

Avoiding Legal Risk When Starting and Running a Business

**A Discussion About
Business Entity Formation • Governing Your Business • Contracts**

Business Entity Formation

SOLE PROPRIETOR

PARTNERSHIPS

- General Partnership
- Limited Partnership
- Limited Liability Partnership

CORPORATIONS

- S-Corporation
- C-Corporation

LIMITED LIABILITY COMPANY (LLC)

- Single Member LLC
- Multi Member LLC

Business Entity Formation

- Factors To Consider When Choosing Your Business Entity



Business Entity Formation

Preferred Business Entities

- Limited Liability Company
- Corporation

Generally Not Preferred

- Sole Proprietorship
- Partnership

Governing Your Business

▶ Governing Documents

- ▶ Bylaws and Shareholder Agreements govern corporations
- ▶ Operating Agreements govern LLCs
- ▶ Partnership Agreements govern partnerships

All of these governing documents more or less set forth the same type of rights and obligations

Governing Your Business

► Why Are Governing Documents Important

- Critically important for businesses with two or more owners
- Describes rights and obligations of owners
- Provides protocol to resolve internal disputes among owners
- Failure to have governing documents means your business will be governed by statutes (RCWs) instead of how you want it to be governed

Governing Your Business

- ▶ Key Provisions in Governing Documents
 - ▶ Ownership Interests
 - ▶ Capital Contributions
 - ▶ Allocations and Distributions
 - ▶ Management of Company
 - ▶ Voting Rights
 - ▶ Adding Additional Owners/Withdrawing Owners
 - ▶ Books and Records
 - ▶ Termination or Dissolution

Contracts

What Is A Contract?

- An agreement between two or more parties
- Requires an (1) offer; (2) acceptance of offer; and, (3) consideration
- Does not necessarily need to be in writing

- Contracts that need to be in writing include the sale of real estate/land, the sale of goods (\$500 or more), and contracts that cannot be performed within one year of the contract being made

- We use contracts to express rights and obligations

Understanding Key Provisions in Contracts

➤ Attorneys' Fee Clause

- Entitles a prevailing party to a lawsuit their attorney fees
- Can work for or against you. Even if the provision is written to favor only one party, the other party can still use it in their favor

Understanding Key Provisions in Contracts

➤ Venue and Forum Clause

- Determines whether a dispute between parties will be in decided in a court or arbitration
 - Determines geographically where the dispute will be decided
 - Determines what state law will apply
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- Key difference between mediation and arbitration
 - Mediation is where a neutral third party attempts to help the parties resolve their dispute (non-binding)
 - Arbitration is where a neutral third party reviews evidence and decides in favor of one party, similar to what happens in court (can be binding)

Understanding Key Provisions in Contracts

➤ Limitation on Liability/Exculpatory Clause

- Limits one of the contracting party's liability if something goes wrong with the service or good being sold
- You can't limit your liability if you have been grossly negligent
- If your limitation on liability clause is inconspicuous and buried in legal jargon, it won't be effective.
- Certain businesses/industries can't limit their liability because it is considered a violation of public policy
 - e.g. doctors and hospitals, real estate agents

Understanding Key Provisions in Contracts

➤ Indemnification Clause

-Entitles one contracting party to be reimbursed for expenses or liabilities stemming from the other contracting party's wrongful actions

➤ Hold Harmless Clause

-Entitles one contracting party to avoid liability to the other contracting party if the former is found to have done something wrong

Understanding Key Provisions in Contracts

➤ Liquidated Damages Clause

- During the formation of a contract the contracting parties designate a certain sum to be considered damages for the injured party to collect as compensation upon a specific breach

 - e.g. late performance, early termination

- In order to be enforceable, the damages being designated need to (1) ordinarily be difficult to determine; (2) the amount is reasonable and not a penalty

Understanding Key Provisions in Contracts

➤ Warranties

- Express Warranty: A seller's promise or guarantee that a buyer relies on when they purchase a good or service. Usually given in writing.

- Implied Warranties: Applies to goods, not services

 - A. Implied Warranty of Merchantability: The goods must reasonably conform to an ordinary buyer's expectations

 - B. Implied Warranty of Fitness for a Particular Purpose: If a seller knows or has reason to know of a particular purpose for which some item is being purchased by the buyer, the seller is guaranteeing that the item is fit for that particular purpose.

Understanding Key Provisions in Contracts

➤ Integration or Merger Clause Clause

- A provision in a contract stating that the contract represents the full and final agreement of the parties and supersedes any other agreements, oral or written, on the same subject.

- This prevents oral agreements or discussions prior to the formation of a written contract from being made part of the contract

Understanding Key Provisions in Contracts

➤ Default Clause

-States what will happen if one of the parties fails to live up to their side of the agreement. Usually leads to termination of the contract

➤ Termination Clause

-States the circumstances or the reasons for which the contract can be terminated
-e.g. non performance, failure to pay

Understanding Key Provisions in Contracts

➤ Miscellaneous Clauses

- Assignment: Allows you to assign the contract to someone else
- Notice and Cure: Allows a breaching party an opportunity to cure their breach
- Force Majeure: Eliminates liability for natural and unavoidable catastrophes that interrupt the expected course of events in a contract

Takeaways

- Understand why you are choosing a particular business entity as your vehicle for operating your business
- Have appropriate governing documents for running your business
- Understand each and every term in your contracts. Understand industry specific risks and contract around them.
- If presented with a contract, make sure you understand the terms being presented to you and the risks you face. Consider negotiating more favorable terms.