

BUSINESS OWNER'S POCKET GUIDE

SECOND EDITION



WAGONHEIM LAW

Redefining what a law firm should be.

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WAGONHEIM LAW DIFFERENCE

Wagonheim Law is redefining what a law firm should be. As entrepreneurs ourselves, we're in the business of developing innovative programs and services that put our expertise at your fingertips while looking out for your company's bottom line. From eliminating billable hours with our innovative Empty Hourglass Program to providing an accessible library of resources for clients and associates, we offer the trusted counsel and representation you need to take your business to the next level. Serving companies across a variety of industries—from promising start-ups to established corporations—Wagonheim Law is committed to making businesses stronger, more secure, and more profitable. Your business is one of your most-valued assets.

We believe your law firm should be, too.

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WAGONHEIM LAW

Passion. It represents the difference between building something great and just mailing it in. Entrepreneurs have it. And I think the people who have taken the time to crack open this guide in search of a nugget or two to make them better at what they do—they have it too. It is these people, those with a passion for business, to whom this guide is proudly dedicated.

But passion alone does not guarantee success. In my experience, the stumbling block for businesses often comes in the form of issues lying outside the founder's expertise. The critical question becomes: "What will the founder do?" Will she try to work through it alone, or look outside herself to find new solutions? In other words, the challenge faced sooner or later by every business striving to take it to the next level lies in the selection and/or expansion of a team.

Each day in my practice, I have the privilege of working with privately held companies of every size and description. I see how the solutions crafted by those teams—ranging from expansion through the purchase of a competitor or the buying out of a partner to the firing of an underperforming employee—mark the difference between a surviving company and one that thrives. I have tried to explain the basics of many of those issues here.

As you proceed through this guide, I hope you will pick up an idea or learn more about a concept that, even in small measure, helps you and your business travel well along your chosen road.

Sincerely,

Eliot M. Wagonheim

ewagonheim@wagonheim.com



INTRODUCING WAGONHEIM LAW'S NEW EMPTY HOURGLASS PROGRAM.

The largest obstacle to a clear line of communication because the prospect of being nickel and dimed to death under a billable hour system. As a result, many times, clients simply choose not to call.

And the cost of that reluctance is enormous as without the proper guidance small issues can quickly blow blossom into big problems. Every day, clients call us for guidance on virtually every issue facing their businesses. Here are just a few examples:

- “We’re bringing on a new partner/member/shareholder.”
- “Can I fire this employee?”
- “How should I handle this employee issue?”
- “Can you help us collect money we’re owed?”
- “We’re being sued.”
- “We’re buying a company.”
- “We’d like to position our company for sale.”
- “We need help with our succession planning.”
- “Can you prepare our year-end resolutions?”

With all that, my concern is about the calls we’re not getting. I suspect we’re not being used as a resource by front-line personnel such as A/R clerks, on-site project managers, or supervisors, perhaps because they lack the authority to start the lawyer’s meter running. So we both lose out. Our firm loses the chance to deepen a relationship; and our client loses an opportunity for advice often when it would be most effective—before the problems actually arise.

There are 1,400 minutes in a day.
And we're probably the only law firm
that has stopped counting them.

Scan here to find out more about our
Empty Hourglass Program.



OUR APPROACH

We can't say "we value relationships" unless we've built our business model around proving it. Wagonheim Law offers a wide variety of flat fee and blended options, but our flagship program is EHP. EHP eliminates the roadblock to client communication by taking the billable hour out of the equation. For less than the amount many attorneys charge for an hour of their time, a client can gain unlimited access to our attorneys for an entire month.

The list of services for each plan is set forth in the chart below:

	EHP	EHP Plus
Unlimited phone calls	✓	✓
Unlimited e-mails and correspondence	✓	✓
Unlimited demand letters	✓	✓
Annual unlimited good standing review	✓	✓
1 monthly contract review and analysis	✓	✓
Free copies of Pocket Guides and publications	✓	✓
Free WL mobile applications with updates	✓	✓
Reduced fees for seminars and workshops	✓	✓
3 monthly contractual reviews and analyses		✓
Free Mechanic's Lien Notices		✓
Annual updated corporate minutes		✓
Annual audit response letter		✓
Monthly in-person conference		✓
Contingency fee for District Court collection matters		✓
5% reduction of all WL hourly rates		✓


SO HOW DOES IT WORK?

