

# Small business counsel from two legal experts

Attorneys offer sound advice on how to succeed in business



Stuart Klein and Frank Mayer, attorneys with Bond, Schoeneck & King, PLLC

If there's one thing small business owners should know before opening up shop, it's that one size does not fit all.

"The fact that there are a variety of types of business entities that can be formed, and that one may be more appropriate for your business than the other is something that the small business owner needs to be aware of," according to Stuart Klein, a trial attorney with **Bond, Schoeneck & King, PLLC** in Albany. "Everything needs to be tailored to that particular small business. Just because you're a small business doesn't mean you're not profitable or that you may not have real legal issues."

Klein and Frank Mayer, a corporate attorney with Bond, Schoeneck & King, recently gave a presentation titled "Big Legal Problems Can Come in Small (Business) Packages" at the Chamber's office. They explained the advantages and disadvantages of some of the more popular forms of doing business and the proactive ways in which small business owners can increase the likelihood that their enterprise will succeed.

Generally speaking, a small business may have three to five employees, perhaps all members of the same family, although they may have more people through affiliation with a larger business, Klein said.

Knowing which type of business entity to form is one of the most important steps in starting a business. "We want to separate the business and personal assets of the client and provide an individual with proper liability protection for business issues that may occur," Klein said.

"The choice of entity is driven by the tax consequences to the parties, which depends on how they're situated legally, perhaps based on their immigration status, and how they want a particular organization to fit into either a new or existing corporate structure," Mayer said. However, once an entity is in place, "it doesn't mean a person can undercapitalize their business, fail to purchase adequate insurance or fail to respect the ministerial formalities of the business."

Generally, a corporation can be operated as what is commonly known as a subchapter C or S corporation, and an LLC can be operated as single- or multi-member. While those are the primary business entities that small businesses need to be concerned about, there are significant differences. An S corporation, for example, couldn't be a subsidiary of another corporation, but an LLC or a C corporation could, Mayer pointed out. And while an S corporation can't have multiple classes of shares, a C corporation may. Most importantly, a C corporation is taxed at both the entity and the shareholder

level, while an S corporation is generally only taxed at the shareholder level.

## In an ideal world

The best situation, from an attorney's perspective, is when a prospective client has an idea for a business, knows where they want to sell their product and keeps an open mind regarding financing, insurance, type of business entity and whether or not they'll utilize workers as independent contractors or employees.

It's a lot more problematic if a business owner comes in after the fact, when they've received a letter from the IRS or the NYS Department of Taxation and Finance asking about their business, or if they've ignored correspondence from another state jurisdiction for several years and now they have a notice of judgment against them.

"We ask questions, because I'd rather tell people what could go wrong than explain to them what has gone wrong," Mayer said. "People may talk to a lawyer and form the right business entity, but they may later sign a lease with a personal guarantee for example, which essentially defeats the purpose of the limited liability entity. In short, it's essential to have an attorney review a lease or other legal document before it is executed."

By the same token, a small business owner should also be inquisitive when it comes to their own legal obligations.

"You have to ask questions because the last thing a small business owner, or any client, should impress upon their lawyer is that they understand the issue when in reality they do not," Klein said. "A small business owner needs to have an active voice and take an active interest in their business."

For example, if a small business owner signs a lease in a commercial space and a customer is injured after a fall, not only could the customer sue the business owner and the landlord, but the landlord could also sue the business owner if the small business failed to name the landlord as an additional insured, a provision which is commonly requested in standard form lease agreements.

"Nobody ever wants to think about bad things happening, but avoiding this scenario is as easy as checking a box on the insurance application and paying a nominal annual fee."

The importance of proper insurance coverage cannot be overestimated, and a small business owner may want to consider any or all of the following types of insurance: property, liability, commercial auto, workers' compensation, business interruption, disability, employment practices liability, professional liability and umbrella/excess insurance. Small business owners also should reevaluate their insurance coverage, and even their type of business entity, as the business grows or shrinks.

"Business owners often wonder why they need to have a legal entity in place if they already have adequate insurance — but there's no insurance against trade creditors," Mayer said. "For a modest investment of time and legal consultation at the front end, it's

much easier for us to work proactively with an emerging business than it is to undo something that's already happened."

## Big versus little

Frequently, small business owners are bullied by larger businesses that threaten litigation and seizure of personal property over a legal issue.

"It can have a snowball effect because big businesses will often try to bury small businesses in paperwork in hopes of detaching them from pursuing a legitimate claim or defense," Klein said. "Although the small business may have a valid claim or defense, they're faced with the reality that it may cost thousands to prove they're right rather than pay less money to make the claim go away." The aforementioned can be prevented if the small business takes the necessary steps at the time of formation.

When lawyers draft agreements with their clients, big businesses may insert language that is much more favorable to themselves than to small businesses.

"A small business owner may wonder why they have to pay the lawyer's fees for the big business if litigation arises, but not vice versa," Klein said. "Make sure all of the rights, obligations and conditions are mutual."

Small business owners should document everything in writing or via e-mail when dealing with another party, as many cases in the small business realm deal with the existence or non-existence of a contract.

## Counsel counts

Small business owners may do their homework and have a sense of what type of business entity they should form, but without the expert advice of an attorney, they risk legal troubles down the road.

"We don't know what we don't know," Mayer said. "When people see on the Internet they can form a corporation for \$24.98, and they have friends who have done so, it can be very tempting."

Nevertheless, small business owners can help themselves whether or not they seek legal counsel at the start-up point of their business.

"When a person has a small, fledgling business, it can be very tough for them to go to a law firm, spend a sizable amount of money and be proactive," Klein said. "But there are things they can do to self-help, so to speak; they can get insurance, document their files, and read their lease to make sure there's nothing onerous upon them."

Of course, even when small business owners perform due diligence, there's always the possibility that they will need a lawyer's advice eventually.

"It's much easier to prevent fires than to extinguish them," Klein said. "The ultimate goal is to make sure documents are created and the organization is structured so that there are no pending legal issues and all potential issues are dealt with; however, problems do happen. The more proactive a business owner is at the inception of their business, the less likely they are to have problems down the line." ■