BUSINESS LAW BASICS

Sponsor: Young Lawyers Division
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Thursday, May 12, 2016
9:40 a.m. - 10:40 a.m.
Meeting Rooms 207-211
Kentucky International Convention Center
Louisville, Kentucky
A NOTE CONCERNING THE PROGRAM MATERIALS

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HEATHER COLEMAN BROOKS is an attorney with English Lucas Priest & Owsley LLP in Bowling Green, where she practices in the areas of business and employment law, school law, and immigration. Ms. Brooks received her B.A. from Western Kentucky University and her J.D. from the University of Kentucky College of Law. She is a member of the Bowling Green-Warren County, Kentucky, and American Bar Associations, the Defense Research Institute, Council of School Board Attorneys, and American Immigration Lawyers Association.
Useful tips and common pitfalls for new lawyers and general practitioners looking to develop or expand a general business law practice for small business clients.

I. INTRODUCTION

Business law clients bring a multitude of issues to a lawyer's desk. From new business owners to veteran shareholders, clients rely on attorneys' expertise to navigate the legal conundrums facing their businesses. As attorneys, our role is to delve into the issues presented, but when we stop there, we fail to fully serve our clients' needs. Clients too often overlook the legal minutiae necessary to protect their interests, and attorneys often overlook the basic business goals the clients are attempting to achieve. To best serve our small business clients, our services must bridge the gap between law and business.

To truly benefit our clients, attorneys must develop a product that enhances the clients' business. Efficient, effective legal services better our clients' bottom-line. Offering quality services in a format that business clients relate to is the key to building or expanding a business law practice.

These materials are intended to assist new lawyers and general practitioners in developing a business law practice by fine-tuning their product, developing a business-friendly fee structure, and minimizing risks in the practice area. The information contained in this outline is meant to provide a broad overview of basic business law concepts encountered in assisting small business clients.

II. DEFINE YOUR PRODUCT

To build or expand a business law practice, you must first identify your target audience. Will you offer formation services for entrepreneurs? Work with established businesses on transactional projects? Litigate business disputes? Defining your product and potential client base will allow you to build your brand as a business law attorney.

A. Formation

Assist budding entrepreneurs by advising of the legal entity best-suited for their business and drafting the documents that will govern the organization.

B. Entity Selection

Entity selection is unique to every client. You must evaluate the client's goals and advise based on the entity best-tailored to fit its needs. This will depend on the purpose for the business, regulations governing the client's industry, the number of owners, the expected revenue, the
potential personal liability, the client's assets, the client's tax and succession planning needs, and the client's desire for corporate structure.

1. Sole proprietorship.

   a. Advantages:
      i. Inexpensive to create and operate.
      ii. No formalities or filings required, but licensing and permitting requirements apply.
      iii. No annual filings required.
      iv. Owner will report earnings on personal taxes.

   b. Disadvantages:
      i. No asset or liability protection for owner.
      ii. Debts and losses will be attributed to owner personally.
      iii. Limited to one-owner operations.

   c. Practical tips: This entity is rarely preferable; advise your client to select an entity which offers greater personal protection.

2. Partnerships and limited partnerships.


      i. Advantages:
         a) Inexpensive to create and operate.
         b) No formalities or filings required.
         c) May voluntarily file documents with Secretary of State to declare partners' authority and associations; if filed, annual filings will be required.
         d) Pass-through entity: profits and losses are reported on owners' personal tax statements.
         e) Wide body of statutory authority and case law governing partnership operations and rights of partners.
ii. Disadvantages:

   a) No asset protection.

   b) Partners are personally, jointly, and severally liable for debts and losses of partnership.

iii. Practical tips:

   a) Governed by Kentucky Revised Uniform Partnership Act (KRS 362.1-101 to 122); will serve as default rules for issues not addressed in partnership agreement.

   b) Partnerships formed prior to July 12, 2006 are governed by Kentucky Uniform Partnership Act.

