

NEW BUSINESS START-UPS

What You Need to Know About Your New Business Start-Up And The Firm's Initial Consultation Related to Same

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A "Start-Up" company faces a number of organizational issues and milestones. This memorandum discusses some of the things we discuss in our initial client intake for a new company.

A. The Entity: Services, Cost and Free Consultation

The entity, of course, provides limited liability protection; that is, unless the owner engages in fraud or a scheme to deliberately keep the company "thin" on assets, the owner will not face a personal liability claim.

Typically, the Firm charges \$550 for a single member limited liability company (LLC), \$750 for a multi-member LLC with Operating Agreement and \$865¹ for an Arizona corporation. (We also routinely do LLC's and corporations in Delaware, Nevada and Wyoming.) A Fee Agreement for a multi-member LLC would read something like this:

Scope: Multi-member LLC fee K: \$750.00 flat fee includes preparation of Limited Liability Company, Consultation with an attorney, Articles of Organization, Operating Agreement, LLC Resolution, Waiver of Notice and Minutes of Organizational Meeting; includes EIN Registration, Filing and Expedited Processing Fees and 3-publishings, all courier fees; also includes Statutory Agent service free the 1st year thereafter, \$95.00 per year.

The Fee Agreement for a single member LLC or corporation would read about the same. Please note that the scope of work includes expedited processing, publication and the registration of the federal Employer Identification Number (EIN). In addition to the above the scope of work and fee includes a free initial consultation with the Client. This consultation generally covers the issues discussed below, but it can include any topic that is within the purview of the firm's business law practice and does not require extensive legal research to explore and answer.

B. The LLC Operating Agreement

¹ Corporations cost more because the Articles are longer and cost more to file and publish.

² The Manager form of management can be useful because the Manager does not need to be an owner, i.e. a

The LLC Operating Agreement is critical because it is the “Money and Power” Agreement. It defines who owns what interest in the company, what they are giving as consideration (i.e. payment) for their interest, how the interests are voted (per person or by percentage), whether the company is member- or manager- managed, how managers are appointed and removed, and if the LLC is manager-managed, then the nature, extent and limit of authority.²

C. The Buy-Sell Agreement

An important companion agreement to the Operating Agreement is the Membership Interest Buy-Sell Agreement, historically called a “Shareholders Agreement” for corporate shareholders. The Buy-Sell or Shareholders Agreement identifies those events which may cause a member or shareholder to be deemed dissociated or withdrawn from the Company. These events include disability and death, and may include bankruptcy or termination of company employment. In most cases this Agreement also contemplates and specifies the treatment of a spouse’s shares in the event of divorce. In such event the company, then the members or shareholders, will have the right to divide and buy the interest or shares of the dissociated members or shareholders, or their ex-spouse.³ The Agreement will state the purchase price (or calculation of same) for the shares or interest and the terms of payment, usually, say, 20% down with five years to pay the balance.

D. The Trademark

Even if your company website does nothing more than state the hours the business is open for business and its location, the Internet makes every company national or international. The effect of this is to make it important to choose a name for your LLC or corporation that A) is not already prominent, i.e. used by others, as shown in Google search results and B) is available for federal trademark registration. There are two advantages to this: 1) the client does not receive a cease and desist letter from a party who does have PRIOR common law or federal trademark rights to the name and 2) these days the company “brand” is critical – both to acquire customers and in determining the value of the business for oneself, financing, or sale.

² The Manager form of management can be useful because the Manager does not need to be an owner, i.e. a member, of the company. This allows the hiring for management positions of persons with special expertise, which the owners may not have or do not exercise because they are passive owners, or for an interested party to control company funds without listing oneself as an owner where such personal ownership could be unlawful or subject to creditor collection efforts.

³ As discussed in the Initial Consultation there are a number of reasons for this, and the results of not having this in place can be disastrous to all concerned.

Most of the time our firm clients have not secured patents. Even if they have patented products or services, the clients may lack the funds for repeated and protracted patent litigation. They must fight and win the war at the marketing level on the basis of their “brand.” An essential part of the brand is the trademark, i.e. name or logo stage (think McDonalds and the Golden Arches). For this reason we recommend the client choose a company name that is not already in heavy use by another company and that is available at the time for federal registration. Checking the present use and availability of the name is part of our initial consultation.