Clients pay month-to-month for each plan—\$350 for EHP and \$550 for EHP Plus through automatic ACH deposits. They can cancel at any time, no questions asked. We also offer the option of signing up for one full year. We offer the following incentives for annual sign-ups:

1. As part of the plan, we will revise a client's contracts used in their businesses for free; and
2. We will donate 100% of the client's 12th monthly fee to the charity of the client's choice.

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WAGONHEIM MOBILE APPLICATION

When you see this icon , you'll know that the section under discussion is covered in our new mobile application, configured for Blackberry, Android, iPhone/iPad, and PC download.

Just as one might expect of an entrepreneurial, business-oriented law firm, Wagonheim Law has developed a first-of-its-kind mobile application specifically designed for business owners. Rather than just learn about legal issues affecting your business, you can use our application to run a detailed point-by-point legal check-up. Organized into sections such as Corporate Formation, Employees, Growth, and Exit Strategy, our mobile application will compile your data from the easy-to-use interview and present you with a comprehensive report detailing:

- The overall health of your business;
- A legal analysis and explanation of issues identified from your answers as being central to the running of your company; and,
- Front-burner issues warranting your immediate attention presented as immediate action items.

Our mobile application works when and where you want it to...just as you might expect from Wagonheim Law.

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Business Podcasts brought to you by
Eliot Wagonheim and WYPR.



I. LEGAL STRUCTURE



WHY LEGAL STRUCTURE MATTERS

To many aspiring business owners, the question of “legal structure” begins and ends with the completion of a preprinted form from Office Depot and the payment of a nominal filing fee to the State Department of Assessments and Taxation. The fact of the matter is that many business owners leave money on the table and unknowingly take significant risks by failing to select the right business entity when they start out, or by forgetting to reexamine their choice at different stages in the companies development.

Selection of a business entity is best determined after considering:

1. Taxes;
2. Day-to-day operations;
3. Growth opportunities;
4. Liability exposure;
5. The organization’s purpose;
6. Exit strategy

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Taxes. Sole proprietorships, limited liability entities, S corporations and partnerships are the so-called pass-through entities in which profit and loss is taxed at a personal level for the owners. Other entities are subject to different tax treatment. The failure to match the type of business to the legal structure can result in significant (and often unnecessary) tax liability.

Day-to-Day operations. Business owners are called upon to make countless decisions in the course of a typical day. Vendor selection, the placement of orders, which contracts to sign or projects to undertake, hiring, promotion, demotion, and firing, taking on an investor, liquidating or

expanding – the list is endless. Some of these decisions are run-of-the-mill. Many may have long-term repercussions. The question of who gets to make these decisions, therefore, is of paramount importance. Legal structure, and the agreements through which the company are formed, determine the identity of the decision-makers as well as the procedures for ensuring that all necessary voices are heard on the issues that matter.

Growth opportunities. Choice of entity can and should be influenced by the founder’s vision of the company’s growth. If outside investment will be sought, corporate or LLC status are usually preferable to a general partnership or a sole proprietorship inasmuch as most investors insist up shielding themselves from liability. In addition, certain types of entities (for example a Subchapter S Corporation) are statutorily prohibited from taking on a corporate shareholder. Accordingly, the company’s timeline and preferences for growth should play a large role in the selection of the entity.

Liability exposure. Depending upon the type of business, limited liability entities and corporations are often vastly preferable to other structures because they insulate their owners from personal liability for acts of the entity. An owner’s personal assets (such as a house, cars, bank accounts, and personal property) are often directly at risk when business is being conducted through a sole proprietorship or in a partnership setting. Protection from risk constitutes a fundamental basis for selecting a business structure.

The organization’s purpose. In 2010, Governor Martin O’Malley enacted a law recognizing Benefit Corporations as a new corporate structure category for mission-based for-profit organizations. In other types of for-profit

business organizations, officers and directors could potentially be held liable for taking actions which did not directly relate to maximized shareholder value. Organization as a Benefit Corporation protects officers and directors from such shareholder actions and lays the groundwork for companies to “do well by doing good.”

In order to gain “B Corporation” status in Maryland, organizations must first register as a Benefit Corporation and report their stakeholder impact according to a third party standard such as the non-profit charity B Lab.

