

“Stay out of Legal Trouble in 2011”

Mind Your Own Business Radio (<http://mindyourownbusinessradio.com/>)
with hosts Alison Hinson and Debi Davis and guest Nate Huckel-Bauer (nhb@ddl.com)

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While economic indicators show the nation as a whole is gradually pulling itself out of the “great recession”, 2011 will likely be another challenging year for small businesses in Maine. The last thing any small business needs now is legal trouble to slow or derail a nascent economic recovery. Although there are myriad *potential* legal concerns lurking to distract you, you’ll be well served in the year ahead if you follow these two simple recommendations: (1) if you are a corporate entity, maintain your corporate status and (2) always put things in writing.

What types of legal trouble are out there for small business owners? Although not all of these concerns apply to each business, an incomplete list, in no particular order includes:

1. business partners and investors
2. clients, customers and suppliers
3. employees
4. the “government” (i.e., taxes and regulations)
5. “Surprises” – accidents, property damage, etc.

Although that list could be debated, extended and parsed almost infinitely, regardless of how you cut it, there are two basic ways to deal with trouble: (1) avoid it and (2) minimize the impact on your business (and you personally). The right approach depends on what kind of trouble it is.

Corporate Considerations

Your business is extremely important to you. But if you’re like most healthy people, you also recognize there are other parts of your life that are important. And an important consideration for any businessperson is protecting those other parts of your life from your business.

Let’s start with a common question for many small businesses: should I set up a corporate entity to operate my business or can I run it as a sole proprietor? The answer depends on your situation. A primary purpose of a corporate entity is to separate and protect the business owner’s personal assets from those of the business. If you look at your *business* and say: this could hurt someone, someone could get sick from this, someone is really relying on my expertise, or there is significant financial liability here, it’s a good idea to operate your business as a corporate entity. Or if your business is not especially risky but you’re lucky enough to have a car or home free of debt, it’s a good idea to protect those assets from your business. I don’t care if it’s a corporation or a limited liability company; just use this opportunity to protect yourself and your family from your business enterprises.

Business Partners

Another purpose of a corporate entity is to allow multiple people to own and operate a business together. Whether you're a window washer or a software engineer, if you are operating your business with another person, please set up a corporate entity. If you do not, the law will likely consider it an equal partnership and that is rarely the intent of the parties. Although you could set up a corporate entity on your own, preferably you will consult an attorney and he or she will help you prepare an ownership agreement that is tailored to your business needs and expectations.

Investors

You may also use a corporate entity to allow others to invest in your business. While this may allow you to take the next step towards success, it raises at least two legal issues. What are your obligations to the investors and what are your obligations to the regulators? Securities regulations are very complex and they apply to almost any situation where someone else gives you money for an ownership interest in your company. Usually if you are raising money from family and friends within your state, you're ok because you're covered by an exemption to the usual regulations. Anything beyond that, its best to consult an attorney.

If investors have put money into your business, the best thing you can do is be very conservative when you spend it – spend it as if it is your child's college fund! Legally, you have a basic obligation to not waste the money and if you have a good justification for each expenditure, you should be ok. But if you use investor's cash to buy yourself a week in the Bahamas, although tempting during the depths of a Maine winter, you'll likely get in trouble. Ultimately the best way to avoid trouble with investors is for your business to be successful and for the investors to get their money back, but if that doesn't happen at least have a good explanation of where the money went. You may want to have a second person sign off on expenses larger than a set amount: for some this may be \$500, for others it may be \$10,000. It depends on your operating expenses. But having a second pair of eyes on your budget will help justify the use of funds.

Corporate Maintenance

If you've gone through the trouble of setting up a corporate entity, you've got to take the next step to make sure it works. Here are a few important tips:

1. If you have a corporation (a C Corp or an S Corp), you need to hold an annual meeting. If you're the only shareholder, sit by yourself for a minute, appoint your board of directors, and make a written record of the meeting. If your business is an LLC, an annual meeting isn't required but it doesn't hurt to for the members of the LLC to sign a document approving all the actions of the prior year and re-appointing the manager of the company.
2. You must file your annual report with the Maine Secretary of State! These are due no later than June 1st of each year. If you have an attorney, he or she should take care of this for you. If you are your own registered agent, you'll need to take care of this yourself. If you don't, there will be a penalty from the Secretary of State and you may lose the protection provided by the corporate entity.
3. Make sure people know your business is a corporate entity:
 - a. Sign documents as president of the corporation or manager of the LLC;
 - b. If you're an LLC, make sure LLC appears with your business name all the time or file a DBA with the secretary of state (i.e., Maine Cookies, LLC d/b/a "Maine Cookies") so you don't need to include the LLC;

- c. DO NOT mix business and personal assets or accounts;
 - d. DO keep separate business and personal bank accounts, tax records and accounting records;
 - e. Use your company's federal tax ID when one is needed; and
 - f. Enter into contracts (building or vehicle lease, suppliers, web services) in the name of the company.
4. If you're doing more than minimal business in another state, file with that state's Secretary of State so your business entity is respected in that state.
 5. Purchase insurance appropriate for your business.

If you use a corporate entity and follow these few tips, you'll be in good shape with your business partners and investors *plus* your corporate entity will maintain the liability protections you expect. A word of caution, Maine has adopted a new law governing LLCs and it will go into effect on July 1, 2011. The new law imposes more requirements than the current law and it is best to consult with an attorney if you are setting up a new LLC after July 1, 2011.

