You have done the hard part. You’ve built a business model and found a partner, or partners – usually good friends – who share your vision for the future. You’ve got a great idea or product, and possibly even some revenue. Maybe you’re even profitable. In short, everything is coming up roses. You don’t need to worry about rainy days now, right?

WRONG. At the founding of a business, optimism is the order of the day, and the founders are convinced that they will sink or – more likely – swim, together, the fruit of their considerable talents and joint labors. Some business owners, to be sure, are proven right, and this idyllic vision carries them from founding through wildly successful exit. Just as often, though, this vision is the product of rose-colored glasses, and when the glasses break, an unprepared owner can suffer catastrophic losses.

Over time, people change. Even without fundamental change to the founders themselves, life happens, and it affects different owners differently. A single, twenty-five-year-old, entrepreneur might be more than happy to spend seventeen-hour days slaving away in the office. The same entrepreneur might be much less happy to do so twelve years later, with a spouse and young children waiting at home. If the entrepreneur sharply changes his work habits, but his partner does not, the partner will likely view the change quite unfavorably. Similarly, partners may need to get large amounts of capital out of the business at different times, for weddings, college tuition payments, unforeseen medical expenses and the like. Other partners, meanwhile, may not have those needs, and may wish to stockpile cash for an eventual sale or other exit, leading to a cushier retirement.

These fundamental changes threaten the very existence of a business. Careful planning, though, can sometimes preserve the business, even through the most intractable of differences. Where the business cannot be preserved, the owners should plan carefully to maximize value, and minimize animosity, in the event of a dispute or sale.

Most importantly, if your business lacks organic governing documentation, such as a full, long-form Charter and Bylaws (for a corporation), an
Operating Agreement (for an LLC) or a Partnership Agreement (for general, limited, and other partnerships), find a lawyer and have that documentation prepared immediately. You should provide for:

**Dispute Resolution**

Address resolution of potential disputes among the parties. Mediation and arbitration both tend to be quicker and cheaper than litigating in court, and so are often preferred business disputes among owners. Among other things, the owners can specify a mutually agreeable mediator and/or arbitrator (or a method of choosing one). This allows the parties to choose someone they trust to make a well-informed, reasoned decision, rather than leaving the matter in the hands of a potential jury, who will almost certainly be less familiar with commercial disputes.

**Handling of Bank Accounts**

Figure out who will sign checks, who will make deposits, and who will open the mail. (We always recommend, especially in a small business, that the mail is opened and checks logged by someone other than the person responsible for signing checks and making deposits). Consider: 1) establishing a threshold over which transactions require approval of more than one owner, 2) determining which expenses will be reimbursed, and 3) whether and for what purposes partners may take money out of the business. Establish routine procedures for the owners to “check up” on one another and the business; owners’ examinations of the financials of the business will seem far less offensive and threatening if they occur at routine times throughout the year.

**Compensation, Profit-Sharing and Liabilities**

Salary, profit-sharing, bonuses, and personal liability for business debt should all be addressed explicitly. For instance, consider whether profit-sharing correlates with the amount of business an owner develops or whether it is tied to sales commissions, hours worked, etc. Consider how bonuses, investments, or other potentially unforeseeable income will be divided.

Also consider responsibility for business debts to minimize risk of disputes over personal liability or lopsided responsibility for large business liabilities.

**Decision-Making**

How will partners make decisions? What happens if there is an even split on voting among partners for a business issue? Outline proposed handling to avoid lengthy, costly and destructive disputes. Be sure to include a provision for resolution of deadlocks, especially in entities where decision making power might split equally on two sides of an issue.

**Dissolution**

Finally, clearly delineate the circumstances under which an owner can voluntarily leave the business or be forced out of it, and establish the value that will be paid to the departing owner in each case. Consider whether you wish to bind the owners to restrictive covenants such as covenants not to compete, or solicit company employees, customers, or vendors.

Most business ventures begin with strong friendships, and the fervent belief that their business will never be beset by crippling disfunction between them. Properly drafted organizational documents will protect owners and their businesses if the rose-colored glasses break.

**Morgan Stanley v. Andrews: Creditors Emerge Victorious From the Murky Waters of Garnishing Joint Bank Accounts**

Debtors’ bank accounts have long been one of the most popular forms of property targeted by creditors seeking to enforce judgments. Any creditor who has attempted to enforce a judgment may soon realize that obtaining the judgment is usually the simplest part of pursuing a debt; enforcing the judgment is typically where hurdles arise. Individually-owned bank accounts are, of course, the low-hanging fruit.
Accounts owned as tenants-by-the-entireties with the debtor’s spouse are at the other end of the spectrum, and are entirely off limits. Accounts jointly owned by a debtor and one or more non-debtors used to fall between the two extremes, potentially garnishable because the debtor owns a divisible interest in the account, but potentially off-limits because the non-debtor does as well.

