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How To Avoid The Top 10 Legal Mistakes That Can Destroy Your Business

PRESENTED BY

Brian J. Burt



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May 31, 2022

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Snell & Wilmer

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www.swlaw.com | www.swlaw.com/blog/emerging-business/

Twitter Comments Welcome...

@EmergingBusines

Snell & Wilmer L.L.P.

A little background

- ❑ Founded in 1938
- ❑ Largest law firm in Phoenix and Arizona, and one of largest in the West with over 460 lawyers in 16 offices
- ❑ Offices in Phoenix, Tucson, Denver, LA, Reno, Dallas Orange County, Las Vegas, Salt Lake City, Los Cabos, Boise, Albuquerque, Portland, Seattle, San Diego, DC
- ❑ A true full-service firm – all of the legal services required to help you start, grow and sell your business
 - ❑ Business, labor and employment, commercial finance, private equity, real estate, immigration, litigation, intellectual property, franchise, employee benefits, healthcare, tax, estate planning, environmental, mergers and acquisitions
- ❑ Ranked the best corporate law firm in Phoenix by Corporate Board Member
- ❑ Ranked #1 law firm in Arizona by Ranking Arizona
- ❑ Learn more - www.swlaw.com, www.swlaw.com/blog/emerging-business/



Presenter

Brian J. Burt

Partner and Chair of Emerging Business Group

Brian is a business lawyer advising entrepreneurs and emerging growth companies in all stages of development, from formation to liquidity.

He has extensive experience in corporate formation, reorganization and governance; private equity and debt financing; shareholder/owner relations, buyouts and disputes; employment and consulting agreements; employee incentive programs; general contract negotiation; supplier/manufacturing agreements; securities regulation; technology transfer licensing; joint ventures and strategic alliances; fund formation; cloud computing; corporate asset protection and planning; and mergers and acquisitions.

Brian represents clients in a wide variety of industries, including banking and financial services, biotechnology, capital investment, consumer products and services, education, entertainment/media, healthcare, high tech, Internet, manufacturing, marketing/public relations, medical device, nutraceuticals, outdoor, professional services, real estate development, renewable energy, and software and information technology.

Having previously founded, raise capital for, and run his own company, Brian brings a unique “real world” perspective to his practice.

Professional Recognition

- *The Best Lawyers In America*® - Business Organizations (2015-2022)
- 2018 ACG M&A Deal of the Year
- Arizona's Finest Lawyers
- *Southwest Super Lawyers*® - Rising Stars Edition, Business/Corporate (2012-2013)

Education

- Harvard Law School (J.D.) - Managing Editor, *Harvard Journal of Law & Public Policy*
- Allegheny College (B.A., Political Science & Philosophy, *summa cum laude*) - Valedictorian, Phi Beta Kappa

Selected Activities

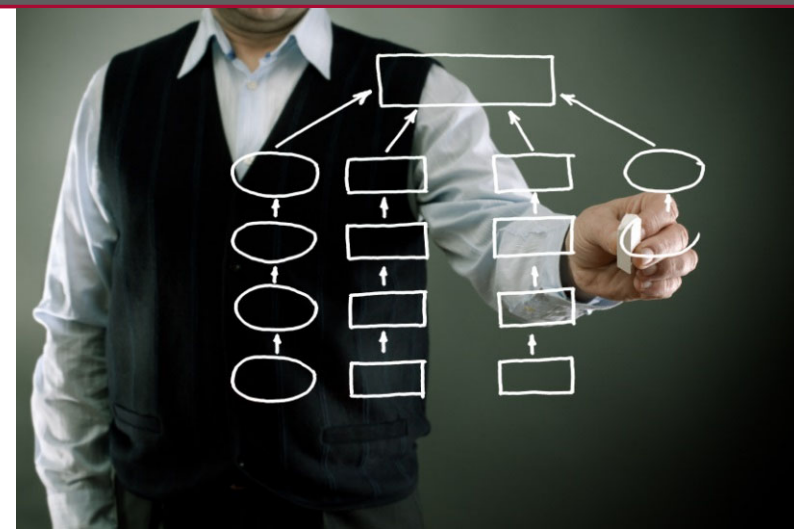
- Better Business Bureau - Board of Directors, Past Chair
- Empower / Center for Entrepreneurial Innovation (CEI)
- Valley Leadership, Class 30