   c) Partnerships are rarely advisable due to the lack of personal liability protection for partners. If clients elect to form a general partnership, document this election in writing.

b. Limited partnerships ("LP"): KRS 362.2-401 to 362.2-710.

i. Differs from a general partnership in that there are two classes of partners: general and limited.

ii. Advantages:

   a) General partners have management responsibility and personal liability for partnership.

   b) General partners are liable jointly and severally for all obligations of the limited partnership unless otherwise agreed. KRS 362.2-404.

   c) Limited partners have limited liability, meaning their personal assets typically cannot be used to satisfy business debts and liabilities. The amount of their liability is limited to their investment in the LP.

   d) Pass-through entity: profits and losses are reported on owners' personal tax statements.
e) Wide body of statutory authority and case law governing partnership operations and rights of partners.

iii. Disadvantages:
   a) Cannot be formed to render professional services.
   b) General partners are exposed to personal liability.

iv. Practical tips:

Limited partnerships formed prior to July 12, 2006 are governed by Uniform Limited Partnership Act (KRS 362.401 to 362.710).

c. Limited liability partnerships (LLP).

i. This is a form of general partnership that limits liability of partners upon election.

ii. Advantages:
   a) Shields partners from vicarious liability for actions of partners; partners are liable for their own negligence, wrongful acts, or misconduct. KRS 362.2-404.
   b) Wide body of statutory authority and case law governing partnership operations and rights of partners.
   c) Pass-through entity: profits and losses are reported on owners’ personal tax statements.
   d) Some filings required, but few other formalities and filings necessary.
   e) Can be used to render professional services.

iii. Disadvantages:
   a) Not as much flexibility as an LLC to choose taxation structure.
   b) Less protection for personal liability of partners than LLCs and corporations.
d. Formation documents.

i. Certificate of Limited Partnership for LPs and LLPs (KRS 362.2-404). Required provisions include:

a) Name and initial office address.

b) Registered office and agent.

c) Name and street address of each general partner.

d) Election to be designated as LLP, if applicable.

ii. Partnership agreement.

a) Key provisions to include:

i) Partners' contribution to the partnership.

ii) Registered office and agent.

iii) Allocation of profits, losses, and draws.

iv) Partners' authority and management duties.

v) Voting rules for decision-making.

vi) Admitting new partners.

vii) Effect of bankruptcy, withdrawal, or death of a partner.

viii) How to resolve disputes.

ix) Disassociation.

x) Dissolution.

b) KRS 362.2-110 prohibits limited partnership agreements from:

i) Varying a limited partnership's power under KRS 362.2-105 to sue, be sued, and defend in its own name;
ii) Varying the law applicable to a limited partnership under KRS 362.2-106;

iii) Varying the filing requirements of KRS 362.2-204;

iv) Varying the information required under KRS 362.2-111 or unreasonably restricting the right to information under KRS 362.2-304 and 362.2-407, but the partnership agreement may provide a different location for the maintenance of the books and records, and impose reasonable limitations on the availability and use of information obtained under those sections, and may define appropriate remedies, including liquidated damages, for a breach of any reasonable limitation on use;

v) Eliminating the duty of loyalty under KRS 362.2-408;

vi) Unreasonably reducing the duty of care under KRS 362.2-408(3);

vii) Eliminating the obligation of good faith and fair dealing under KRS 362.2-305(2) and 362.2-408(4) (note: the partnership agreement may establish reasonable standards by which the performance of the obligation is to be measured);

viii) Varying the power of a person to dissociate as a general partner under KRS 362.2-604(1), except to require that the notice under KRS 362.2-603(1) be in a record;

ix) Varying the right of a court to decree dissolution in the circumstances specified in KRS 362.2-802;

x) Varying the requirement to wind up the partnership’s business as specified in KRS 362.2-803;
xi) Unreasonably restricting the right to bring direct or derivative actions under KRS 362.2-931 to 362.2-935; or

xii) Restricting the right of a partner to consent to a merger or conversion or the right of a general partner to consent to an amendment to the certificate of limited partnership which deletes a statement that the limited partnership is a limited liability limited partnership.

c) Statement of Qualification.

