newsletter from
the Law Firm

GOULD & RATNER

The GReview is published by the law firm of Gould & Ratner to update clients and friends on legal trends and developments of interest. The material contained in this newsletter is only a synopsis of recent cases and legislative developments and is not legal advice. If you have a question or an individual claim involving a topic covered in this newsletter, you should seek a legal opinion based on the law as a whole and the facts of your particular case. Professional rules in some jurisdictions may treat the GReview as advertising.

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ATTORNEYS IN THE SPOTLIGHT

Howard Turner, Of Counsel with Gould & Ratner, spoke to the mechanics lien judges at a "Lunch and Learn" session at the invitation of Judge Meacham, the Presiding Judge of the Mechanics Lien Division.

Mr. Turner also played an important role in drafting recently adopted legislation which amended the Mechanics Lien Act.

Mark E. Leipold was appointed to the Bankruptcy Court Liaison Committee for the Northern District of Illinois. This committee, consisting of selected practitioners and judges, promotes communication about court procedures, etiquette, filings and other issues, and assists the court and attorneys in creating a more efficient practice environment. Additionally, the Committee develops and sponsors educational programs concerning issues affecting the bench, attorneys, financial institutions, and consumers. The Committee provides an opportunity to relay issues, concerns or ideas anonymously to any of the Committee Members and allow those concerns to be communicated to the Court. The Committee also creates social opportunities to allow greater interaction between the members of the Court and those who appear before it.

THE ABC'S OF FRANCHISE LAW

By David R. Brown

Thousands of brands of goods and services reach the market each day through franchises. Business owners in fields as diverse as fast food restaurants, hotels, and real estate brokerages, find the franchise model appealing. They perceive that operating a franchised business under a recognized brand name inspires confidence in the consumer as to the origin and quality of their offerings, and look forward to easy access to a proven business model. Franchising trade groups estimate that today there are over 534,000 franchised businesses operating in the U.S., which though a mere 3.2% of all businesses by number, represent fully 35% of revenue in retail goods and services. In light of the growing prevalence of franchises as a business model, and their considerable economic power, the nature of the legal relationships which they entail bears examination.

What is a Franchise?

In essence, a franchise is a method of licensing independent persons or entities to sell a good or service, or do business employing unique techniques, using the franchisor's intellectual property, such as trademarks and patents. The law recognizes three main types of "franchise." The first, which best fits the commonplace idea of a "franchise," and which is the focus of this article, is the *business format franchise*. Business format franchises entail a very close and comprehensive relationship between the franchisor and the business owner-franchisee. Chain restaurants and auto dealerships, relatively uniform and familiar in appearance, menu and cleanliness standards, exemplify the business format franchise. Certain product distributorship and licensed manufacturing operations which involve a limited grant of intellectual property to a business owner, are also sometimes referred to as "franchises," but are not considered here.

As they have grown in popularity since the 1960's, business format franchises have developed in a patchily-regulated environment. The perception of overwhelming bargaining power on the part of the franchisor, evidenced by franchisee complaints and frequent litigation has led the federal government and a minority of states to regulate the offering of franchises, and to a lesser degree, franchise

relationships themselves. The regulatory trend has been, and continues to be, policing the disclosures contained in franchise offering documents so that each potential franchisee has sufficient information to make an informed decision on the franchise being offered, and not towards active regulation of the franchise relationship once formed except as required to correct truly unfair or abusive franchisor practices.

Who Regulates Franchise Offerings and the Franchisor-Franchisee Relationship?

There is no comprehensive federal franchise regulation program, although the Federal Trade Commission ("FTC") does prescribe minimum disclosures to potential franchisees known as the "FTC Franchise and Business Opportunity Disclosure Rule" or simply the "FTC Rule." Fifteen states (the "Regulating States") have adopted franchise statutes which complement the FTC Rule, and which prescribe the use of a standardized franchise offering document, the "Uniform Franchise Offering Circular" or "UFOC." Illinois is one of these states. Like its counterparts in majority of the other 15 regulating states, the Illinois Franchise Disclosure Act (the "Act") puts disclosure of the terms of the franchise first, and provides only a few limits on the terms of the franchise relationship beyond a general prohibition of deceptive practices.