Exit Strategy. All good things must come to an end. Whether the business owner is anticipating a 40-year career or a two year cash-out in the business, exit strategy must always be considered in business formation. If one is looking to approach the investment community for a capital infusion, anticipates bank financing or hopes to sell to employees or a third party at a later date, it is best to select a business structure and negotiate terms with co-owners most amenable to the particular scenario envisioned.

Finally, regardless of their current business entity, business owners can decide to change their structure at any point in the company’s evolution. It is, however, easier said than done, and such change is often accompanied by significant legal, accounting, and tax expenditures. So, although change is possible, it is better (as in most things) to get it right the first time.

CHOOSING THE RIGHT ENTITY



Businesses operate in many forms. The most simple – and most common – is the sole proprietorship in which one literally starts a business simply by opening the doors. A sole proprietorship requires no legal paperwork to form and requires no professional fees to establish. It also offers no asset protection or tax advantages.

A conversation with an accountant and a business attorney at the outset of the enterprise is vital to the selection of the business form which best matches the founder's current situation and future plans. While these consultations need not be overly time-consuming or even expensive, they do represent the classic ounce of prevention worth a pound of cure. Changing entities down the road, once the business has assets and income, while certainly possible, can be a time-consuming and expensive proposition.

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The following chart describes the most frequently used entities and their characteristics. To select the form that is right for your business, it would be wise to consult with both an experienced commercial lawyer and an accountant familiar with your industry.

Details	Sole Proprietorship	General Partnership	Limited Liability Partnership	Limited Liability Company	Corporation	S Corp	B Corporation	Business Trust
Formation	- At owner's discretion - No state filing required	- By agreement of two or more partners - Filing not required in most states	By agreement of two or more partners, with one serving as the General Partner. Filing of a Certificate of Limited Partnership required.	State filing required (articles of organization)	State filing required (articles of incorporation)	- State filing required (articles of incorporation) - Must elect S corp status with the IRS	- Complete B Impact Assessment, a Review, and document corporate purposes. - File articles of incorporation.	Trust Agreement required. State filing of Certificate of Trust required.
Term of Existence	Terminated if business ceases or upon owner's death	Dissolves upon partner's death or withdrawal, unless otherwise stated in partnership agreement	Dissolves upon death or withdrawal of General Partner(s) or otherwise as stated in the Limited Partnership Agreement	Perpetual, unless otherwise stated in articles of organization	Perpetual	Perpetual	Perpetual	Perpetual unless otherwise stated in the Trust documents.
Ownership	One owner	Two or more partners; ownership divided as partners see fit.	Two or more partners, with at least one General Partner and at least one Limited Partner	One or more members; ownership divided as members see fit.	One or more shareholders; percentage of ownership in proportion to shareholder's investment.	No more than 100 shareholders; percentage of ownership in proportion to shareholder's investment.	One or more shareholders; percentage of ownership in proportion to shareholder's investment.	Beneficial owners have undivided interest in all BT property.
Liability	Owner bears personal liability for all debts and obligations	Partners equally liable for all debts and obligations	General Partners are jointly and severally liable. Liability of Limited Partners limited to the extent of their investment in the company or as set forth in the Limited Partnership Agreement.	Members generally not liable for debts and obligations	Shareholders generally not liable for debts and obligations	Shareholders generally not liable for debts and obligations	Shareholders generally not liable for debts and obligations	Same as corporate shareholders
Management Control	100% controlled by sole proprietor	Each partner has equal authority, unless partnership agreement states otherwise	By the General Partner(s)	Member-managed or manager-managed	Shareholders elect directors who manage the company's affairs; officers manage day-to-day business activities.	Shareholders elect directors who manage the company's affairs; officers manage day-to-day business activities.	Shareholders elect directors who manage the company's affairs; officers manage day-to-day business activities.	Trustee manages business activities
Operational Ease	Easiest; no state requirements	Easy; little if any state requirements	Moderate – must comply with the Limited Partnership Agreement with regard to rights and notification requirements pertaining to Limited Partners	Easy; some states require annual report to be filed	- Formal recordkeeping requirements - Annual meetings required - Annual reports required	- Formal recordkeeping requirements - Annual meetings required - Annual reports required	- Formal recordkeeping requirements - Annual meetings required - Annual reports required	Must comply with Business Trust Agreements
Taxation	- Pass-through taxation - Subject to self-employment tax	- Pass-through taxation - Subject to self-employment tax	Normally pass-through taxation, but must meet certain requirements to avoid being taxed as a corporation.	- Pass-through taxation - Subject to self-employment tax (limited partners in LLCs taxed as limited partnerships are usually exempt from self-employment tax)	- Separately taxed at corporate income tax rates - "double taxation": profits are taxed at corporate level, then taxed again when paid as dividends to shareholders	- Pass-through taxation - Only salary is subject to employment tax (shareholder distributions are not subject to employment tax)	- Separately taxed at corporate income tax rates - "double taxation": profits are taxed at corporate level, then taxed again when paid as dividends to shareholders	Complex – determined by involvement of beneficiaries in management of the Trust
Capital Fundraising	Sole proprietor typically provides all capital	Partners provide capital	Often used as a vehicle for raising capital due to the limited liability of the Limited Partners	Membership interest may be sold (subject to operating agreement); doing so may subject LLC to securities laws	Corporate stock may be sold subject to securities laws	Corporate stock may be sold; shareholder limitations (e.g. S corp stock cannot be owned by other corporations)	Corporate stock may be sold subject to securities laws	Beneficial owners provide capital
Interest Transferable	No	No	Yes, subject to the Limited Partnership Agreement as well as state law and federal securities laws.	Yes, unless otherwise stated in Operating Agreement	Yes, unless otherwise stated in Charter or Stockholder's Agreement	Yes, unless otherwise stated in Charter or Stockholder's Agreement	Yes, unless otherwise stated in Charter or Stockholder's Agreement	Yes, unless otherwise stated in governing instrument.