LLPs must file a Statement of Qualification with the Secretary of State, and file annual reports thereafter.

3. Limited liability companies (LLCs) and professional limited liability companies (PLLCs) (KRS 275):

a. Advantages:

i. Flexibility in structure and operations.

ii. Few formalities required.

iii. Can have one or more members.

iv. Shields members from personal liability. KRS 275.150(1).

v. Members may elect to be taxed as a disregarded entity, partnership, S-Corp, etc.

vi. Profits and losses will be allocated to members in proportion to members' contributions.

vii. Creditors can reach only the membership interest of the member liable, but cannot participate in management or force dissolution. KRS 275.260.

b. Disadvantages:

Relatively new corporate structure with small body of case law.
c. Governing law:

i. Kentucky Limited Liability Company Act governs relations of the LLC, members, managers; is the default law for issues not addressed by operating agreement. KRS 275.003(8).

ii. Statute gives "maximum effect to the principles of freedom of contract and the enforceability of operating agreements." KRS 275.003(1).

d. Formation documents:

i. Articles of Organization.

Requirements set forth in KRS 275.025. Articles must include:

a) Name that satisfies KRS 14A.3-010.

b) Registered office and initial registered agent.

c) Mailing address of the initial principal office of the limited liability company.

d) Statement that the LLC is to be managed by a manager or managers or that the limited liability company is to be managed by its members.

e) Note: Term of a limited liability company will be perpetual unless otherwise stated in articles of organization.

ii. Operating Agreement.

Few statutory requirements, but may:

a) Eliminate or limit the personal liability of a member or manager for monetary damages for breach of duty of care or loyalty. KRS 275.180.

b) Provide for indemnification of a member or manager for judgments, settlements, penalties, fines, or expenses incurred in a proceeding to which a person is a party because the person is or was a member or manager. KRS 275.180.
c) Specify penalties for a member's failure to contribute capital or obligations otherwise required. KRS 275.003.

iii. Important provisions should detail:

a) Capital contributions of members.

Members may lose their limited liability protection if they fail to adequately fund the company; adequate capital contributions should always be identified, and organizers should consult their tax advisors to determine an appropriate amount. See, e.g., Inter-Tel Techs., Inc. v. Linn Station Properties, LLC, 360 S.W.3d 152, 163 (Ky. 2012).

b) Registered office and agent; include consent of agent if different from organizer (required).

c) Principal office address (required).

d) Management structure (member-managed or manager-managed) (required).

e) Members' management authority.

f) Voting rules for decision-making.

g) Procedure for adding new members.

h) Effect of bankruptcy, withdrawal, or death of a partner.

i) Dispute resolution process.

j) Dissolution process.

4. Corporation: KRS 271B.

a. Advantages.

i. Provides limited liability for shareholders and participants.

ii. Owners may hold different types of stock interests (allow for different levels of dividends).

b. Disadvantages.
i. Strict regulation of formation, filing, and operating requirements.

KRS Chapter 271 governs corporations, and includes requirements for:

a) Organizational meeting: KRS 271b.2-050.

b) Annual meetings: KRS 271B.7-010.

c) Annual filings: KRS 14A.6-010.

ii. Dividends paid to shareholders are subject to "double taxation:"
Corporations pay tax on their profits first at the entity level and then owners pay taxes at the individual level on profits received as dividends.

c. Formation documents.

i. Formation is governed by the requirements set forth in KRS 271B.

ii. Articles of Incorporation: Requirements set forth in KRS 271B.2-020.


iv. Initial Consent of Incorporator.

v. Shareholders Agreement.

vi. Stock Certificates.

vii. Subscription for Shares.

See KRS 271B.2-210.