Get it in Writing

If you've minimized legal risks with your business partners, the next group of potential risk is your clients, customers, and suppliers. The best thing you can do here is GET IT IN WRITING. Yes, do your best to get a written contract for each transaction. This may be as simple as a receipt given to your customer or it may be as complex as a twenty-page, ten-year agreement for a supplier of your key ingredient. This is especially important for a relationship that is expected to continue over a longer period of time: in fact, you may not be able to enforce a long-term contract if it is not adequately documented. Other good reasons to have a contract . . .

1. If you are dealing with another business, you can negotiate terms that are better for you, such as longer payment period if you're the buyer or they pay for collection expenses if you're the seller.
2. You can require the parties to mediate before going to court – this can save time and money and it may repair a relationship that recently soured.
3. If you're dealing with consumers, say if you're an electrician, you *must* put things in writing and you need to make sure the contract complies with the state's requirements. The maine attorney general has a sample contract for home construction, currently available at: (<http://www.maine.gov/tools/whatsnew/attach.php?id=27938&an=1>).

Employee Matters

Assuming you've documented each external relationship and transaction, you can now turn to dealing with your employees. The key issues here are:

1. Make sure your employees have documents that allow them to work in the United States – a few downeast blueberry growers have paid significant fines recently because they employed undocumented workers.
2. Treat employees fairly and equally – unequal treatment can be grounds for a lawsuit.
3. Correctly classify your employees:

- a. Is the person an independent contractor? If they work at your business location and on your schedule, probably not. If the person is actually an employee, you may owe various employment taxes and could get fined if you haven't paid them.
 - b. If the person is actually an employee, is he or she an employee that is entitled to overtime? Salaried and management employees may not be entitled to overtime, but you should consult an attorney to confirm your situation. An incorrect classification could require you to provide back pay to the employee and fines to the government.
4. If you have any confidential information, such as customer lists or secret recipes, you should have a contract that requires your employees to keep these things secret.
 5. If you have to fire someone for poor performance or other good cause, make sure you document the reasons and preferably give them at least one warning, *in writing*.

Dealing with the Government

Usually the biggest concerns small businesses have when dealing with the government are taxes and regulations. The best way to avoid tax trouble is to engage a competent accountant or tax preparer. This person can audit your records to make sure you are paying appropriate taxes and may find opportunities for tax credits or deductions that you were not aware of.

Assuming your tax situation is under control, the next government concern is compliance with regulations. This is especially important if you are in a business dealing with consumers. Often there are specific disclosures you must give consumers or specific terms that must be included in any contract with consumers. Finally, make sure you have all the licenses required for your type of business. The State of Maine provides a helpful guide called the "Business Licensing Assistant." The guide is currently available on the web at: <http://www.maine.gov/businessanswers/BLA.shtml>

Plan Ahead

Hopefully sometime in the year ahead your business will be exceeding your expectations and you'll have a chance to plan beyond the next day or week. If that's the case, it's a great time to take a few steps to promote the long-term success of your business.

One way to do that is to protect your brand name, also known as your trademark. This is important if your customers associate your superior product or service with a logo, phrase or name. The best way to protect your brand name is to file a trademark registration with the U.S. Trademark Office. Although limited trademark protection may be available without such registration, it is much easier and less costly to protect your brand name if it has been registered as a trademark. While awaiting your registration, use the TM symbol after your brand name or logo. If you're launching a new brand in the year ahead, consider doing a trademark search before you choose the name. That may help you avoid the situation where you are forced to change your brand name because it was already in use by another company (i.e., don't use "Coke" for your new soda company). Although its possible to search and register a trademark without an attorney, hiring an experienced trademark attorney will assure the tasks are done right, likely saving time and money in the long run.

Once you've built your business and your successful brand, its time to think about vacation. Or, less pleasantly, what if you get sick or injured? Who will run the business when you're away? In addition to picking someone to manage your business while you're away, you should prepare a power of attorney so that person may act in your place. And if you're thinking of retiring, you may want to explore ways to bring the next generation of managers or family into the business. You can do this gradually, over time by transferring partial ownership rights to children, family members or key

employees while you retain management control. This is better than waiting and hoping the person managing your estate will do the right thing. This process often implicates estate and gift tax considerations on top of the corporate law issues. As a result, its best to consult an experienced attorney before trying it on your own.

Helpful Resources for the Year Ahead

If this quick summary has left you with more questions and concerns, resist the urge to ignore these issues and instead seek help! The start of the new year is a great time to reach out to your professional support system to renew relationships and talk about the year ahead.

Even if you have no specific legal questions, ask your lawyer to lunch and talk about your business. A short chat a few times during the course of the year may save substantial costs and headache down the line by avoiding legal mistakes. If you're worried about cost, ask if your lawyer will provide any services for a flat fee or at a reduced rate. Its also a good idea to call your insurer. They'll often do an insurance audit for free and the end result may save you money or confirm that your policies cover all the activities of your business. Finally, if you haven't talked with your bank in the last six months, now is a great time to do it. Ask about better terms for your loans or deposits. Although interest rates have gone up within the last few weeks, they are still very low and your business could save thousands of dollars monthly just by amending the terms of your loans.

If you have questions about anything covered in this summary or any other small business legal issues, please contact Nate Huckel-Bauer at the phone or email provided below.

Nathaniel R. Huckel-Bauer, Esq.

<http://www.linkedin.com/in/nhuckelbauer>

nhb@ddl.com

Drummond & Drummond, LLP

One Monument Way

Portland, Maine 04101

207-774-0317

www.ddlaw.com