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When Starting a Business, Don't Forget to Consider the "What Ifs"

Businesses are started every day; some will succeed and many will not. To protect yourself and your investment, it's important to consider the "what ifs" from the beginning. The following scenario is all too common, yet with a little preplanning and the right guidance, is almost entirely avoidable.

The idea

You have a great idea for what is sure to be a wildly successful business. You talk with your spouse or your best friend, or perhaps both, and they are all enthusiastically supportive of the idea. You decide right then and there to start a business and invite the others to be your partners. Your spouse is a no-brainer, and your best friend is a terrific person who, incidentally, has some of the cash that you will need to get the business up and running.

Setting up shop

You quickly discover that there are some definitive formalities that need to be addressed, including a business name, registration with the state, and a business license. To obtain these, the three of you decide to see a lawyer. Another friend tells you about an attorney who put his sister's business together and you make an appointment with him. The three of you go in to see him and in that meeting decide that you want a LLC, if for no other reason than it looks good on paper. The lawyer gives you some general business advice and steers you to a CPA for any tax advice you may need. You all agree to have this lawyer draw up the documents to establish your business LLC, and to do the ancillary filings to make your business legal. You then set an appointment for the following week to come in and sign the documents. When you come in for the scheduled appointment, everyone happily signs the documents that bring the idea to fruition. At no point in the process have you given any thought to the "what ifs" that so frequently end in personal conflicts and can lead to financial crisis and even divorce or bankruptcy.

The unexpected

Things are going well. The business is flourishing and the three of you are working splendidly as members of your LLC. You have debt but the business is covering that and is beginning to produce enough income to pay each of you a reasonable salary. You've also split responsibilities that are essential to the continued success of the company amongst yourselves. All is going well. That is, until the day your best friend tells you and your spouse that he has decided to go into the Peace Corps and not only is he leaving at the end of the month, but he also wants to be paid "his share" of the business before he leaves.

Trapped

After the initial shock wears off, you talk with your friend about the buy-out and it quickly becomes apparent that you and he are on different planets in regard to what he wants and what you think you should pay him. Your dispute quickly escalates and now encompasses not only what, but when and how he should be paid. He is leaving the country and wants his money now. You know that the business can't, nor can you, afford to cash him out, and besides, there is a disagreement over just how much he is entitled to.

Scrambling for assistance, you call the lawyer who drafted the initial business organizational documents and find that your partner has already called him. You all meet with the attorney and quickly find that he cannot represent any of you against the other, nor can he give you the legal advice that you desperately need. He advises each of you to retain your own lawyers because of his conflict of interest and your nightmare begins in earnest.

Upon obtaining your own lawyer, you are advised that the LLC Operating Agreement is either radically unfriendly to you in its Dissolution provisions and the obligations that follow a departing member's withdrawal, or that absent a unanimous agreement, you're headed to arbitration. In either case, you tell your attorney that you never discussed, let alone agreed to those provisions and that you were surprised that the lawyer put them in the agreement. At the same time, your friend's new lawyer is giving him the same advice. Meanwhile, he's not coming to work so you decide to withhold his paycheck and the dispute escalates.

Protect your dream from the start, consult legal counsel

Unexpected challenges are an inherent part of owning a business and planning ahead can greatly reduce the headache and liability when situations arise. In this particular situation, if each partner had consulted their own individual attorney before the business documents were prepared and signed, it is likely that the entire dispute would have been avoided.

When people start businesses, they don't like thinking about the potential of it not working out or the departure of a member, partner, or shareholder. As a result, many do not properly prepare for such situations. Whether it's a friend leaving the business, a death or divorce, failing to prepare for such unforeseen circumstances is often the cause of what becomes protracted and very expensive litigation, all in an effort to resolve questions and issues that could have, and should have, been addressed in your organizational meetings. These issues should also have been outlined for in your Operating Agreement, Buy-Sell Agreement, or Partnership Agreement (depending upon the business form you choose). By not planning ahead, the disputing members are forced to spend enormous amounts of time and money on what quickly becomes ugly and frequently very personal litigation that often leaves one or more key players, or even the business, in bankruptcy.

When done right, owning a business can be dream come true. Set yourself up for success by seeking independent legal advice before going into a business relationship. Albeit it might be your best friend, your sibling, parents, or even your spouse, the best way to avoid a disastrous end is to work with your legal counsel to prepare for life's "what ifs". Lawyers often work very well together at the beginning and in the creation of the of a business enterprise. It is only after conflicts develop for which there has been no definitive planning that the lawyers' advocacy reflects the conflict that they are hired to resolve. By working together from the start, legal advisors can and often do save you time, money, and emotional energy.

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