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Don't step into these 4 legal traps

SPENCER FANE ATTORNEY MCCANN EXPLORES STARTUP'S COMMON PITFALLS

It's easy to overlook the importance of getting solid legal advice when you're setting up a business and every dollar counts, but making a legal mistake at the start can lead to far more expensive situations down the road.

Mike McCann, chairman of the corporate group at Spencer Fane LLP in Kansas City, said he often spends time with entrepreneurs who didn't seek advice and end up stuck in one of several common pitfalls. He discusses four of those traps for the unwary:

ANDREW GRUMKE

Mike McCann, chairman of the corporate group at Spencer Fane LLP, says he sees businesses make lots of regular missteps in their early days. McCann offers ways to avoid making four of those mistakes.

Choosing a legal entity

It's one of the first legal decisions every business owner has to make. McCann said he regularly sees people who pick the wrong entity or taxation scheme for their business, and it comes back to hurt them when they try to sell the business, minimize taxes or make another important move.

Many think they need to immediately become a corporation for liability protection. But if the owner is the only employee, that's probably not the best route because it leads to adverse tax situations.

"If you're the only employee and something happens, you're probably going to get personally sued anyway," McCann said. "I also talk to people, and they say they have to personally guarantee financial agreements. Well, then you're not getting any financial protection anyway."

Partnering up

McCann also advises people to choose partners wisely. It's human nature to possess a fear of starting a business by yourself, so many want to lean on a partner. But if they choose poorly, it creates fresh challenges.

"Maybe they're not very bright or not a hard worker," he said. "Then you've got a 50 percent partner, even though you're doing 95 percent of the work, and you come to me wanting to get them out of the business. Well, it's not that easy because they're a 50 percent partner and you can't just kick them out. So if it's your idea and your business, hang onto control of it. Be very wary about giving those interests away."

Fundraising

McCann said many entrepreneurs raise money from family and friends without getting advice and end up running afoul of securities laws. Sure, you trust your friends and family members, but what if you want to raise money later from people outside that group?

You need to clean up that first fundraising round before you can entice any outsider to jump in, McCann said, and it's a lot more expensive to fix a mess than to ensure that it's set up properly in the first place.

"If you've done a family-and-friends round and people aren't clear what their rights are, that's a basic building block for your business," he said. "You don't want to start out in a situation where your current investors may sue you because you violated securities laws."

Nondisclosures

McCann said it's also important to use simple nondisclosure agreements when you're talking to people about your business, even if they are family and friends. Future investors will want to see that other investors and employees signed nondisclosures to be sure they're investing in a company that is protecting its intellectual property.

– James Dornbrook