

Entrepreneurs should address legal structure at start

Legal aspects of a new business must be addressed to avoid future headaches

"Welcome to self-employment!" my entrepreneurial friend said when I left corporate America to start a solo law practice. "With one person, you have anxiety," she said. "With two people, you have conflict. With three, you have politics. Take your pick!"



EXPERT
OPINION

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Those words rang true then and seem even more appropriate today. Legions of new entrepreneurs are starting ventures after leaving their corporate employers in an economic downturn.

Fortunately there are several things entrepreneurs can do to alleviate the challenges that go with starting or buying a business. These steps should be considered regardless of whether they are flying solo or taking on one or more partners. Here are some:

- Consider a limited liability company. Whether you are starting a business from scratch, acquiring a business or buying a franchise, the potential liabilities from your new operations are the same.

If you operate as a sole proprietor (without a business entity) then you and your personal assets will be subject

to the claims arising against your business.

That's why many entrepreneurs choose to operate a business through a formal legal entity, typically a corporation or a limited liability company. They provide a legal shield against personal liability.

Since its introduction in North Carolina in 1993, the LLC has become an increasingly popular vehicle for small businesses and investments. In 2008, the N.C. secretary of state filed almost twice as many new LLCs as new business corporations.

- Have a written operating agreement. This is a document signed by LLC members that governs its operations. While state law doesn't require operating agreements to be in writing, and, in fact, doesn't even require an LLC to have an operating agreement, new-business owners are well advised to have one in writing.

It should address the key issues in the conduct of their enterprise. In the absence of written operating-agreement provisions to the contrary, N.C. statute provides "default" rules governing LLCs formed in the state that can easily lead to unexpected results and frustrate the intentions of the majority owners.

As a general rule, every LLC would benefit from a written operating agreement.

- "With one person, anxiety." Single-member LLCs are no exception to the rule of the need for written operating agreements. Entrepreneurs flying solo still have the anxiety of creditors potentially attempting to "pierce the veil" of the personal-liability shield provided by their LLC.

There's also the anxiety of who will act on behalf of the LLC when and if the solo owner is disabled or otherwise absent. Having a written operating

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agreement that provides for a non-owner assistant manager empowered to act in the owner's absence gives some reassurance of continuity of management. Having the operating agreement signed by the owner and having his signature notarized provides proof that the business owner respected the formalities of establishing and operating the LLC early on. This helps reduce the risk of the entity later being portrayed by a creditor as a sham or "alter ego" of the owner that should not be respected by a court.

- "With two people, conflict."

Many entrepreneurs prefer to start their new businesses with a partner, frequently a friend, family member, neighbor or a colleague from a former employer. Frequently, in the 50/50 spirit of the relationship, the partners agree on

equal ownership. Unfortunately, with two equal owners come the possibilities of differing opinions regarding the conduct of the business and a stalemate in operations. In these situations, the written operating agreement needs anti-deadlock provisions to provide a mechanism for resolving conflict. Typically, one member can either buy out the other or be bought out in case of irreconcilable conflict.

- "With three people, politics." Operating agreements for multimember LLCs should have a buy-sell provision. This can smooth out any politics and ensure the remaining members do not have an outsider foisted upon them when one member goes through a major transition such as divorce, bankruptcy or death.

Buy-sell provisions give remaining members the option to buy the interest of the transitioning member. That prevents that share from falling into the potentially unfriendly hands of an ex-spouse, creditors or estate. "Drag along" provisions likewise can limit the political drama in a multimember LLC by requiring in advance that a member agree to a sale arranged by other members.

Embarking upon a new business is a challenge in the best of times and even more so in today's economy.

By addressing the legal fundamentals up front, the new entrepreneur can navigate the anxiety, conflict and politics that come with the territory and chart a clear path to successful, fulfilling self-employment.

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