

The Legal Intelligencer

THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843 - 2010

An ALM Publication



Pro Bono

May 2010

May 2010

TUESDAY, MAY 25, 2010

Pro Bono • PB7

Businesses Need Pro Bono (or Low-Bono) Help, Too!

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Special to the Legal

Blogs and advertising abound with tips for would-be entrepreneurs about starting new businesses. Many warn that 90 percent of new businesses fail in the first one to five years and suggest ways to avoid being at the wrong end of that statistic. Others advertise how to incorporate without a lawyer.

Entrepreneurs watching their pennies are often tempted to believe the ads that tell them it's simple and all they have to do is plug their business facts into the software. People think they are saving money or feel they simply cannot afford to hire an attorney, when the reality often is that they cannot afford not to, because in the end they could lose valuable assets, including their homes. These entrepreneurs and start-up businesses need our help.

The risk is that the business will fail, and the founder, owners and/or investors, having not taken the proper legal steps, will end up personally liable for the debts of the business or in hot water with the Internal Revenue Service, Securities and Exchange Commission or other federal, state or local agencies. No one starts a new business expecting it to fail. Fortunately, the latest research from the Small Business Administration (SBA) tells a more encouraging story, indicating that about 66 percent of businesses survive the first two years and that on average about 45 percent survive to the five year mark. The issue of personal liability, however, for the owners of the 55 percent of businesses that do fail is crucial.

Too many entrepreneurs, especially "necessity entrepreneurs" (people who start businesses because other income opportunities are gone), do not invest sufficiently in the legal aspects of business start-



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up and end up paying more to correct problems later or risk personal bankruptcy by losing the protections of limited liability.

According to the Global Entrepreneurship Monitor (GEM), a research project that tracks entrepreneurship, the rate of so-called "necessity entrepreneurship" increased sharply in the United States during the recession. GEM surveys indicate that in 2009, necessity was a factor for 24.7 percent of new U.S. ventures, up 18 percent over 2007.

The vast majority of new businesses start as sole proprietorships, as high as 80 percent according to the SBA. Entrepreneurs find many excuses for not getting the right legal help up front: "Attorneys are too expensive. I can do it myself. I don't need an attorney yet, I'll hire an attorney once I have my business plan done, once I have funding in place, once I am up and running" If a sole proprietorship fails, creditors can and do attach the personal assets of the individual owner as well as the business assets. Merely signing a lease, hiring contractors or inviting potential customers onto the business premises can create enormous potential liability for the sole proprietor, although the risk can be somewhat offset with insurance.

The combination of a lack of funding, lack of awareness of the availability of affordable legal assistance for business start-ups (through clinics, law schools and law firms offering pro bono or discounted rates for start-ups), and aggressive advertising for do-it-yourself incorporation has caused many entrepreneurs to shortchange the legal aspects of their start-ups.

Entrepreneurs need assistance selecting and creating the correct organizational form to fit their specific business plan and situation. The limited liability partnership (LLP) and limited liability company (LLC) are the most popular types of business entities and are suitable for many business start-ups. However, product-based companies that are likely to expand rapidly and attract venture capital are generally more suited to the corporate form. There are many factors that go into selecting the correct business form for any given organization. The important aspect is to limit the owner's and/or investors' potential liability to the amount invested.

Even when entrepreneurs take the time to file for incorporation or to create an LLC, a court may still impose liability on the entrepreneur if the business fails by piercing the corporate veil. The court looks to see if the business form is a façade or sham for the dealings of the dominant shareholder by examining whether corporate formalities have been observed and corporate records kept, whether there are outside officers and directors, whether there is sufficient capitalization, and whether there was comingling of assets between the business entity and the dominant shareholder's personal assets.

For instance, in *Fletcher-Harlee Corp. v. Szymanski*, the court pierced the corporate veil of a concrete company and extending liability to the sole shareholder where the sole shareholder was also the only officer and director, made all of the business decisions, did not keep proper financial records (or purposely withheld them), and testified that all of his corporations leased space in a building owned by another of his corporations (without a written lease). Many entrepreneurs do not recognize the importance of maintaining the new business as a completely separate entity or the potential consequences for failing to follow the corporate form.

Entrepreneurs need advice on how to proceed once the entity has been formed. Too many entrepreneurs go online and incorporate themselves without understanding the required steps to maintain the business as a separate entity. After formation of the business entity, the laws require that the entity follow certain organizational steps.

For example, the incorporator of the new corporation is required to elect or appoint directors, the new directors are then required to adopt bylaws, elect officers, adopt a fiscal year, banking and other operating resolutions, and accept subscriptions for the issuance of shares. It may seem silly for a single owner entity to have to hold meetings, take minutes and adopt written resolutions, yet this is what the court expects because an entity cannot act on its own. Entrepreneurs need assistance from business attorneys who will take the time to explain the importance of each of these steps and the ongoing activities needed to maintain the separate legal entity.

According to Carl J. Schramm, president and CEO of the Ewing Marion Kauffman Foundation, "[a]cross the country, entrepreneurs are turning their dreams of starting businesses into reality, and in the process they are revitalizing their communities by creating new jobs. This is nothing new: Some of today's biggest companies were started by entrepreneurs during bad economic times, including Microsoft, BET, Whole Foods and Adobe Systems. On average, more than half a million people start a business each year."

Experienced business attorneys may want to consider donating time to business start-ups on a pro bono or close to pro bono basis (i.e. heavily discounted), especially during these challenging economic times, to facilitate the process for entrepreneurs starting new businesses. The American Bar Association urges all attorneys to provide a minimum of 50 hours of pro bono services annually. Although the ABA rule does not specifically address pro bono work for small businesses, clearly for many new entrepreneurs, the payment of standard legal fees would significantly deplete their economic resources and inhibit their ability to proceed. Starting a business the right way can create jobs and transform communities; when done wrong, it can also destroy personal finances and create lasting problems.

We have the ability to add significant value for needy organizations. The decision about what type of entity is best and the creation of appropriate bylaws, shareholder agreements and/or operating agreements should be tailored to the goals of the new enterprise. One size does not fit all. Experienced business attorneys and newer attorneys with experienced mentors should help entrepreneurs get off to a good start and educate, coach and mentor entrepreneurs regarding the business formalities needed to maintain and grow their organizations.

Attorneys can offer their services on a purely pro bono basis or on a "low-bono" basis, where the entrepreneur is expected to pay a mutually agreed-upon percentage of the normal cost of the services offered. A low-bono arrangement is often preferable because charging a fee, albeit a very low one, ensures that the entrepreneur is serious and will appreciate the attorney's time and effort, while still making legal assistance affordable for the start-up. Some attorneys require that entrepreneurs or start-up clients have at least a first draft business plan and an idea of how they intend to obtain financing before taking on a pro bono or low-bono client. It is also a good idea to keep a list of up-to-date referral sources on hand for entrepreneurs, such as to Philadelphia VIP (www.phillyvip.org).

For the attorney, there is both the satisfaction of helping to grow the economy and the opportunity to grow a long-term client relationship. Successful start-ups often come back for more assistance over time and can grow into excellent sources of business and referrals. And many entrepreneurs that are unsuccessful often try again. •