A Hustle or a Business?

7 Legal Mistakes to Avoid in Your Business

Barbara M. Littles, Esq.

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http://www.barbaramlittles.com

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INTRODUCTION

After 30 years of working as a business attorney to small business and corporations, I reflect on the legal issues that I consistently encountered over the years with clients. Aside from being in the courtroom, the most rewarding part of my legal career was advising and counseling entrepreneurs. In this e-book, I will share with you valuable counsel based on those three decades of experience – the kind of counsel that could save you thousands of dollars in legal fees, and could very well save your business.

You must first decide whether you have a hustle or a business. I describe a hustle as the ability to make money for a specific purpose or limited time without the formalities and structure necessary for sustainability. It is very different from running a business, where the considerations are different, the outlook is different, the thought pattern is different, and what we are willing to invest in money, time, and energy over the long haul is different. A hustle is not sustainable over a long period of time. This e-book is for those of you who are building or running a business.

I once asked a very successful entrepreneur if he were starting his business over again, what would he do differently. Without hesitation, he said: (1) get an attorney, (2) get an accountant, and (3) get a marketing person. He then proceeded to share with me horror stories of time, money, and opportunities lost because of his lack of foresight.

This e-book is written to add value to those who are beginning to build a business or who may have already started doing business without considering all of the legal ramifications of their decisions. As much time, money, and energy as you put into building your business, it is important to protect your assets, especially if you plan for your business to be successful.

This document will identify seven legal mistakes to avoid in your business. Of course, this list is not exhaustive; however, if you avoid these mistakes by establishing a solid foundation for doing business, you will avoid some major pitfalls.. Because those of you who are reading this may be in various states or outside of the United States, I refer to these principles in general, as laws vary from place to place. This resource will increase your level of awareness regarding questions to ask and where to seek additional assistance. Most of the concepts listed within this document are applicable to all types of businesses.. Even if you don't currently have a business partner, thinking bigger from the beginning and being aware of many of these issues will help you when you begin to enter into joint ventures with others.

MISTAKE NO. 1

Failure to Properly Incorporate Your Business

Very often, potential entrepreneurs print business cards and letterhead, pay to have a logo done, purchase a domain name, put up a website and social media page, begin advertising their business, and are in the market building their brand, only to realize that someone beat them to the punch and did it the right way. Many people begin doing business prior to checking name availability in their state or province, and prior to incorporating or protecting their logo and other proprietary interests. To avoid this mistake, make sure you do the following:

- Follow appropriate corporate formalities of filing the initial articles of incorporation
- Properly capitalize the business. Failure to consider the amount of money it will take to establish and sustain your business while it is being built can be devastating.
- Ensure you are using the corporate entity properly, thereby avoiding fraud.
- Properly document transactions between owners, individuals, and corporations in writing with all parties' signatures.
- Keep financial records of the corporation separate from your personal records, including individual shareholders.
- Identify intellectual property that needs to be protected.

Check with your state or province, as some places require different levels of corporate formalities in the continued operation of your business. These may include: (1) keeping of financial reports by corporation, and (2) shareholder board and committee meeting minutes.

MISTAKE NO. 2

Failure to Protect Intellectual Property Rights

Many times after enormous expense and time, you may find the name you are using for your business is unavailable in the state or province you live in since someone else is already using the name or something so similar, it would be confusing in the market. In the State of Michigan, the corporations bureau will deny use of a name that is already registered or one that is so close that it is confusing in the marketplace. It is important to check the state or province in which you live to determine the procedure for establishing corporations and reserving names. Sometimes people file locally with their county government and believe that they are covered only to discover they are not. The reason for filing with the county is so the local government knows you are operating a business and so they can collect the appropriate fees.

Over the years, I've had clients who were fortunate enough to begin making money in their business very quickly, which caused them to become busy just as quickly. Unfortunately, when running into a legal problem later in business, I had to be the bearer of bad news - that since they had never taken care of the necessary legal formation work in the beginning, all of their personal assets were at risk or that they were facing other major legal battles.

If you are planning on building a business - one that will last, that is truly a business and not just a hustle - you will have to put work into it on the front end to avoid problems on the back end.

So what is intellectual property? Any word, name, symbol, design or combination that identifies products or services and that serves as an indicator of the source is intellectual property. This can sometimes include color as well. There are many types of intellectual property, including but not limited to the following:

- Patents
- Trade Secrets
- Copyrights
- Right of Publicity
- Domain Names

Why does intellectual property matter from the beginning? Intellectual property can be among one of your or another company's most valuable assets, and it is important to make sure protections are in place at the time you are forming your business to avoid problems down the road. Avoid some of these intellectual property issues by doing the following:

- To avoid infringement claims, make sure prior to using a name that you search current uses or previous uses and make sure you have searched and cleared any trademarks.

