REDUCING BUSINESS RISK THROUGH PROPERLY DRAFTED AGREEMENTS

A common topic which business owners raise in establishing their venture is how to reduce risk. After all, that is a large portion of what is behind the decision to select a business entity like a corporation, LLC or limited partnership, to name a few. But other ways to reduce business risk are also present, and should not be overlooked or rejected out of hand. By and large, these are common sense mechanisms for risk management that should be considered by any businessman or woman, and discussed with their attorney.

Insurance

Insurance is a basic cost of doing business for most ventures. The reason is simple: we live in a world full of risks, which, if not properly contained or mitigated, can put us out of business. Depending upon the business structure, at times your personal assets can be at risk. Almost any type of risk can be insured against. The issues facing you will include that type of risk is most common to your type of business, and whether that risk can be insured against for a reasonable cost that you can afford. A common type of insurance is commercial general liability insurance (CGL), so common in fact that many commercial landlords require it. Basic risks insured against include customers filing suits for bodily injuries or property damage received on the business premises and suits for advertising injury. Other types of insurance available include employee injury, covered by workers compensation insurance or similar replacement coverage under an ERISA plan, auto coverage, professional liability coverage for those practicing a licensed profession (e.g., doctors, accountants, lawyers, engineers, realtors), travel insurance, and even manufacturing insurance. The concept of insurance has two major components: indemnity and defense. Your insurer has a duty to defend a claim of liability against you (if covered), and to protect you by paying any settlement or judgment. Obviously, what insurance you secure, including policy limits and deductibles, is an economic decision which should be carefully considered in consultation with an insurance professional and perhaps your CPA.

Employment Contracts

The days when employment contracts were reserved solely for CEO's or other highly paid executives are gone. All states allow employment "at-will" meaning that the employer can fire an employee any time he/she is not performing to job standards or adhering to company policies. However, the exceptions to the at-will doctrine have become numerous and complex enough, that smart employer is well advised to reduce to writing the nature of the employment relationship. Besides spelling out things like compensation, the contract should set out

expectations, any restrictions on competition or use of company information both before and after termination of employment, and whether there is a term of employment. This brief treatment of the subject is not meant to be a primer on how to draft such an agreement. The circumstances surrounding each employment relationship vary based on industry, company, position, and the duties inherent in a job. Because laws governing the relationship also vary state-to-state and it is an area of growing complexity, an employment lawyer should be consulted to prepare the necessary agreements for your company, and to update them as the law changes.

A quick word is in order on businesses that don't have employees as such. Many businesses involved in construction or similar pursuits use "independent contractors" or "1099" individuals to deliver their services to customers. Without commenting at this time on whether such individuals qualify as independent contractors for tax purposes, let me just say that it is at least as important that you have a written contract with such individuals as if they were employees, and perhaps more so. At a basic level, it is difficult to argue that one is an independent contractor when there is in fact no written contract. There are many other reasons to have a contract in place as well, that are beyond the scope of this article.

Customer Agreements

It should be an article of faith that every business has its own customer/client agreement, which defines the rights and duties of the parties. But I am continually amazed at how many businesses function for years on nothing more than an "order form" or similar document, with no stated terms and conditions. The "if it ain't broke, don't fix it" maxim favored by many Texans simply won't help you here, because by the time you realize that the relationship is "broke," you are already in the middle of the soup! In other words, it is far better to invest a reasonable amount of time and energy in developing one or more standardized customer agreements now, so that you already have an agreement in place each time you render a service or sell a product. That way, when something goes cross-ways--and it will--you won't be running in all directions relying on vague or non-existent company "policies" that don't have the force if law behind them. Common agreements of this sort include limited warranty language, return policies, language which limits your liability for unavoidable occurrences or circumstances beyond your control, and "scope of work" clauses. Even if you subscribe to the view that you shouldn't tie up your customer with a plethora of requirements, at the very least you should clearly define in writing what you are obligated to do for the customer and what you are not. This is just common sense. And bear in mind that contractual language in the last two decades has trended strongly toward "plain language" and away from "legalese," so that it is more understandable. Most customers expect to encounter some sort of contract, especially if you are going to be rendering service or delivering product on a repeat basis over time.

Vendor Agreements

Every employer buys certain products or services from others in manufacturing or delivering its goods or services. In many, but not all cases, non-retail vendors who sell to you on a repeat basis will have their own contractual terms. Some of them will be simple and easily understood, but some will be lengthy and complex (as, for example, contracts governing transportation of goods between states). Your attorney can be helpful in (a) reviewing (b) negotiating changes in and (c) if necessary, drafting or redrafting such agreements. In some cases, you may not have sufficient bargaining power to get the vendor to change his/its terms, but in others, you may. This is important to get right, since most vendors' attorneys have spent time and effort drafting agreements that strongly favor their clients---sometimes, unfairly so. You may think this is "no big deal" until you find yourself in a dispute over, say, damaged goods or improperly rendered services. Then, the terms which you considered a mere "form" can suddenly assume great importance. But by the time that happens, it will be too late to change them.

Partnership/Shareholder/Membership Agreements

Internal business agreements that clearly define the rights of the principals in the business are essential to prevent small disagreements from growing into major schisms that threaten the business' operation. In the case of a partnership, although the law allows oral general partnership, only a fool would rely on one. I once represented a psychologist who did just that, in a lawsuit against a psychiatrist over a clinic they ran together. Each side spent many thousands of dollars and the case went all the way to the Texas Supreme Court over the issue of whether a partnership actually existed and, if it did, what the terms were. Trust me, you don't ever want to find yourself in that situation.

Limited partnerships and registered limited liability partnerships, by their very nature, require a written agreement, which must be filed with the state. With regard to other business structures, including corporations, and limited liability companies, while written agreements between shareholders or members are not required, in my opinion, they should be. The phrase, "good fences, good neighbors" is apt here. While everyone is on the same page and moving in the same direction as friends or associates is the time to enter an agreement as to what will happen to the business and how it will be handled if it ever winds up, or someone wants to sell their equity, divorces, dies. These agreements are much harder, or sometimes impossible to reach in the middle of a divisive argument or a business crisis. By consulting your attorney and reaching them during business formation, you are ensuring the orderly continuation of your business, or its orderly exit in the event of a sale or wind-up. Entering a proper agreement of this nature may also contribute to the asking price for your business, should you ever sell it to a third party buyer.