5. S-Corporation.

a. An S-Corporation is a corporation that obtained the Subchapter S designation from the IRS.

b. Advantages of an S Corporation.

Tax savings: Members of LLCs are subject to employment tax on the entire net income of the business, but only the wages of the S-Corp shareholder who is an employee are subject to employment tax. The remaining income is paid
to the owner as a "distribution," which is taxed at a lower rate.

c. Disadvantages.

Strict regulation of formation, filing, and operating requirements (see Corporations above).

d. To qualify for S corporation status, the corporation must meet the following requirements:

i. Be a domestic corporation.

ii. Have only allowable shareholders.

   a) May be individuals, certain trusts, and estates.

   b) May not be partnerships, corporations or non-resident alien shareholders.

iii. Have no more than 100 shareholders.

iv. Have only one class of stock.

v. Not be an ineligible corporation (i.e. certain financial institutions, insurance companies, and domestic international sales corporations).

e. Election is made by completing IRS Form 2553.


a. Tax implications are an integral part of entity-selection. The basic summary of tax implications for business entities is below:

   A business entity with two or more members is classified for federal tax purposes as either a corporation or a partnership. A business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.

   16 F.R. §301.7701-2.

b. If you are not well-versed in tax law, advise clients in writing to seek the advice of their tax advisor, and work
collaboratively with tax advisors to ensure clients are adequately protected.

7. Organize in the state where the company primarily operates.
   a. Do not fall for the hype that organizing under the laws of a foreign state will benefit your client when forming partnerships or LLCs.

   Clients will be responsible for registering their business in all states in which they operate; filing out of state will only increase filing requirements and fees, and subject clients to out-of-state tax filings.

   b. If forming a corporation, consider the benefits of foreign jurisdictions as statutory formalities will effect operations and governance.

C. Existing Business

1. Drafting and reviewing documents.
   a. A substantial portion of a business law transactional practice for small business clients involves drafting and reviewing agreements with customers, vendors, lenders, lessors, employees, and business partners.

   b. Draft and review documents like a litigator.

      i. For each provision, assume it will be breached and be sure your client is adequately protected when it occurs. Consider:

         a) Events of default.

         b) Legal remedies available.

         c) Dispute resolution process.

      ii. The most common cause of disputes in business contracts is ambiguities in the documents. If disputed, basic rules of contract construction will apply, as well as industry-specific standards.

         a) The construction and interpretation of a contract, including questions regarding ambiguity, are questions of law to be decided by the court. See, e.g., Frear v. P.T.A. Indus., Inc., 103 S.W.3d 99 (Ky. 2003).
b) Review applicable industry regulations before drafting and reviewing documents.

iii. Your duty to your client requires that you draft an agreement that will withstand scrutiny, which requires it be commercially reasonable.

'Unconscionability' doctrine is used by the courts to police the excesses of certain parties who abuse their right to contract freely; it is directed against one-sided, oppressive and unfairly surprising contracts, and not against the consequences per se of uneven bargaining power or even a simple old-fashioned bad bargain.


c. Important clauses.

i. Indemnity clauses.

Indemnity is "[a] duty to make good any loss, damage, or liability incurred by another[,]" and "arises from a promise by the indemnitorto safeguard or hold harmless a party against an existing or future loss, liability, or both." Frear v. P.T.A. Industries, Inc., 103 S.W.3d 99, 107 (Ky. 2003) (citations omitted); see also 41 Am.Jur.2d Indemnity §1 (1995) "...[G]eneral principles of contract construction apply equally to indemnification agreements. The right of an indemnitee to recover of the indemnitor under a contract of indemnity according to the terms of such a contract is well recognized. Such a contract is not against public policy and will be enforced if the indemnitee has suffered loss thereunder and has complied with its terms." United States Fidelity & Guaranty Co. v. Napier Elec. & Constr. Co., 571 S.W.2d 644, 646 (Ky. App. 1978). Enerfab, Inc. v. Kentucky Power Co., 433 S.W.3d 363, 366 (Ky. App. 2014).