- Make sure you secure a critical domain name before use and before you have built goodwill in the name by using in your business.
- Obtain patent protection prior to disseminating a product, and secure confidentiality agreements when discussing your ideas/patents with other people.
- Make sure by written agreement that you own any logo or web design created by or for you. This includes photography. Without a specific agreement to the contrary, photographs are typically owned by the photographer and cannot be used or duplicated in any form without permission (yes, even though it's a picture of you!).

It is best not to assume anything concerning intellectual property rights. This is a specialized area of law, and there are state, federal, common law, and international laws that may govern this issue depending upon what the intellectual property is and how it is being used. If you have an invention or are building a platform around a product, it is best to explore at minimum copyright issues. In some instances, rights attach upon use so BE AWARE!

MISTAKE NO. 3

Failure to Complete Due Diligence with Partner(s)

When we get an idea, one of the first persons we want to share it with is our best friend. Sometimes as a result of the relationship, people will decide to go into business as partners. Consider the following to avoid some of the pitfalls of partnering:

- Do we have complimentary skillsets that are necessary in business?
- Does my potential partner have current legal issues or problems that could affect the business? i.e. IRS, divorce, other litigation
- What is my potential partner's financial integrity? i.e. credit worthiness, including assets and liabilities
- Determine if there are other relationships that are conflict of interest with the business you intend to build.

If any of the above issues are present, it doesn't mean you shouldn't enter into business with that person, but you need to be aware of issues that may arise to determine: (1) how to structure agreements to best protect yourself; and (2) if there is pre-work that needs to be done prior to partnering. In many ways partnerships are like marriages. In a very huge way, your life becomes intertwined with the person or persons you are partnering with, including your reputation. It would do you well to take time to find out who you are getting "into bed with" prior to making such a big commitment. When done well, it can be one of the most rewarding experiences in business and you may find yourself developing friends for life. There are many forms of partnerships; some that limit your legal and financial liability more than others. A well drafted joint venture agreement (See # 5) instead of a formal partnership may be a good option depending on the intended outcome.

MISTAKE NO. 4

Failure to Establish an Exit Strategy

If going into business with other people, make sure you consider the end from the beginning. Let's face it. Very view people stay together these days, personally or in business. You may be fortunate to find lifetime partners, but life happens, and situations change. As a result, you need to decide on an exit strategy from the beginning so that everyone understands under what circumstances they will be able to exit the business, the timing, the method of valuation of the business (as there are many ways to value a business), whether the shares of the business are transferable upon death to other family members, etc. If these issues are not decided upon and reduced to writing, you could potentially end up with partners that you never intended to have and who don't have the same vision and or passion for the business. You must exit a business properly; otherwise, you could find yourself years later being legally liable for business dealings and transactions for the entire operation of the business whether or not you were actively involved.

MISTAKE NO. 5

Failure to Effectively Establish a Board and/or Advisory Board

In many places, if you are incorporated, you are required to have a Board of Directors. Most people choose to have family on their Board of Directors because they believe they will have fewer problems. However, your board should be your "calling card." One of the first questions asked when a business is applying for a loan or a grant, or seeking investors is "Who is on your Board of Directors?" A good board can lend instant creditability to a business that has not been well established in the market.

When seeking to add members to your board, it is important to have people who already have credibility and can bring business acumen to the table, i.e. accounting, legal, marketing and sales, public relations, and networking knowledge, just to name a few. Think strategically about what each individual will bring to the board. Consider their other affiliations and network of people. You only need to ask people who may be several steps ahead of you in business. Sometimes people will ask persons to join their board who have been in business for 25 years to join their start-up. Generally, those people will decline your invitation because of their own commitments, but may be willing to serve as a mentor to you with less of a time commitment.

Prior to establishing a board, you must understand the role of the board. In many instances, the board has the ability to unseat the CEO, which is YOU, if care is not taken in the structuring process. One of the people that most readily comes to mind is the late Steve Jobs, who was once unseated from Apple, the company he started.

MISTAKE NO. 6

Failure to Do Business with Well-Drafted Contracts

As an attorney, I have always believed that simple is better….at least most of the time. Make sure you have contracts when doing business with individuals and other corporations. Most people believe it is not necessary if "they know" the individual, but there are so many variables and situations that can occur that I strongly advise that you work with contracts. Sometimes, it is not until your agreement is reduced to writing and all parties review it that you realize you have different thoughts on how things would operate than the person you are contracting with, not to mention the things you are forced to think about once you actually reduce your expectations to writing. I have had many people sit across the desk from me thinking they had figured out their verbal agreements only to find me asking questions that they didn't know the answers to because they had not thought about it or discussed it with their potential partner, customer, or client. It is worth paying a few bucks to get standard contracts and agreements in order. It is not an expense that you have every day but could save you a lot of money and time in the long run. A lot of attorneys make more money off the "back end" when clients came back to litigate their cases because they refused to put recommended agreements in place from the outset. The "back end" costs are significantly higher than the front end costs. It always pays to do it right the first time