KEY CONSIDERATIONS



The choice of legal structure for a business should be an educated one, rather than the product of a knee-jerk reaction to the suggestion of friends, neighbors, or radio advertisements. Incorporation, for example, is right for some businesses and disadvantageous for others. The following are some of the key considerations a business owner should discuss with an accountant and an attorney experienced in that particular business owner's industry.

Liability and Asset Protection. When one does business as a sole proprietor or as a general partner in a partnership, one's personal assets are always at risk. A bad project or a contract gone wrong could cost the business owner his or her car, house, and savings. In order to place personal assets outside the reach of business risks, business owners must frequently turn to the formation of corporations or limited liability companies (known as LLC's) through which to carry on their business. The importance of legal structure as a consideration is directly proportional to the size of the potential business risks. For example, a construction company or a business involved in the handling of hazardous materials has significantly greater exposure to risk than would a residential lawn care company. Liability protection, therefore, would loom as a very large consideration for those types of companies.

Key Point: The cost of protecting your assets through incorporation is nominal -- especially when compared to the risk of losing your house.

Profit and Loss Allocation. In a pass-through entity, the allocation of profit and loss to the company's principals is often just as important a question as compensation. Depending upon the business structure, profit and loss does

not have to be allocated to the principals in direct proportion to their ownership shares. Certain structures, like LLC's, can be set up to separate voting authority from entitlement to profit and losses. Once again, consultation with qualified legal and accounting professionals is often just as important as determining compensation.

Tax Ramifications. Legal structures such as corporations and LLC's are required to file tax returns in addition to the returns which may be filed by their principals. There is a difference, however, in the manner in which taxes will be assessed against income earned by different types of entities. As shown on the Comparison Table on page 6, certain entities are known as "pass-through entities" and do not pay taxes on their income. Instead, profits and losses attributable to the entity are passed through to the principals.

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Whether or not the formation of a business as a pass-through entity would be advantageous to its principals is a matter for serious discussion with a qualified tax advisor. It is, however, imperative that business owners review the variety of tax ramifications to any choice of business structure with an eye toward determining the most advantageous treatment of profit, loss, expenses, and depreciation.

Partnership. In the legal world, a "partnership" is a specific form of legal entity. In the real world, however, people refer to "partnership" or "partners" as individuals with whom they join in the ownership of a business. Whether the "partnership" in question actually anticipates fellow stockholders in a corporation or co-members in an LLC, going into business with a "partner" or taking on a "partner" is a very serious consideration.

While all partnerships are begun with the best of intentions, an all too common mistake is that business owners fail

to reduce their expectations to writing. These matters may include expectations concerning workload, areas of responsibility, financial support of the enterprise, and exit strategy.

An equally serious mistake is the transfer of a portion of an existing business to a new, untested “partner” in exchange for a promise of future performance or the infusion of cash to assist with a temporary shortfall.