ii. Arbitration clauses.

a) In Kentucky, and across the nation, there is a strong public policy in favor of arbitration as an alternative to litigation.
b) Draft clause to require arbitration to occur in Kentucky pursuant to Kentucky Uniform Arbitration Act:

i) "Subject matter jurisdiction to enforce an agreement to arbitrate is conferred upon a Kentucky court only if the agreement provides for arbitration in this state. Thus, an agreement to arbitrate which fails to include the required provision for arbitration within this state is unenforceable in Kentucky courts.... Parties need not suffer the expense and delay of the arbitration hearing, only to find that the award is unenforceable. When the issue arises prior to the arbitration hearing, as it has in this case, and the agreement upon which arbitration is sought fails to comply with the literal provisions of KRS 417.200, the courts of Kentucky are, pursuant to KRS 417.200, without jurisdiction to enforce the agreement to arbitrate." Ally Cat., LLC v. Chauvin, 274 S.W.3d 451, 455-56 (Ky. 2009).

ii) Kentucky courts will have jurisdiction to enforce an arbitration agreement if arbitration is to be conducted under the Federal Arbitration Act, since the FAA has no requirement that arbitration occur within this jurisdiction. Ernst & Young, LLP v. Clark, 323 S.W.3d 682 (Ky.2010).

iii. Limitation of liability clauses.

a) Limitation of liability clauses are enforceable, but must be drafted to not be unconscionable.

b) "[A] party to a contract may agree to release another from liability for ordinary or gross negligence, but not for willful or wanton negligence or where contrary to public policy. Exceptions to this rule include:

(1) Contracts for exemption from liability for a willful breach of a statutory duty; (2)
contracts between master and servant relating to negligent injury of the servant in the course of his employment; and (3) contracts where one of the parties (such as a railroad) is charged with a duty of public service, and the bargain relates to negligence in the performance of its duty to the public.

Contracts exempting from liability for negligence are not favored and are strictly construed against the parties relying on them. The wording of the release must be 'so clear and understandable that an ordinarily prudent and knowledgeable party to it will know what he or she is contracting away; it must be unmistakable.' United Servs. Auto. Ass'n v. ADT Sec. Servs., Inc., 241 S.W.3d 335, 342 (Ky. App. 2006).

2. Business-friendly services and marketing.
   a. Small business and business start-ups have the greatest need for legal services, but traditional fee structures act as a barrier to obtaining counsel. Establishing alternative fee arrangements offers business clients services in a format that benefits their business
   b. Alternative fee arrangement (fixed fee).
      i. Charge appropriate fee based on what value the client receives and how that client perceives value.

      ii. Profitability depends on improving efficiency.
      iii. Scope of representation should be limited (sample fee agreement attached).
      iv. Ethical concerns.
         a) See Douglas R. Richmond, "Understanding Retainers and Flat Fees," 34 J. Legal Prof. 113 (2009).
         b) Must be reasonable; consider the time and labor required, the fee customarily charged
in the locality for similar legal services, and the time limit imposed by client.

c) Fee is earned when services are complete.

d) Clearly define scope of representation in writing (see sample fee agreement attached).

c. Referral sources.

i. Accountants/tax advisors.

ii. Chamber of Commerce/business organizations.

iii. Attorneys.

3. Limit risks of malpractice.

a. Most common legal malpractice claims that apply to business law:

i. Failure to know/apply law.

ii. Planning error.

iii. Failure to file documents.

iv. Procrastination.

v. Failure to obtain client consent.

vi. Conflict of interest.


b. Identify who you represent.

i. Undertake representation of the business or a business owner individually, but not both. Business owners have personal interests that may be adverse to the interests of the business.

ii. In case of a dispute among owners, representation of the business will likely create a conflict of interest that prohibits representation of an owner.

