

18

Legal Issues:
Recognizing Your Small
Business Needs

Source: Entrepreneurial Small Business, Katz & Green, 2e
McGraw-Hill/Irwin

Chapter 18

Example

Finding The Right Lawyer

- Most new businesses need legal advice regarding a wide range of matters
- Consider the types of liability issues inherent in your business
- Best way to find a lawyer is a referral from someone you know who also owns a small business
- You can look to trade groups or industry associations

<http://www.entrepreneur.com/management/legalissues/legalissuescolumnist/jeffreysteinberger/article182148.html>

Chapter 18

You and the Law

- There are always unavoidable risks
- In a 2002 poll, less than 1 in 10 small business had been sued in the prior five years
- It is easy to underestimate the number of laws that apply to small businesses
 - **BUSA 2106** provides an overview of some major federal laws
- State laws applicable to small businesses are extraordinarily varied

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You Need A Good Attorney

- Find an attorney experienced in forming **new business entities** and handling the needs of small businesses
- Depend on one general purpose lawyer and several specialists

18-4

Chapter 18

• Sampler of Legal Specialties

- Administrative
- Bankruptcy
- Biotechnology
- Computer / Technology
- Contracts
- E-Commerce
- Employment
- Estate planning
- Insurance
- Intellectual property
- Media / Entertainment
- Mergers / Acquisitions

18-5

Chapter 18

- **Hourly fees:** rate based on price per hour
- **Fee structures:**
 - **Hourly fees:** vary greatly from one part of the country to another
 - **Flat fees:** fixed amount paid for a certain task
 - Example: flat fee paid for handling all the paperwork to establish a corporation

18-6

Chapter 18

- **Fee structures:**
 - **Retainers:** paid a specific amount every month regardless of the workload for that month
 - **Contingency:** fee paid by a client to an attorney for legal services that is dependent upon the outcome of a case
 - Not usually used in everyday contract and business-related matters

18-7

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Can I Do This for Free?

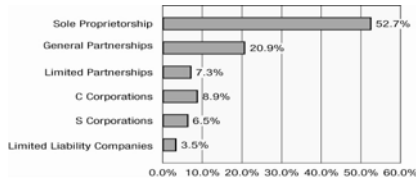
- **Free information available:**
 - www.business.gov: the general business site
 - www.reginfo.gov: regulatory information website
 - www.dol.gov: for labor laws
 - www.sba.gov: the Small Business Administration site
 - www.business.gov/regions/states: state's offices

18-8

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Choosing a Business Form

- **Business form:** types of separate, legal entities
 - Legal entities can own property, sue, and be sued
- Seven general types shown in Figure 18.1



18-9

Chapter 18

TABLE 18.2 Advantages and Disadvantages of Corporations

Advantages	Disadvantages
Can have representative management	Impersonal
Ease of raising large amounts of capital	Owners have limited interest in firm's activities—except profits
Legal entity separate and distinct from its owners as individuals	High incorporation fees and high taxes, especially double income taxation
Relatively permanent, since life of firm not affected by loss of any shareholder	Burdensome procedures, reports, and statements required by governments
Owners' liability for the firm's debt limited to their investment in it	Powers limited to those stated in charters—may be difficult to do business in another state

Source: Adapted from Megginson/Byrd/Megginson, *Small Business Management* 5th edition, 2006, p. 61. Copyright © 2006 by The McGraw-Hill Companies, Inc.

18-10

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TABLE 18.3 Advantages and Disadvantages of Sole Proprietorships

Advantages	Disadvantages
Secrecy	Limited capital
Unique tax advantages	Difficulty in obtaining credit
Owner doesn't have to share profits	Inadequate management and employee skills
Relative freedom of action and control	Unlimited liability for the firm's debts
Easiest and simplest form to organize, operate, and dissolve	Limited life because business and owner are legally the same

Source: Adapted from Megginson/Byrd/Megginson, *Small Business Management* 5th edition, 2006, p. 58. Copyright © 2006 by The McGraw-Hill Companies, Inc.

18-11

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TABLE 18.4 Advantages and Disadvantages of Partnerships

Advantages	Disadvantages
Easy to form	Limited life
Division of labor and management responsibility	Unlimited liability for debts of the firm
Can use ideas and plans of more than one person	Each partner is responsible for the acts of every other partner
Specialized skills available from individual partners	An impasse may develop if the partners become incompatible
Can raise more capital since good credit may be available	Death of any one of the partners terminates the partnership
Obtains financial resources from more than one person	A partner cannot obtain bonding protection against the acts of the other partner(s)

Source: Adapted from Megginson/Byrd/Megginson, *Small Business Management* 5th edition, 2006, p. 58. Copyright © 2006 by The McGraw-Hill Companies, Inc.