Last fall, the Maryland Court of Special Appeals, in Morgan Stanley & Co., Inc. v. Andrews, muddied the waters, but ultimately gave creditors an important victory. The Court determined that a creditor may only attach money in an account jointly owned by its debtor and a non-debtor to the extent that its debtor had an equitable interest in the money, but then established a presumption that the debtor had an equitable interest in all the funds in the account, and placed the burden of rebutting the presumption on the debtor. A brief explanation of the facts and history of the case will make the ruling somewhat easier to understand.

Morgan Stanley won a judgment against John Andrews, and garnished a bank account titled jointly in the names of John and his father. Andrew's father moved to release the funds from the garnishment, offering largely uncontroverted evidence that he had put all of the money into the account, and that all of the expenditures from the account had been for his benefit. His son's name on the account was, he argued, irrelevant to the question of whether the funds could be garnished by his son's creditor.

Morgan Stanley contended that the funds were subject to garnishment, regardless of their source or intended use, because John was a named owner and authorized signatory who had the authority to “deposit and deplete funds in the account.” Thus, Morgan argued, a debtor who has legal title to a joint account is vulnerable to the depletion of those funds by a judgment creditor, regardless of the source of the funds.

The Court of Special Appeals drew a distinction between legal ownership of the account itself, and equitable ownership of the funds in the account, holding that funds in such accounts are garnishable, but only to the extent that the debtor has an equitable interest in them.

Then, though, the Court held that joint legal ownership of an account created a rebuttable presumption of joint equitable ownership of the funds in the account, and that the burden of rebutting the presumption was on the debtor “… [to] prov[e], by clear and convincing evidence, which portion of the account belongs to each co-owner.” In making the ownership determination, the Court indicated that various factors might be considered but the two primary factors were 1) the exercise of control over the funds in the account, and 2) contribution, or the source of funds within the account.

As a practical matter, the Court’s decision can only be viewed as a win for creditors. The presumption of joint equitable ownership is now settled law, and the burden and expense of proving otherwise will fall squarely on debtors seeking to avoid garnishments.

Getting paid for your work is the linchpin of keeping your business profitable. No matter how wonderful your widgets, or how stellar your service, if customers don’t pay you, your doors will be shut in short order. Ideally, of course, all customers would pay, in full, on time, and without objection. In practice, few businesses are so lucky. Most regularly have to decide whether to pursue a non-paying (or slow-paying) customer, or write off some amount of money owed. If your business is facing such a decision, you should consider at least the following three
things before deciding whether to pursue your customer or write the money off:

1 **Consumer Debts are Subject to Much Greater Regulation, and Thus are Much Harder to Collect, Than Non-Consumer (Commercial) Debts.**

- The Fair Debt Collection Practices Act, a federal statute (the “FDCPA”), as well as statutes in all fifty states, regulate collection of consumer debts.
- Although the FDCPA generally applies only to third-party debt collectors, and not to the original creditor, many states, including Maryland, apply similar (or more onerous) restrictions to the original creditor.
- Under the FDCPA, consumer debt is generally debt arising out of a transaction in which the money, property, insurance or services are primarily for personal, family, or household purposes.
- Under the FDCPA, a debt collector’s *first contact* with the debtor must notify the debtor that he or she may challenge the validity of the debt, and provide other basic information.
- Because of the first contact requirement, even attempts to resolve the debt amicably by writing letters or making phone calls might violate the FDCPA.
- The FDCPA also prohibits debt collectors from taking a variety of steps to collect debt, including (among other things) calling before 8:00 a.m. or after 9:00 p.m., calling at all if the debtor is known to be represented by a lawyer, and threatening action that the creditor cannot take by law.
- Violators may be liable for actual damages sustained by the debtor, plus additional damages in the discretion of the court in the amount of $1,000 per violation, plus court costs and the debtor’s attorneys’ fees.

2 **Certain Debts Cannot be Collected at All.**

- If the debtor has filed bankruptcy, all collection activity must cease immediately, absent relief from the bankruptcy court; contact experienced bankruptcy counsel right away.
- If the debt is discharged in bankruptcy, it is extinguished forever, and all collection activity must stop forever.
- If you sue a debtor who is in bankruptcy or whose debts have been discharged, even unintentionally or unknowingly, you may be sanctioned by the bankruptcy court, and the sanction can be severe. Bankruptcy filings are publicly-available on line, and should *always* be checked before collection activity begins.
- If debt is time-barred by the statute of limitations, it cannot be collected unless the debtor has done something to revive or re-affirm it.