[A] lawyer shall not represent a client if the representation involves a
concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

Notwithstanding [the above], a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing. The consultation shall include an explanation of the implications of the common representation and the advantages and risks involved.

Ky. SCR 3.130, RPC Rule 3.130(1.7). But cf., Marcum v. Scorsone, 457 S.W.3d 710 (Ky. 2015) ("Law firm's prior representation of two shareholders and officers of corporation in litigation brought against them by the corporation while at the same time advising the corporation's board of directors regarding other litigation did not create an actual conflict of interest requiring disqualification of law firm from representing several shareholders

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and officers, including the two former clients, in shareholder derivative suit.").

c. Document the following in writing:

i. Explain that business owners' interests may conflict with that of the business, and advise owners to seek independent counsel (see sample fee agreement attached).

ii. Advise owners to seek advice of tax advisor for issues related to tax election and business operation.

iii. Advise clients of obligations to follow applicable filing requirements.

iv. Detail fee arrangement.

v. Explain limited scope of representation.

d. Emerging concern: cyber liability.

Business attorneys are especially vulnerable to new threat of breach of data through cyberattacks due to the sensitive financial information in client files.

i. Legal and ethical violations result from data breaches.

ii. Protect sensitive client information stored electronically.

iii. In case of breach, follow notification obligations in KRS 365.732.

SAMPLE FEE AGREEMENT

John Doe
Doe's Investments, LLC
111 Smith Street
Bowling Green, KY 42103

Re: Fee Agreement

Dear Mr. Doe:

Thank you for contacting our firm to be of assistance to Doe's Investments, LLC (the "Company") in its new business venture. This letter will confirm that Doe's Investments, LLC has engaged us to assist in matters related to its formation as a Kentucky limited liability company.

In accordance with the rules of professional responsibility, we need to confirm the terms of our engagement. At this time, the Company is retaining us to assist in forming an LLC and related initial business tasks. We have agreed to charge a fee of $_____ for the following tasks: drafting the Articles of Organization, drafting the Operating Agreement, filing the formation documents with the Kentucky Secretary of State and the Warren County Clerk, and obtaining an employer identification number. Before performing any task other than those listed, we will need to discuss and reach agreement on the terms of representation, which may include payment of a retainer. The Company shall remain responsible for any and all expenses incurred in this matter, including, but not limited to, all applicable filing fees. If this firm agrees to advance said expense, all expenses advanced by the firm shall be paid within 30 days.

Our firm will represent the interests of the Company in this transaction, and not the interests of you and the other members individually. Should you have questions or concerns regarding your interests related to this transaction, you should consult independent counsel.

This firm represents many clients engaged in various enterprises. Our work for you shall not preclude the firm from representing other clients who may have business dealings with or interests adverse to the Company. Confidential information obtained from the Company will not be shared with any other current or future client of the firm.

We ask you to waive any objection to the firm's representation of others who in the future might retain us for unrelated transactions or litigation involving it and/or any entity affiliated with it. This waiver does not authorize the firm to represent another client adverse to you in a matter related to our representation on this matter.

We will retain the file for this matter for ten years after our representation is concluded. We may, at our option, retain the file in electronic format and destroy the hard copy. The Company may claim the file at any time during that period by sending the firm a written request or by contacting me. After ten years, if you have not claimed the file, it will be subject to destruction. If the file is claimed, we have the option of retaining a copy of all or any portion of the file and of charging you for the reasonable cost of making any such copies. At our option, we may return the file or any portion thereof in electronic format.
Please signify agreement to these terms of engagement in writing by email or by printing this letter, signing it, and returning one signed copy to me.

We are very pleased to have this opportunity to represent the Company. If you have any questions regarding this letter, please call me.

Very truly yours,

Your Attorney

I have read and understand the terms and conditions of representation and agree to the provisions contained in this letter.

DOE'S INVESTMENTS, LLC

BY: ________________________________

ITS: ________________________________