Key Point: Companies can employ many different mechanisms to enable people other than the owner to share in their success without giving up an ownership share.

If, either at the inception of the business or sometime later, two or more people hold an ownership share, not only must each individual’s required contribution to the business be determined, but the parties must also discuss and agree upon the handling of tax issues and exit strategies such as buyout and retirement. While hardly fun to think about at the exciting beginning of a business, it is much better to decide on these things **before** any one partner has a vested interest in the outcome of one of the issues.

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Purpose. Through the creation of the “B” Corporation, Maryland placed corporate purpose front and center. B Corporations were envisioned as “low profit” or “higher purpose” entities which, while still profit oriented, focus on a larger social purpose. The purpose of the founders, therefore, can constitute a key consideration in selection of business entity.

Exit Strategy. Rarely do all co-owners of a business have the same goals, long term outlook, and ability to move in lockstep with each other throughout the years to retirement. Instead, even in the best of circumstances, it is not unusual

for one owner to want to cash out of the business while the other owners wish to stick with it. Alternatively, people often find that partnerships, like many marriages, simply do not work out. Perhaps, because of different philosophies, or long term goals or maybe because one partner simply stops devoting enough effort to satisfy the other, one or more members of the original team need to be ushered out the door.

A well-crafted agreement addressing exit strategy, drafted before disputes or different agendas among partners emerge, is vital to ensure that each partner may realize a fair return on his or her investment when departing the enterprise, while those who stick with it are not overburdened by debt service to the withdrawing owner.

Transfer of Ownership. Most companies place certain restrictions upon the transfer of an owner's interest to a third party. The simple reason for this is that people generally want to be assured they will not wake up one day to find that they are now partners with a person unknown to them, or someone with whom they did not want to be in business. Accordingly, while many companies will allow transfers from owners to trusts or other vehicles for estate planning purposes, there are often strict guidelines set (or outright prohibitions) when it comes to the transfer of ownership interests to people outside the original ownership group. The nature and extent of these restrictions should be incorporated into an agreement between the principals at the outset of the enterprise.

Key Point: Properly drafted transfer restrictions can prevent a soon-to-be former spouse from gaining partial ownership in the company and becoming an unwelcome and unwanted part of the ownership group.

Valuation. Valuation of the business and/or of each owner's individual interest is a vital facet of company planning. Whether the owners wish to position the company for sale, contemplate bringing in a new co-owner, or are looking to buyout an existing owner, the owners must address the means and methods of valuing the company. Not surprisingly, different companies and different industries require different strategies. Sometimes, rather than a calculation of the precise dollar value of a company or ownership share, the valuation strategy revolves around finding the right valuation formula. Either way, consultation with a qualified attorney and credentialed valuation specialist is critical when making the right determination for each individual business.

Voting Rights. The issue of control is an important one to be determined at the outset of any enterprise. But the decision on control is not all or nothing. The business can be set up in such a way that certain decisions, such as ordinary day-to-day issues, can be made by a simple majority or by a designated officer, while more significant issues such as mergers, taking on an investor, liquidation, or even hiring and firing must be made by what is known as a "supermajority." A "supermajority" can be 75%, 80%, 100% or any number greater than a simple majority.

Many businesses use this two-tiered decision-making structure to prevent the paralysis which may come by requiring votes on run-of-the-mill decisions while ensuring that owners of minority shares can weigh in on crucial issues facing the company.

There are many ways voting rights may be determined in addition to simply allocating them by percentage of ownership. Some business structures permit different classes of owners, with each class retaining different powers. For example, one class of ownership may be entitled to a profit

or loss allocation without any actual voting powers. In addition, some owners may reserve a greater right to elect directors, thereby ensuring a majority voice on the company's Board of Directors. This is often the case when an institutional or equity investor elects to invest or take a greater role in a given company.

DOCUMENTS THAT MATTER

Articles of Incorporation. The filing of Articles of Incorporation with the designated state agency (in Maryland, the State Department of Assessments and Taxation) mark the corporation's "birth." The Articles need not be exceptionally detailed, in that they can provide for the corporation's involvement in a specific industry or in any legal activity. The Articles need only establish such basic information as the corporation's name, the Resident Agent, the corporation's address in-state, and the incorporator.

Articles of Organization. This is the formation document for a limited liability company akin to a corporation's Articles of Incorporation.