E. Contracts, Website Terms and Conditions

After basic organizational issues are satisfied, perhaps the most common shortcoming of even well established businesses is their everyday agreements. For a start-up company, having good contracts with customers, distributors, vendors, employees and on the website, is important. We have several articles on our Website dealing with Contracts, including:

- A. **The Falsity of Forms, Ten things You Need to Know about Business Contracts©**
(Including “The Documents Look ‘OK’ to Me Fallacy,” “The You Want a Priest Not a Lawyer Mistake,” “The Candy Jar Speech,” “The Doctor’s Office Speech,” “The Skyscraper Speech,” and other useful information), and
- B. **Distribution Deals, The “Dirty Dozen” of Distribution Contract Terms©⁴**

Often there are more things wrong with the client’s existing contracts than we can cover in this summary article, but in general the contracts tend to be “the wrong size and out of style.” They are not tailored to the business and its products and services. The agreements may contain unenforceable terms and not contain very favorable terms. Some old contracts begin to look like a “hall closet” with duplicate, inconsistent or jumbled terms. A statement of “Terms and Conditions” for a Website is critically important to define the offer and scope of work and to limit liability. Often the Website Terms and Conditions can be a variation of a hard copy contract, so the client gets two agreements for the price of one.

⁴ We also just posted an article “WHY PEOPLE SUE, The Ins and Outs Commercial Litigation, *Including Discussions of Decision Rules for Litigation, “The Reality Check,” “The Money In, Money Out Fallacy,” “The Follow the Money Rule,” “Metaphysical Market Forces,” and the Axiom “Maximum Benefit Requires Maximum Input.”*

F. Leases: Real Property and Equipment

It used to be that almost every client start up we represented was negotiating a commercial lease. Sometimes the client almost treated the lease as an “after-thought,” not realizing that the lease can be the “tail that wags the business dog” in terms of operations and even the sale of the business. (By having the right to approve a buyer of the business as a tenant, the landlord in effect can control who may buy your business.)

These days we review fewer real property leases, but many clients still have leased equipment. Equipment leases, next to personal guarantees, can be among the most onerous of legal documents. The reason is that, unlike most debt where the borrower saves money by paying the loan off early, with equipment leases, even if you pay off the full amount the very next day after signing the lease, the full amount of interest, say for five years, is fully due and payable.

For these reasons it is important to have your attorney review and advise you on real and personal property leases. This leads to what I call my “Landmines Speech:” We, i.e. the client and the firm, may not have the bargaining power to renegotiate all of the adverse terms of a 43 page commercial property lease, or of an equipment lease (collectively, the “land mines,”). But, we can work to remove or improve the most unfavorable landmines and we will know what and where the rest of the land mines are.

G. Business Models and Other Matters

Many times the Start-Up’s business model raises legal issues. Tesla is attempting to sell direct to customers outside of a dealer network. This is illegal in most states. I understand that PayPal’s business model caused merchants to violate agreements with their credit card companies, but by the time the credit card companies realized this or took action PayPal was big enough to hire legal counsel for its defense.

Sometimes the business model is not presently illegal but becomes so. Some years ago the firm helped two guys in their 20’s establish and operate their Arizona check cashing and money transfer business. The Arizona economy was booming at the time and many workers were cashing checks or sending funds to family members in their home country. The clients were literally driving around in

an old car with more than \$100,000 in cash. The industry attracted banks and other major players. My clients sold out to a Mexican bank. The bank in turn lobbied the Arizona legislature and was able to change the law to in effect “close the door behind it.” Client like mine, who helped create the industry, would no longer have qualified to even be in it.

Other times the client’s business model idea is not necessarily illegal but raises issues of actual or prospective state or federal regulation of the industry: Internet gambling, bit coin, and world coin to name a few. This firm has advised both state and international internet gambling companies on how and where to set up operations. We also helped a client exit its bit- and world- coin business, at least for now, due to multiple and inconsistent regulations enacted or pending.