The FTC Rule sets out minimum disclosure standards for franchise offerings nationwide, but defers to more specific state laws where they exist, i.e., in the Regulating States. Among the information required to be disclosed under the FTC Rule is: the experience of the franchisor and its principals; the franchisor's litigation history; the economic details of the franchise offer, including all initial and ongoing fees; territorial and customer limitations on the franchise; the term of the franchise and renewal options; training programs required or offered; and current financial information on the franchisor. The FTC Rule does not require that the offering materials be filed with any government agency, so it is important to note that neither the FTC nor any other regulator has examined or passed upon its contents.

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THE TOP SIX THINGS ONE SHOULD KNOW ABOUT THE NEW BANKRUPTCY REFORM LEGISLATION

By Christopher J. Horvay and Heather H. Manning

On April 20, 2005, President Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") into law, ushering in some of the most substantial changes to the modern day bankruptcy code since its inception in 1978. In bankruptcy circles, this was a highly controversial piece of legislation, and the battle over its enactment had raged for approximately nine years. Most of the BAPCPA provisions will not become effective until October 17, 2005 and will only apply to bankruptcy cases filed on or after this date. This article summarizes some of the highlights of BAPCPA and its impact on the existing bankruptcy code (the "Code").

1. Filing Individual Consumer Cases Is Likely to Become More Difficult and Costly

- *New Means Test for Individuals.* In order to qualify for Chapter 7 relief, the BAPCPA provisions state that a debtor must pass either a "Median Income" test (debtor's current monthly income may not exceed the median income for a family of the same size in his or her state of residence) or a "Means" test (debtor's current monthly income as reduced for certain expenses may not exceed the amount allowed under the cost of living standards enacted by his or her state of residence).
- *Attorneys Must Review and Verify all Debtor Filings Submitted to the Court.* BAPCPA requires a debtor's attorney to make a "reasonable inquiry" in order to verify that all filings submitted to a court or to a bankruptcy trustee on behalf of a debtor are truthful and not misleading (including all related schedules, such as lists of a debtor's assets and liabilities). A court may impose sanctions on the attorney if the debtor's filings contain factual inaccuracies or provide an inadequate legal basis for submitting a Chapter 7 filing. This provision alone is likely to create a substantial roadblock to many attorneys serving as counsel to a Chapter 7 debtor.

2. Debtors Will Have to Comply with Strict New Chapter 11 Time Constraints

- *Strict Time Limit on the Assumption/Rejection of Non-Residential Real Estate Leases.* Under the existing Code, a reorganizing debtor in possession ("DIP") has sixty (60) days after filing in which to determine whether to assume or reject its existing non-residential real estate leases, after which it may seek an unlimited number of extensions "for cause" from the court, which extensions often have been granted. The BAPCPA provisions initially grant the DIP a 120 day assumption/rejection period but limit the extension period to be granted by the court "for cause" to a single ninety (90) day period. Additional extensions beyond the 210 day period require the prior written consent of the lessor. The effect of the new legislation will be to create enormous time pressure on large retail DIPs to make quicker decisions about exiting Chapter 11, thereby creating leverage in favor of lessors.

- *Strict Time Limit on Debtor's Exclusive Period for Filing a Chapter 11 Plan.* BAPCPA provides that the period in which a debtor has the exclusive right to file a disclosure statement and Chapter 11 plan may not exceed eighteen (18) months after the order for relief is entered and the periods in which a debtor has to obtain acceptances and rejections may not exceed twenty (20) months after the order for relief is entered. No extensions are permitted with regard to these "exclusivity" periods, unlike the prior law where extensions have been granted, in some cases, for three or more years.