Buy-Sell Agreements. A Buy-Sell Agreement is exactly what it sounds like—an agreement among co-owners of a business setting forth the terms under which one may (or must) sell his or her ownership share to the other owner(s). Buy-Sell Agreements may be as simple or as complicated as the owners wish to make them.

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It is imperative that a Buy-Sell Agreement reflect a logical and well-thought-out valuation process or formula that will withstand the test of time. While some Buy-Sell Agreements provide that the principals will agree annually on the valuation of the company, we see this as an impractical approach. Too often, immediate concerns get in the way and company principals find their Buy-Sell Agreements to be hopelessly outdated precisely when they are needed most.

A well-crafted agreement will provide for many different scenarios, including an owner's death, disability, inability (for whatever reason) to perform his or her duties,

retirement, expulsion, or a voluntary withdrawal from the company. Different calculations for purchase and sale price as well as payment terms are often incorporated into the agreement depending upon the circumstances of the departure. A Buy-Sell Agreement does not have to be a separate document. Instead, many companies choose to incorporate buy-sell provisions into other documents such as Operating Agreements and Shareholder Agreements.

Key Point: It is easier to reach agreements concerning valuation at the beginning—before any of the owners want out.

16 **Bylaws.** Bylaws are best described as the “constitution” of a corporation in that they provide the rules by which the corporation is to be governed. While some business owners may be content to obtain “boilerplate” Bylaws online, carefully drafted Bylaws will actually reflect certain specific rules determined by each company’s owners as necessary to the running of the business. Among the many topics to be addressed by the Bylaws are: (1) voting rights; (2) how the Board of Directors is comprised; (3) what constitutes a quorum; (4) duties and responsibilities of officers and directors; and (5) how corporate decisions are to be made.

Impact Assessment. An impact assessment is conducted by a certified third party to determine the nature and extent of a proposed B Corporation’s impact on third party stakeholders such as the community as a whole. An impact assessment is a requirement for an entity seeking to obtain B Corporation status in Maryland.

Operating Agreements. An Operating Agreement is to a limited liability company what Bylaws are to a corporation. True to its name, an Operating Agreement determines

the rules under which a limited liability company will operate. In addition to the issues identified in the Bylaws section above, Operating Agreements may also incorporate buy-sell provisions and Restrictive Covenants.

Maryland law does not require LLC's to have a written Operating Agreement. Although we recommend written Operating Agreements for companies other than single-member LLC's, Maryland law provides that the statutory or "default" Operating Agreement will serve as the company's Operating Agreement in the absence of a separate, written document.

Stockholder or Shareholder Agreements. A Stockholder Agreement is an agreement between the owners of the corporation which usually includes provisions of a Buy-Sell Agreement, addresses Restrictive Covenants such as non-competition and non-solicitation issues, and delves into such areas as requirements for additional capital contributions, stock transfer restrictions, and expands upon different classes of stock, if any.

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Summary

Buildings turn out better if you start with a completed set of plans. So too with companies. The choices one makes in determining the most effective structure and agreements depend entirely upon one's plans for the business. A consultation with experienced professionals at the outset along with candid (and sometimes difficult) discussions with prospective partners will go a long way toward enabling you to put the right building blocks in place. What's more, the cost of these initial discussions is minimal compared with the potential costs of curing the headaches down the road.

II. GROWING A BUSINESS



WAGONHEIM LAW'S TOP TEN BUSINESS GUIDELINES

In the late 1990's, so-called business experts were touting the unheard of success of the dotcom business models and declaring the end of business fundamentals as we knew them. PETS.COM proved them wrong.

Fundamentals don't change. Neither do these:

1. *Make It Easy for People to do What You Want Them to Do.* Lawyers and staff at Wagonheim Law know this phrase by my shorthand name for it: **Rule Number 1.** I find it to be applicable to every phase of my life, from running a business to working with my wife to raise our children.

Allow me a brief illustration of its applicability in business:

Two weeks before writing this section, an attorney in my office tried to order a deposition transcript from a court reporter we had never used before. They didn't accept credit cards, so we had to send a check. They couldn't send us the transcripts electronically so we had to wait for them to arrive in the mail. They wanted more business from us, but they will never get it...because they made it hard for us.

The point is that in business or in any phase of life, make it easy for people to do what you want. If you want people to contact you, make sure they have multiple ways to do it. If you want a judge to rule in your favor, make it easy by providing her with chapter and verse each step of the way. If you want to get paid, make sure you offer the payment methods favored by your customers.