Joint Venture Agreements

Joint venture agreements govern situations where two or more people decide to come together for a specific purpose and usually for a specified time. They have separate corporations and may have no interest in each other's corporations. They are simply coming together for a common cause. For example, there may be a large contract that covers three common areas of expertise. It is possible that three businesses with different areas of expertise may come together for the purpose of submitting a proposal for that business jointly. Some joint venture partners will form another corporation just for purposes of a particular joint venture. Agreements are extremely important when participating or forming a joint venture since each party generally shares some risk. It is important to discuss that risk and reward allocation on the front end. Also, each party needs to determine what resources it will bring to the table for the joint venture since each party may have other interests or corporations that have nothing to do with the joint venture. It is also important in this case to clear conflicts of interests (see enclosed conflict of interest sample) as we discussed earlier when considering board appointments.

Shareholder Agreements

Shareholder agreements are contracts between people who share an ownership interest in a business. The agreement usually outlines the amount of capital being contributed to the business by each party, the percentage of ownership of each party in the corporation, revenue sharing, and risk allocation. Usually the shareholder agreement addresses the fiduciary duty of each shareholder, which generally minimally includes a duty of loyalty, duty of care, duty of honesty, and duty of good faith and dealing.

Shareholder agreements are also important because they generally outline any other contribution made to the corporation by an individual to which the corporation owes a financial duty. The agreement will also cover the method of dissolution of a company (causing the company to no long exist). Remember, you cannot form a company and just decide to walk away from the business without properly dissolving - or what we call "winding down" - your interest in the company. How to notify the other shareholders and dissolve your interest or have your interest bought out by another person currently inside or outside of the company should be outlined in the agreement.

I DO NOT recommend going into a store and buying agreements off the shelf. Using agreements out of a box is like playing roulette with your business. If nothing ever happens, you may be okay, but the reason you have agreements is to better navigate misunderstandings, to assert your legal rights, and to more smoothly run your business. Please know that if you don't trust a person to begin with, don't enter into a business agreement with them. thinking a contract is going to protect you. These are people who want to put every single contingency in an agreement, which is impossible. There needs to be some level of trust when dealing with people but not so much that you fail to protect yourself, your assets, and your family.

MISTAKE NO. 7

Failure to Do Estate Planning

Estate and succession planning is one of the most loving things you can do for your family while you are living so that you don't add to the enormous amount of stress they will feel when you are gone. Just as you would want to determine who gets the house or bank account, you would want to determine how your business is carried on beyond you. This should be determined from the very beginning. Particularly, if you are the only person in your family involved in your business, you need to have documents in place to protect your family in the event something unfortunate happens to you. Many times, I have had wives or husbands walk into my office with no idea about the business, the state of the business, or the financial affairs of the business. They walk in at the mercy of the remaining business partners or the state law because estate planning hasn't been done, and they don't know where to begin to look for documents. Furthermore, because family structures have gotten more complicated or involved over the years, you should make necessary decisions so that your family - or worse yet, the government - doesn't have to make those decisions. There are ways for an attorney or investigator to research and find certain information, but it will be extremely costly. During the time your loved ones are grieving, they should not have to be drawn into protracted litigation with your ex-business partners. Take care of this business on the front end. If you have worked with an attorney, the spouse can at the very least find him or her and receive consultation or direction.

CHECKLIST TO DOT YOUR I'S AND CROSS YOUR T'S

- What type of business structure do I need to incorporate?

  (Consider tax issues, future direction of business, financing)

- Have I consulted with an attorney?
- Have I consulted with an accountant?
- What type of business will I engage in?
- Will I have a partner?
- Will I have shareholders?

(Partners vs. shareholders depends on the type of business entity you decide upon. For a partnership, you will have partners and for a corporation, you will have shareholders. They all have some ownership interest in the business.)

- What is the name of my business? Is that name available for incorporation of my business? Is that name available as a domain name?
- Do I have a unique logo, trademark, etc. that I need to protect?
- Does my business have a tangible product that needs to be protected?
- Is a Board of Directors or similar governing group required?
- Who will I ask to sit on my Board of Directors? Why? What do they know? What credibility do they add?

About the Author

Barbara M. Littles is a business attorney, masterful leadership coach, speaker, and trainer, and licensed evangelist whose passion is to add value to both for profit businesses and non-profit corporations, including faith-based organizations and churches. She pursues her purpose with passion in coaching executives, board of trustees, entrepreneurs, leaders, and individuals who desire to move from “stagnant in success” to "significant in purpose".

Find out more at http://www.barbaramlittles.com