3. Debtor-In-Possession Loans May Become More Costly and More Scarce in Chapter 11 Cases

- *Priority Amounts Raised For Wage Claims and Employee Benefit Plan Contribution Claims.* Under the existing Code, priorities for wage claims and employee benefit contribution claims were capped at \$4,925 per person. Under BAPCPA, these amounts are raised to \$10,000, and the likely effect will be to increase both the difficulty of emergence from Chapter 11 and the cost of emergence.
- *New Administrative Claim for Pre-Petition Vendors Relating to Sales Made in the Ordinary Course of Business Within Twenty (20) Days Before the Bankruptcy.* This new administrative claim is limited to the value of the goods. Again, it appears that this provision is designed to increase the cost of Chapter 11 and the difficulty of obtaining a Debtor in Possession loan facility.
- *New Extended Reclamation Right Granted to Pre-Petition Vendor Relating to Sales Made in the Ordinary Course of Business Within Forty-Five(45) Days Before the Bankruptcy.* The pre-petition vendor must make such reclamation claim in writing not later than (1) 45 days after the receipt of the goods by the debtor or (2) if the 45 day period expires after the commencement of the bankruptcy case, then 20 days after the date of the case's commencement. One should note however, that this reclamation right is subject to the prior rights of any party who holds a prior perfected security interest in the goods, and in most cases will prove of limited utility to the vendor.
- As a result of the foregoing changes, a DIP will have to increase the budgeted expenses it seeks to have paid by the DIP lender at the outset of a Chapter 11 case.

4. Unsecured Creditor Committee "War Chests" Will Become Smaller in Chapter 11 Settings

- Under BAPCPA a trustee may not void an alleged preference payment if the debt was incurred in the ordinary course of business of both parties and the payment either (1) was made in the ordinary course of business of both parties or (2) was made according to ordinary business terms. Under the existing Code both (1) and (2) had to be met. Accordingly, it

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ATTORNEYS IN THE SPOTLIGHT (CONTINUED)

John Mays was named to the Roosevelt University Chicago School of Real Estate Advisory Board and recently served as a juror for the Urban Land Institute's Lifetime Achievement Award; the Metropolitan Planning Council / Homebuilder's Association / ULI Community Vision Award; and DePaul University's Urban Plan Competition.

Fred Tannenbaum gave a speech in Cambridge, England in September before LawExchange International attorneys, together with investment bankers, bankers, accountants, and business owners. The talk was on US merger and acquisition and venture capital activity. Gould & Ratner is a member of LawExchange International, a group of law firms from commercial centers around the globe.

The second edition of Mr. Tannenbaum's book entitled *Organizing, Financing, Growing, and Selling Businesses: Forms and Advice for Lawyers*, is complete and due out early next year.

David Michael is serving his second term on the steering committee for the Human Resources Manager Association of Chicago's Leadership Series.

Chris Horvay, past president of the Turnaround Management Association, will continue as a director of the Chicago Chapter until the end of the year and will serve as parliamentarian next year.

THE TOP SIX THINGS ONE SHOULD KNOW ABOUT THE NEW BANKRUPTCY REFORM

LEGISLATION

(CONTINUED)

should be easier for a creditor to defend against a preference action if the payment was made in accordance with industry standards.

5. Single Asset Real Estate Cases Will Likely Become Less Common

- Under the existing Code, special provisions are made applicable to single asset real estate debtors, which category consisted of debtors which held a single property or project (including rental properties other than residential properties with fewer than four units) whose income was derived from and whose business consisted almost exclusively on such property or activities pertaining thereto and which debtor had no more than \$4,000,000 in secured debts. BAPCPA has eliminated the \$4,000,000 cap, thereby enlarging the universe of potential single-asset debtors and forcing them to pay monthly adequate protection to their respective lenders or otherwise file a plan of reorganization within ninety (90) days of their petition date.

