

**CENTRAL BUCKS CHAMBER OF COMMERCE
WOMEN IN BUSINESS COMMITTEE**

LEGAL ISSUES AND YOUR BUSINESS

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Introduction:

The nature of the legal issues faced by a business owner depends significantly on the type of business. Different types of businesses involve different areas of the law. Some businesses (health care, real estate and banking, for example) are more heavily regulated than others. The goal of this presentation is to discuss general areas of the law that impact most businesses.

Starting Your Business:

1. Types of business entities

- Sole proprietorship – one owner, no separate entity, owner is legally responsible for the business's debts.
- General Partnership – two or more owners who share responsibility for running the business and who are jointly and severally liable for the partnership's obligations.
- Limited Partnership – two or more owners, some of whom have passive involvement in the business (the limited partners) and one or more of whom are responsible for running the business (the general partners). Limited partners' liability for partnership debt is limited to their investment in the partnership. General partners are fully liable for partnership obligations.
- Corporation – a separate "person" under the law, a corporation is owned by one or more shareholders. Shareholders' liability for corporate obligations is limited to their investment, but officers and directors may be personally liable for their actions.
- Limited Liability Company – similar to a corporation but is generally a "pass-through" entity for tax purposes. Offers limited liability for owners similar to a corporation.

2. Choice of entity

Factors to consider in selecting the type of ownership structure for your business:

- number of owners
- who are the owners and how involved will they be in decision-making
- the need to protect personal assets from business creditors/claims (i.e. limited liability)
- tax considerations

3. Setting Up and Maintaining Your New Entity

- Surround yourself with a good team of professionals: accountant, insurance agent, banker, attorney, etc.
- Certain types of entities require filing with the State (limited partnership, limited liability company, corporation)
- Decide whether your business will have operations in other states. If so, you will have to file as a foreign corporation in those states, which involves paying a registration fee.
- For most types of business entities, you should have an agreement to establish the obligations and expectations of the parties regarding governance, distribution of profits, admission of new members, selling of ownership interests, etc. This is especially important where the owners are friends or family members, often the case with small businesses. In a partnership, this is called a partnership agreement. For a corporation, the owners (shareholders) typically enter into a shareholders' agreement a/k/a buy-sell agreement to memorialize their agreement regarding transferability of their shares, and the corporation's bylaws establish rules for governance (i.e. decision-making). The owners (members) of a limited liability company use an operating agreement a/k/a LLC agreement.
- One of the main purposes of using a separate legal entity is to limit your personal liability for business debts. In order to take advantage of the limited liability offered by a separate legal entity, however, you must treat the entity as in fact separate from the owners. The agreements described above are one of the formalities that a court will look for in determining whether the business is a separate legal entity or the "alter ego" of its owner. If a court finds that a business is merely the alter ego of its owner, the plaintiff creditor will be permitted to "pierce the corporate veil" and hold the owner personally liable for the business's debts. Courts consider several factors in determining whether a business is the alter ego of its owner:
 - inadequate capitalization;
 - substantial intermingling of corporate and personal funds; and
 - failure to adhere to corporate formalities (such as having bylaws, a shareholders' agreement, or operating agreement, keeping minute book, and maintaining separate financial records).

- Analysis for limited partnerships is slightly different. A general partner is personally liable for partnership obligations; in order to preserve limited liability, a limited partner may not actively participate in the partnership business.

Operating Your Business:

Many areas of the law can apply to running a business. Some areas that are common to most businesses include:

1. Contracts

- Contracts don't always say "contract" or "agreement" at the top of the first page. Any agreement (written or oral) that evidences the intent of the parties to be bound and involves obligations on the part of one or both parties and the exchange of money or anything else of value is a contract. This includes leases, purchase orders, service orders, and the like.
- General rules:
 - Know your rights and obligations, as well as those of the other party.
 - Be careful what you say in the contract – these are "representations" and could form the basis for a lawsuit if they are untrue.
 - Don't rely on statements that the other party makes outside of the contract – if it's not in the contract, it usually isn't considered in a contract dispute.
 - Be wary of a landlord or other party who gives you a "form" contract to sign – forms are almost always negotiable and some forms are worse than others.
 - One clause to watch out for is the confession of judgment provision. This provision allows the other party to obtain an immediate judgment if you default under the contract, without having to go through a trial first. It is a very powerful remedy that frequently appears in commercial leases and commercial loan documents.

2. Employment Issues

- In Pennsylvania, employees without a contract and not in a union are "at will", meaning that you can fire them without cause for any reason, unless that reason is prohibited by law (e.g., the employee is in a protected class by reason of gender, age, race). There are numerous laws, such as wage and hour and occupational safety laws, that protect employees once they are hired.

- Because of these protected classes, you need to be careful about the questions you ask during the interview. You cannot base hiring decisions on the existence or absence of certain factors (marital status, age, ethnicity, etc.).
- Employers often do background checks of prospective employees. A business owner should tread lightly here. You need to balance your need to know against the candidate's right of privacy. The scope of the background check will depend on the job the candidate is applying for – a child abuse background check is appropriate for a teaching position but perhaps not for an accounting position. Keep in mind that whatever information you uncover you are forever charged with knowing.
- Be sure to document in writing your employees' performance or failure to perform.
- If you engage the services of an independent contractor, you need to be careful to avoid having that person classified as an employee by a court or by the Internal Revenue Service. In general, if the hiring party enjoys the right to control the manner and means by which the services are provided, the hired party is considered an employee of the hiring party. Factors that could be considered include work location, the duration of the relationship, discretion over work hours, skill required, and the right to assign additional projects.
- Some employers (particularly service companies, technology businesses and medical practices) require executive, sales or management-level employees to execute agreements that they will not compete with the employer after the end of the employment relationship terminates. These agreements typically include an agreement not to hire away the employer's other employees or steal customers. Employers should narrowly tailor these agreements to protect their business interests. Courts will examine the geographic scope and duration of the agreement to determine if it is reasonable in light of the type of business being protected. Some courts are not friendly toward non-competes that bind former employees (as opposed to sellers of business) because they could impede the employee's ability to earn a living. And the employee must be given consideration for the agreement not to compete (for example, the new job itself, a promotion, or a bonus) for the non-compete to be enforceable.
- Non-Disclosure Agreements (NDAs or Confidentiality Agreements) are used by employers to protect their trade secrets and other proprietary information from being wrongfully disclosed by an employee or ex-employee. The employer should define the confidential information to be protected as broadly as possible and maintain the protection for as long as possible.

3. What to Do if You Get Sued

- Try to protect yourself from being sued in the first place by properly establishing and maintaining your business entity.
- Be sure to carry sufficient liability insurance to protect your business.
- If you've been sued, don't put the complaint aside in the hopes that it will go away. If you do nothing, the plaintiff will be entitled to a default judgment against you. Review the complaint with your legal adviser without delay and decide whether to litigate or settle the matter.

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