3 **Corporations, LLCs, and Other Entities Cannot Generally Appear in Court Without a Lawyer.**

- Certain small claims matters are excepted from this rule, so it may be worth suing for less than you are owed.
- An officer of a corporation (or similar individual in an LLC or other entity) can generally represent the entity if the matter is a small claims matter (for less than $5,000, as of the date of this article), and the debt has not been assigned to the corporation.
• There are other restrictions on the circumstances under which a corporation may be represented by a non-lawyer; it is best to first consult with a lawyer familiar with the issue.

**Why You Really Want to Get Audited This Spring**

The word “audit” usually strikes fear, or at least loathing, in the hearts and minds of most business owners. Certainly, an IRS audit will cost -- at the very least -- a great deal of time and productivity. The right kind of audit, though, can actually be a boon for businesses and their owners. A legal audit can streamline operations, avoid problems before they occur, and minimize the impact of problems that are unavoidable, all saving the business money in the long-run. Legal audits are unfortunately rare in the business community but, done right, they can and should be a cost-effective, regular part of what makes a business thrive. This article will briefly explain what they are, what might be covered, and why they are beneficial.

**What is a Legal Audit?**

A legal audit is, to borrow a medical term, a full-body scan for your business. An experienced business lawyer will, if he or she doesn't already know you and your business, meet with you to learn as much as reasonably possible about your business and your goals for it. Then, the lawyer will develop a plan and schedule for examining all aspects of your business. When the examination is complete, you should receive a written report, ideally with recommendations in each of the areas on the report. Recommendations should generally be “triaged” into at least three tiers of urgency, one for items needing immediate attention, one for items that require attention, but not immediately, and the last for items that could be improved but could also be left as they are. Cost will vary widely, based on the size, age and complexity of the business. The lawyer or lawyers doing the audit, though, should be able to provide either a flat fee or a “not-to-exceed” cost, after familiarizing themselves with the business and the scope of the task at hand.

**What Areas Are Covered?**

This will vary based on the business being audited, but some areas will need to be reviewed in any audit. Some of the questions to be addressed are:

**Corporate Structure and Documentation**

• Does your business use some form of entity for liability protection and governance (corporation, partnership, LLC, etc.)? If so, would another entity make better sense?

• Does your business have the appropriate corporate documentation? Is it state-of-the-art?

• Are corporate records properly maintained, certified (where necessary), and protected?

**Employees**

• Are you complying with all Federal, State, and local laws applicable to your business and your employees?

• Do you have an employee handbook? If so, is it legal and up-to-date? If not, do you need one?

• Do you have personnel files for your employees? Do they contain everything they should?

• Do you have contracts and/or restrictive covenants with any or all of your employees? Should you?
Confidential Information & Trade Secrets

• What information is critical to the survival and success of your business?

• Where is that information? Is it protected as well as it can be?

Contract Review

• Do you have contracts with all of the customers and vendors that you should?

• Do you understand all of your obligations under your existing contracts (leases and lines of credit often impose obligations that business owners have ignored or forgotten)?

• Are you at risk of defaulting under any of your contracts?

• Are your contracts consistent (i.e., do any of them require something forbidden by another)?

• Can any of your contracts be re-negotiated for more favorable terms, either immediately or at the next renewal?

This is, of course, a non-exhaustive list of the significant questions that an audit should address. The importance of the answers will vary from business to business; every question will not be significant to every business.

Why Does This Matter to My Business?

A legal audit will almost always reveal areas for potential improvement for any business – some extremely important and others less so. An audit might reveal, for example, that your business is quite vulnerable to the theft or loss of confidential information or money, whether from departing employees or otherwise. You might learn that your corporate documents, or existing contracts, preclude you from the sort of significant borrowing needed to launch your next new product, or that you have been unintentionally in breach of one of your customer contracts for many months.

Of course, not everything you learn about your business will require immediate attention. If you discover that your lead salesman is free to leave the company at any time and take all of his customers with him, you'll want to address that immediately. If you discover that the company's charter is missing state-of-the-art liability protection for directors and officers, you might be willing to put that fix off for a while. No matter what the result, you'll come out of the audit fully informed and able to make the best decisions possible to run your business your way.

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