In other cases the law may be more established, but our client, coming from out of state or out of the country, is not familiar with the state or federal law and wants extensive advice in the area. If industry or business model research and case “work up” are required, the firm will provide same for a fee agreed to by the client. We have performed this service for local, national and international companies engaging in water treatment, modular building, solar heating and cooling, wireless services, security and nano-chip technology.

H. Fees

These are just some of the topic areas covered in an initial consultation for a new Start-Up. A longer, more comprehensive, but still not all inclusive list is attached as an exhibit to this paper. How each of the above and attached topics applies to you would be determined in the actual meeting.

Normally, the firm charges \$395 for a consultation. But the Consultation –on any or all of the above topics, the filing fees, expedited filing fees, payment for three publications, EIN and courier fees are all included in the price of the LLC or corporation.

For new clients who come to discuss contracts or other documents the consultation fee is \$395. This amount is credited back against the cost of whatever document(s) the firm is asked to prepare.

For clients who seek consultation and advice on a particular business matter, typically a dispute, the Consultation Fee includes case intake, pre-meeting document outline, review and analysis; consultation and advice on the matter,

including options, the pros and cons of each option, and a recommendation based on our discussion with the client. The client leaves, not just with information, but with knowledge of “where the client stands” and a plan.

I. Black Hat, White Hat”

Seldom are decisions on business legal issues simply black or white. Firm consultations with business clients are not necessarily limited to a discussion and analysis of the applicable law and how it applies to the matter at hand (the “black hat”), but usually will include a discussion of practical business issues as well (the “white hat”). It is not the firm’s place to tell the client what to do, but to be sure that the client is fully informed to its satisfaction on both legal and practical issues, so it can make an informed decision.

Actually, it is not unusual for the client *not* to follow the firm’s legal advice to the letter. For example, a semi-conductor company is not likely to fire a software engineer who makes the company \$1,000,000 a year because of visa problems. For that kind of money the client will analyze its options. Bottom line, \$1,000,000 will pay a lot of attorneys’ fees, so in such cases the client, after consultation and advice and with knowledge of the legal and practical issues, may decide to take a calculated risk.

Not all law firms can engage in this “black hat-white hat” analysis because the partners or associates lack actual business experience. Learning the practical aspects of business law is like raising a child: Sure, you can read the books about child rearing, but it is by actually having and raising a child that one “gets it.” At this firm “we get it” as to business Start-Ups. We have extensive practical business formation and management experience in addition to years of practicing law and my teaching business law at ASU.

We hope this explains some of the issues for your new business Start Up and how the firm’s Initial Consultation about them is covered by the cost of your LLC or corporation. If you have any questions about any of this please feel free to contact us at azbuslaw.com, or call 602-265-7997 and ask for Tom. Thanks.

Start-Up Company Checklist

Owner Operated

A. Investment Stage

1. Non-Disclosure Agreement (NDA)
2. Founders Agreement
3. Security Purchase Agreement for Investors
4. Investor Questionnaire
5. Private Placement Memorandum
6. Regulation D filings, state & federal⁵

B. Entity

7. LLC, corp., Sub-S
8. Operating Agreement: contribution, %, voting, Manager
9. Special Provisions: Voting, Dissociation, buy-out
10. Buy-Sell Agreement –Member leaving, shares from spouse for buy-out, etc.

C. Brand

10. Trademarks: Name and logo
11. Copyrights

D. Operations

12. Manager Contract
13. Key Employee Contract
14. Employee Confidentiality Agreement
15. Lease
16. Sales Agreements

E. Growth

17. Consulting Agreement (e.g. before franchise)
18. Representatives Agreement
19. Distributors and Sub-Distributors Agreement
20. Dealers Agreement
21. Franchise Package of Agreements.

⁵ Regulation A \$5,000,000 limit 12 month Short Form Registration (Offering Circular)

Regulation D Rule 504 \$1,000,000 limit 12 month period. No limit accredited or non-accredited investors

Regulation D Rule 505 \$5,000,000 limit 12 month period No disclosure requirement , 35 non-accredited investors

Regulation D Rule 506 No \$ limit 12 month period. Disclosure. 35 non-accredited, sophisticated investors