#1 Selecting The Wrong Form of Corporate Entity

...consider converting if you did

- ❑ Options: C corporation, S corporation, limited liability company, limited (liability) partnership
- ❑ All entities offer equal liability protection
- ❑ LLCs offer maximum flexibility and no corporate level tax
 - ❑ Unless you have a *realistic* chance of going public, will be seeking capital from professional investors who still insist on a C corp., or just really like funding the federal government, consider the LLC
- ❑ Carefully consider the tax consequences of converting... but understand the problem only gets worse as your company appreciates
- ❑ Lesson learned: the \$20M corporate tax problem



#2 Not Protecting Your Corporate Shield

- ❑ Does operating your business out of an entity guarantee personal asset protection?
- ❑ Must prevent piercing of the corporate veil
 - ❑ Corporate formalities/alter ego
 - ❑ Undercapitalization
 - ❑ Fraud (third party perspective)
- ❑ Personal liability can still exist for corporate officers and directors, LLC managers, LP/LLP general partners, personal guarantees...and individual “bad acts”
- ❑ Lesson learned: the bankrupting DBA and personal guarantees



#3 Putting All Corporate Eggs In 1 Basket

- ❑ Way to avoid having liabilities take down the entire company
- ❑ Parent/subsidiary or affiliate structure
- ❑ Decide which fences to build
 - ❑ Geographic, lines of business
 - ❑ Asset types (real property, equipment, intellectual property)
- ❑ Understand issues related to a reorganization (corporate, employment, tax, logistics)
- ❑ Respect your own fences (i.e., don't pierce corporate veil)
- ❑ Lesson learned: buying your own software



#4 Having No (or a Poor) Shareholders / Operating Agreement

- ❑ Why do you need one?
 - ❑ Because partners will disagree!
- ❑ Purposes
 - ❑ Understand and align owners' vision, goals, and expectations
 - ❑ Allocate management, economic, and information rights (and override undesirable statutory default provisions)
 - ❑ Preserve enterprise value
 - ❑ Facilitate orderly ownership transfer and corporate succession
 - ❑ Resolve disputes...without damaging or destroying the company
- ❑ Lesson learned: family members at war



#5 Raising Capital...Illegally(!)

- ❑ When are the securities laws triggered?
 - ❑ When 1 share/unit is offered (not sold) to 1 person
- ❑ All offerings must be registered or exempt
- ❑ Exemptions are based on security or transaction
 - ❑ Transaction exemption required at federal and state level
- ❑ Exemption availability depends on:
 - ❑ number, sophistication and location of investors, and their relation to the company (if any); value of securities being issued; type of disclosure contemplated or desired; manner of soliciting participants contemplated or desired; plans for additional offerings in the near term
- ❑ General solicitation, disclosure requirements and “finders”
- ❑ Lesson learned: felonies are no fun



#6 Failing To Protect Your Intellectual Property Rights

- ❑ Identify your company's intellectual property
 - ❑ Patents, trademarks, copyrights, trade secrets
 - ❑ Use of IP audits
- ❑ Confirm your ownership or actual scope of rights possessed
 - ❑ Focus on partners, employees, consultants and who created, derived or conceived the IP
 - ❑ Understand the work for hire concept and obtaining assignment
- ❑ Determine how it can be protected
 - ❑ Consider both formal legal and non-formal legal protection strategies
 - ❑ Use patent and trademark registrations; confidentiality, non-competition, anti-piracy and assignment of invention agreements (one size doesn't fit all)
- ❑ Lesson learned: a brand you didn't protect