6. Asset Protection Trusts To Receive Increased Creditor Scrutiny

- BAPCPA adds a new provision which permits a trustee to avoid any transfer by a debtor to an asset protection trust or similar device made within ten (10) years prior to the filing of the petition if the transfer was made with the "actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted." Such avoidance claims will likely be uncommon because "actual intent" cases aren't nearly as common as "constructive" fraudulent transfer cases.

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If you have any additional questions about BAPCPA or its applicability, please contact Chris Horvay, Mark Leipold, Mark Abraham or the other attorneys in the Gould & Ratner Creditors' Rights and Bankruptcy Group.

THE ABC'S OF FRANCHISE LAW

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The Regulating States require that franchisors provide a Uniform Franchise Offering Circular ("UFOC") to each potential franchisee. The UFOC provides many of the same disclosures as does the FTC Rule, but generally in greater detail, and, importantly, is allowable as a disclosure document under that rule. As a result, franchisors generally use the UFOC in all states in order to streamline the offering process. In a major departure from the FTC Rule, the Regulating States generally do require that the UFOC and other offering documents be filed with the appropriate franchise regulator before any offer of the franchise is made, although the level of substantive review carried out by a particular state is generally minimal and should not be relied upon by a potential franchisee as a sign of the offering's merit.

What Special Provisions Does Illinois' Franchise Law Contain?

Illinois provides few restrictions on franchisors or protections for franchisees, with two important exceptions. First, franchisors must allow potential franchisees at least 10 days to review the UFOC and other offering materials, before signing a franchise agreement, in contrast to other states which lack such a "waiting period." Second, franchisees whose franchises are terminated by the franchisor and who are

then bound by a covenant not to compete generally are entitled to reasonable compensation for the value of their business.

What's the Bottom Line for Potential Franchisors?

A business considering expansion through franchising must first ascertain whether franchising represents a viable business model. If it does, in light of the very detailed disclosure requirements of the FTC Act and the UFOC, close cooperation with counsel and state regulators is essential in order to ensure that potential franchisees receive all required information, minimizing the risk of lawsuits and regulatory action years later.

And for Franchisees?

Potential franchisees must carefully consider whether the benefits of the franchise outweigh the loss of control over even seemingly unimportant business decisions (e.g., what color napkins will we use?). With very few exceptions, the law offers them little in the way of meaningful protection from even onerous franchisor requirements, if properly disclosed at the outset. Thorough business and legal due diligence on a potential franchise must be conducted so that all aspects of the relationship may be evaluated before making a long-term commitment.

UPDATE: SUPREME COURT TO HEAR WETLANDS CASES

We reported in our newsletter last fall that whether property owners are required to obtain a "Section 404" permit to fill wetlands depends upon whether those wetlands are adjacent to navigable waterways. But what that means has never been clear. The United States Supreme Court will address the issue this term when it entertains argument in two cases from Michigan: *Rapanos v. United States* and *Carabell v. U.S. Army Corps of Engineers*. In these two cases, developers were trying to build apartment and shopping complexes on property containing wetlands. The developers claim the wetlands are isolated, are therefore not subject to U.S. Army Corps of Engineers jurisdiction and that no permit is required to fill them. The wetlands are connected via man-made ditches to navigable lakes and

streams. Thus the issue is whether this connection through man-made ditches and drains is sufficient to constitute "adjacency" to navigable waters for purposes of Section 404 regulation. In both cases, the lower courts had determined that the connection was sufficient to confer jurisdiction under the Clean Water Act.

The cases have been consolidated into one for hearing. It is hoped that the ruling on these cases will end the confusion over the issue of adjacency.

For further information, please contact Karin O'Connell at 312/899-1616 (koconnell@gouldratner.com) or Shannon Clark at 312/899-1632 (sclark@gouldratner.com).