2. *Consult with the Right People.* Every month, I consult with business owners who received wrong, incomplete, and sometimes catastrophic advice, from neighbors or relatives who happen to be professionals—albeit with the

wrong kind of experience. Far worse are those consultants offering low cost or no-cost services as a “favor.” After all, your brother-in-law may be a great guy, and, right out of college, he may have known all the forms to file when it came to preparing your tax returns. Same goes for your aunt the legal wizard who handled your sister’s divorce. Each may be a great person, with skills applicable to tasks within his or her specialty, but business is different. More importantly, *your* business is different.

It is never a mistake to pay for quality advice. And cheap advice, personal favors, and counsel from people out of their depth will always come back to haunt you. What’s more, people who give their time and attention as a favor, will invariably put your concerns last.

3. Companies Run Better with Rules. “No rules” is a great slogan, but it’s just that—a slogan. There comes a time when real rules have to be put into place. People have defined responsibilities, employees must stick to certain hours, vacations have to be cleared, expectations have to be met. For most companies, putting real policies in place means growing up. Growing companies should consider creating and living by an Employee Handbook and standardized interviewing, hiring, promotion, and disciplinary policies. (For further discussion on employee handbooks, please see the Employees section of this guide.)

4. Good Habits are Formed in Bad Times; Bad Habits are Formed in Good Times. In other words, regardless of how the balance sheet looks, make your decisions as if you were low on cash and had to make every dollar count. Too many companies find themselves flush and wind up squandering capital on marginal projects, large bonuses, or unwise hires. It is never a mistake to pilot your boat as if the rocks are always close.

5. Learn to Shield Assets. As they grow, companies should consider whether assets should be distributed into one or more different entities. Take a construction company as an example. Construction companies sometimes accumulate a lot of hard assets such as tools, equipment, trucks, etc. Unfortunately, one bad project or incident could expose all of those assets to loss. A good strategy would be to keep the hard assets in a company separate from the operating company. The operating company could lease the equipment from the second entity, thereby retaining full use of the assets without exposing them to a risk of loss¹.

6. Market in Good Times. When companies are too busy to even think about marketing is precisely the time they should be ramping up their marketing efforts. By the time the pipeline looks to be a bit thin, it is often too late to ride out the slow times without a major overhaul.

Remember, marketing is like exercise. No results will come from a year of inactivity followed by two weeks of frenetic action. Make it a point to do some marketing activity at least once a week. Whether that means getting reacquainted with some old contacts, attending a networking event, or writing a newsletter article for a trade journal, not one week should go by without your having done something to market your business.

7. Companies don't have to be busy; they have to be profitable. In over 20 years of practicing law, I never regretted *not* taking on a client. I have, however, had occasion to rue the day I overrode my better judgment and accepted an engagement. And that's the point. Sometimes companies sense a slowdown and see some people idle at their desks,

¹ In making such a move, however, you must explore the sales tax consequences of adopting this leasing strategy. There is, after all, no free lunch, and you should always check with an experienced professional consultant before effectuating any changes to your business.

and start accepting any work that comes their way. This is a mistake—sometimes a company-breaking one. Companies that accept work outside their area of core competence will have to rely on a good bit of luck to keep things from turning disastrous. Luck is not something to bet your business on.

8. *Expand the Right Way.* There are many ways to expand. Depending on the company, the right method may be opening new offices, rolling out new product lines, bringing in a partner, buying a competitor, or a combination of these or other possibilities. The important thing to remember, however, is that the right way depends upon taking a considered approach after speaking with your consultants.

Key Point: Never give away a portion of your company on an untried relationship or promise.

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Avoid taking on large amounts of debt without having run numbers with your accountant and your banker. More importantly, even in today's fast-paced business environment, give large ideas time to simmer before signing on the dotted line.

9. *Know when to go pro.* It is not inevitable, but companies often outgrow the management expertise of their founders and principals. Frequently, the “highest and best use” (to borrow a real estate phrase) of a principal is to be out on the road selling. That would leave the work of actually running the company to others. While it may be extremely difficult, ceding control to one or more professional managers may be exactly what separates a company at a plateau from one that is poised to keep climbing.

