

New ventures can lead to unfamiliar legal territory

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OKLAHOMA CITY – Some business owners learn the hard way that putting more thought into the front end of the start-up process can save them legal headaches down the line, attorneys say.

Take the guy who took out a \$78,000 telephone book ad as an individual before placing himself behind the protections that incorporation provides. After the business turned bad, he was found personally liable for the advertising costs in bankruptcy proceedings.

“He was deemed to be a promoter without the corporate veil to protect him,” said Oklahoma City attorney Christopher Griswold.

That’s just one bad-choice example that Griswold and colleague Michelle Campney have encountered over the years in representing business owners.

Campney said not planning for events such as the incapacitation of a business owner is another mistake people make.

Recently, she said, a woman who owns a sole-proprietor business with several employees became incapacitated suddenly.

“We had an entity that was not going to continue, and we had no power of attorney in place,” Campney said. “You need to have somebody that can come in and operate your business if something happens to you.”

She said the latter is true of any business, regardless of its structure.

One key element definitely needs to be settled upfront, she said.

“The most important thing when beginning to think about a business is what kind of an entity you are going to be from a legal standpoint,” Campney said.

There are positive and negative aspects to most, she said, whether the choice is a sole proprietorship, partnership, corporation or limited liability company.

“The thing that you have to think about is liability,” Campney said. “If something goes wrong in your company, the first line of defense is the type of entity that you have.”

With a corporation or LLC, she said, a person can protect his or her assets, for the most part. There’s also the issue of business continuation.

“A sole proprietorship dies when you die,” Campney said. “But corporations and LLCs are going to continue.”

Campney said the two usual forms of corporation, Subchapter S and Subchapter C, are formed basically the same way.

However, she said “S corps” are taxed like partnerships, with tax obligations passed on to the individual owners. She said members of business partnerships are taxed however they are set up, according to each partner’s ownership in the company.

Campney said people form S corps because they want the legal protections of a corporation without the disadvantages of a C corp, chiefly double taxation.

“The C corp is taxed itself, then if you give a dividend, the shareholders are taxed as well,” she said.

Campney said C corps work better for larger companies with numerous shareholders and firms that need more formality in their structure.

LLCs are a perfect fit for people with a small business who want some legal protection without the recordkeeping and minutes-keeping requirements of S corps, she said. People who have not kept up with those requirements can find themselves facing allegations of a sham corporation. If that claim is successful, she said, the corporate structure and its protection from liability are lost.

Campney said people can tailor LLCs to their business needs, including whether they will be taxed as a partnership or corporation, but with liability protections similar to corporations.

“If you’re a limited liability company and you start out small and grow into something bigger, you can change the way that you’re taxed,” she said. “There’s more flexibility in it.”

Campney said she has seen of a lot of businesses that start out as friendly handshake deals becoming really complicated when partners fall out with one another. Without planning, she said, they most likely do not have a buy-sell agreement in place that gives one partner the first option to buy the other out when they want to part ways. She said buy-sell agreements can be formed at any time during a business relationship.

Griswold said another major mistake some people make is trying to start their own business after they quit their day-to-day job. He said these people find it difficult if not impossible to make financial arrangements for business credit and capital.

Campney said former employees of a business sometimes open themselves up to lawsuits if their new enterprise competes with their former boss’s, particularly if they’ve signed a non-compete agreement. However, she said the farther away from their former company they are, both geographically and timewise, the more likely a court is to find in their favor.

She said people also forget that they need business insurance, from a good liability policy to coverage for property and other needs, depending upon the type of business.

Some missteps, such as choosing the wrong type of business entity, may be fixable, Campney said, although sometimes the first must be dissolved first.

“We try not to do that, especially if you’ve been in business for a long time,” she said.

“The other thing is, you don’t want to lose your goodwill in your business. You want to keep that name. You can try to restructure things.”

Campney and Griswold, who practices mainly commercial real estate law, are with the Walls Walker Harris and Wolfe law firm in Oklahoma City.

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