#7 Mismanaging Key Employee Issues

- ❑ 50% of employees were looking for a new job in 2022!
- ❑ Ensure proper hiring and firing
- ❑ Understand what employees want:
 - ❑ Job security with employment agreement
 - ❑ Benefits – improve life at office or quality of life
 - ❑ Performance bonus
 - ❑ “Piece of the pie” - liquidity bonus, phantom ownership, actual ownership
- ❑ Determine proper status – employee or contractor; at-will or employment agreement; hourly or salary
- ❑ Prevent discrimination and harassment
- ❑ Lesson learned: one small error



#8 Failing To Use Commercial Contract Best Practices

- ❑ Create and use your own forms
 - ❑ Customers, vendors, employees, contractors
 - ❑ Review and update annually and as needed
- ❑ Process third party contracts efficiently
 - ❑ Internal protocol calls for review and negotiation
 - ❑ Know when to call outside counsel
 - ❑ Read the whole thing...but pay particular attention to key terms
 - ❑ The “business deal” and its duration
 - ❑ Reps and warranties
 - ❑ Limitation of liability and indemnities
 - ❑ Termination rights and liquidated damages
 - ❑ Dispute resolution (and venue)
- ❑ Lesson learned: no damage limits



#9 Asking for An Unnecessary Fight

- ❑ Understand, and train employees to identify, the causes of litigation
 - ❑ Emotions overtake rational thought
 - ❑ Failure to communicate
 - ❑ Broken promises
 - ❑ Absence of a written agreement
 - ❑ Poorly drafted written agreement
 - ❑ (Mis)treatment of employees
 - ❑ Lack of internal controls
 - ❑ Product liability
 - ❑ Intellectual property infringement / misappropriation
 - ❑ The 50/50 partnership
 - ❑ Failure to respect minority owners rights
 - ❑ Failure to create a “business prenup” - or succession plan
 - ❑ Doing business with unethical people



#9 Asking for An Unnecessary Fight

- ❑ Employ strategies to reduce exposure
 - ❑ Work with ethical people
 - ❑ Follow the “golden rule”
 - ❑ Take *informed* business risks
 - ❑ Know and document expectations
 - ❑ Build an agreed-upon escape hatch into every business
 - ❑ Interact often and in person (or at least on the phone)
 - ❑ Follow the law
 - ❑ What’s right under the law (or contract), may be bad for business
 - ❑ When a perceived dispute arises, get a reality check (pause and sleep on it)
 - ❑ Pause and sleep on it - avoid emotion-driven calls or emails
 - ❑ Consult with outside expert to determine the existence and magnitude of the issue, your rights and leverage, and an appropriate response (if any)
- ❑ Lesson learned: the other party may behave in a completely illogical and irrational manner...and those are the most dangerous individuals



#10 – Not Planning For An Eventual Liquidity Event

When does “not now”
become “never”?

Doing the right thing today
will increase the value of
your company tomorrow

Lesson learned: back to work



Get a Regular “Legal Checkup”

- ❑ Conduct an initial legal audit to identify areas of exposure
- ❑ Work with counsel to create an action plan to address
- ❑ Create internal oversight and compliance programs and a budget to implement and sustain
- ❑ Revisit the programs:
 - ❑ When issues arise or laws change
 - ❑ Every 6 or 12 months
- ❑ Lesson learned: an ounce of prevention



Other Upcoming Programs and Events

How To Start A New Business

June 23rd | 3-4:30 pm | Virtual

How To Start A New Business

June 28th | 5:30-6:30 pm | LIVE at WBC

How To Motivate and Incentivize Employees

July 12th | 9-10 am | Virtual

How To Structure Consulting Relationships

July 26^h | 5:30-6:30 pm | LIVE at WBC

How To Negotiate and Prepare Contracts

July 28th | 3-4:30 pm | Virtual

The Emerging Business Seminar Series

First Wednesday of Every Month

8:00 - 9:30 am

LIVE at SkySong

Upcoming Program

- No Program In July
- August 3rd program TBA - starting our 14th year



Continually Updated List of All Seminars:

www.brianjburt.com/events