18-12

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- **Six major factors at play:**
 - Personal liability of the business owner
 - Taxation of both the entity and its owners
 - Complexity and organizational costs in setting up
 - Control of the business
 - Continuity of the business
 - Ability of the business to raise capital

18-13

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Everything is Negotiable, Negotiation is Everything

- **4 steps to structure a negotiation:**
 - **Prepare** what you need to achieve
 - **Position** by putting your best foot forward
 - **Propose** solutions that provide value and balance
 - **Pounce** when agreement on any part of the negotiation appears at hand

18-14

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Legal Liabilities

- **Torts:** arise when another's legal rights are violated in ways other than from a breach of contract
 - **2 typical arguments to deflect liability:**
 - Actor is not an employee, but an **independent contractor**
 - Actions were **outside the scope** of agency/employment

18-15

Chapter 18

- **Independent contractor argument:**
 - Many retail stores contract with an independent contractor to provide store security
 - If those security officers commit a tort, the department can **avoid vicarious liability** because the guard is an employee of the security firm

18-16

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- **Scope of authority argument:**
 - If employees make a decision requiring more authority than they really possess, the business can argue that it was not liable for the problem
 - Firm must fully train employees of the exact authority they possess

18-17

Chapter 18

TABLE 18.6 Litigation vs. Arbitration vs. Mediation		
Litigation	Arbitration	Mediation
Uses court system	Works outside of court system	Works outside of court system
Formal	Informal	Informal
Public judges	Private judges	Attorneys or mediation specialists
Multiple levels of postdecision appeal	Limited appeal possibilities	Full range of appeals
Can force other party into court	Occurs by agreement or accepting clause to arbitrate	Occurs only by mutual agreement
Binding decisions	Binding decision if agreed to beforehand	Nonbinding decision
Public	Confidential	Confidential
Most costly	Costly	Least costly
Slowest	Moderately fast	Fastest
Favors those with more money for legal help	More balanced than courts	Friendly format for small businesses

Source: John R. McKinley, Jr., "Arbitration or Litigation? Having Trouble Choosing between the Two? Here Are Some Factors to Consider when Making Your Decision," *Entrepreneur*, April 01, 2002. <http://www.entrepreneur.com/article/146121>; Steven C. Batta and Jane Easter Batta, "Stick in the Middle: You're Jammed between a Court and a Hard Place. Get Free with Third-Party Mediation," *Entrepreneur*, November 2000. <http://www.entrepreneur.com/article/146121>.

18-18

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Avoid Torts

- Transactions between businesses and customers are an interchange of communications between people
- Lawsuits are often filed out of frustration or anger
- Being perceived as a likeable person can save you from an angry situation

18-19

Chapter 18

Contracting

- **Contracts:** agreements in which the parties exchange promises
 - **Standard contracts:** company can just fill in the blanks as needed
 - **Specialty contracts:** unique contract terms, large dollar amounts at stake

18-20

Chapter 18

- **Contracts:** cont.
 - **Interstate contracts:** when doing business outside your home state it makes sense to have your lawyer draw up the contract because state laws vary
 - **Noncompete clauses:** promises not to open a competing business or work for a competitor; need to be part of another agreement and cannot stand alone

18-21

Chapter 18

- **Contracts: cont.**
 - **Exculpatory clauses:** a party to the contract will not be responsible for certain things
 - **Hold harmless agreements:** one party is agreeing not to hold the other responsible for his or her actions; giving up legal rights to sue

18-22

Chapter 18

Internet issues in contracting

- **B2B contracts involving electronic data interchange (EDI)**
 - Order for new inventory submitted electronically
 - Transactions are entered into and there is generally a master contract

18-23

Chapter 18

- **B2C contract:**
 - Ensure control over the selling process
 - Representations of merchandise or services are not actual offers to the buyer
 - Seller reserves the right not to sell to everyone

18-24

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Intellectual property

- Patents:
 - www.uspto.gov: U.S. Patent Office
 - **Design patent**: covers the look of a product and those parts that are essential or a part of the design; last 14 years
 - **Utility patent**: covers processes and functions; last 20 years

18-25

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- **Trade secret**: information known to certain people in the company that makes that company more competitive
 - Includes more than patents
 - No expiration dates
 - 5 steps to protecting trade secrets

18-26

Chapter 18

- **5 steps to protecting trade secrets:**
 1. Trade secrets must really be secrets
 2. Use warning labels
 3. Restrict physical access: a big vault
 4. Confidentiality agreements
 5. Keep doing steps 1-4

18-27

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- **Copyright:** involves the expression of ideas
 - Copyrights for creative works last the creator's life, plus 70 years
 - "Work for hire": lasts 120 years after creation or 95 years after its first publication
 - Unique expressions of ideas

18-28

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- **Trademarks:** identify certain goods
 - Owner of the mark can keep others from using a similar or identical mark to identify similar or identical goods
 - Lasts for 10 years
 - Can continue to be renewed 10 years at a time

18-29

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- **Trade names:** name of a business used to identify itself to the public
 - Filing is made with Secretary of State's office
 - Best to consider trademark implications and check with the Secretary of State for a list of all registered entity names before selecting a business name

18-30

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Example

Top Secrets

- Enter firstuse.com, an online registry for intellectual properties and other important documents
- Company's unique authentication process allows users to document text, graphic, video or audio files in any spoken or computer language without requiring them to divulge the actual contents of the files themselves
 - registration certificate is not a legally binding document
 - been successfully used in U.S. courts as supplemental documentation of the ownership of intellectual property

<http://www.entrepreneur.com/startupbusiness/inventing/protecting-a-idea/article22568.html>

18-31

Chapter 18

Summary

3-32