10. *Learning does not end with graduation.* The Japanese have a word for it – kaizen. Roughly translated, it

means continuing, incremental improvement. Kaizen should be the watchword for any business owner. Make a commitment each year to attend at least one (and possibly two or three) seminars or workshops to learn new skills. Read a business leadership book or strategy guide on your next plane trip instead of the latest thriller. Companies led by people who continue to renew themselves and their thinking invariably outpace those who don't.

UNDERSTANDING THE NUMBERS

There is perhaps no facet of business management that is more critical and more intimidating than financial management. Many business owners would sooner spend a day playing in traffic than trying to interpret the confusing array of numbers that make up their company's balance sheet; yet playing in traffic is probably less risky than ignoring the company's vital statistics.

Being able to interpret a financial statement will enable your company to better plan for its future and efficiently allocate valuable resources. While a comprehensive accounting course is well beyond the scope of this guide, there are two key concepts every business owner should grasp:

1. **The Metrics.** Every industry has its own metrics (def: standards of measurement). For example, contractors and physical therapy practices may each measure profit-by-employee, but the determination of what's good and what's lacking are significantly different. Get to know performance standards pertaining to your industry. (Tip: If your accountant doesn't know them, try your trade association or, better still, either find a new accountant or supplement your accountant with a qualified industry consultant.)
2. **Ratios.** Financial Statements can best be understood, not as a collection of numbers, but rather as a series of comparisons—debt-to-equity, this period to last period, earnings per share, etc.

So, what's the best way to make quick work of financial statements while taking the intimidation factor out of the picture? Simply put, it is understanding certain basic Financial Ratios. Most people have heard of "Earnings per Share" or "Price to Earnings," which are two of the more common fi-

nancial ratios regularly discussed on networks such as CNBC and other financial programming. But fewer business owners are familiar with the more obscure (and for most privately held companies, infinitely more useful) financial ratios which measure the four basic attributes of any business:

1. **Liquidity** (i.e., a short-term view of the ability of the company to satisfy its currently maturing obligations);
2. **Leverage** (i.e., a longer term view of the use of debt by the company and its ability to service that debt);
3. **Activity** (a measure of the efficiency of the utilization of the company's resources, such as measures of inventory turnover); and
4. **Profitability** (e.g., as compared with investment, or profit margins based on sales).

What are acceptable ratios in each of these four categories of measurement? Generally, there are no hard and fast rules. Ratios are valuable because of what they can tell you about the current state of your company and the direction in which it is moving, rather than whether a company is in imminent danger of failure or can coast without another sale for the next two years. In that sense, it is useful to compare ratios over time.

What constitutes an acceptable ratio also depends on a number of outside factors, including (1) the company's industry, (2) its accounting practices, (3) its goals, and (4) quite simply, what the company's owners feel are acceptable ratios in light of those goals. Most business owners should have a discussion with their financial advisor or accountant in order to set acceptable ratios within the four attributes described above, and then formulate a plan to adhere to those ratios.

While many business owners simply slough-off these matters off onto their accountant, the savvy business owner will understand (and should want to understand) the numbers that make his or her business work.

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WHAT BANKERS LOOK FOR

We may be experiencing a bad economy, but economic fundamentals do not change. When a banker is considering extending credit to your company, one question is uppermost in that person's mind: "Can the borrower pay it back?"

So, what do bankers look for to answer the question?

Working Capital. Companies running on a shoestring are rarely appealing to bank underwriters. In reviewing a balance sheet, one of the first things a banker looks for is working capital. Is the company highly leveraged or does it have the resources to sustain normal operations without outside financing?

Cushion. Does the company have the resources to weather the bad times or do the owners drain the company of cash at every opportunity? In other words, does the company have any retained earnings? The company's cash position is particularly important if the company retains any hope of eliminating or limiting the bank's requirement for personal guarantees from the principals.

Use of Credit. One of the first items reviewed by underwriters is whether or not the prospective borrower is using credit appropriately. Take a line of credit as an example. Lines of credit are typically put into place in order to enable companies to handle temporary dips in cash flow. Lines are drawn against to pay ordinary operating expenses and are repaid once receivables are collected. If, however, a company has taken some longer-term advances against a line of credit to buy equipment, for example, the pattern may not only indicate a deeper problem, but it may leave the company with scarce resources with which to handle a cash downturn.

Quality of Guarantors. Many businesses, particularly closely held companies, make it a point to drain the company's cash at the end of each fiscal year in order to minimize taxes. Banks understand this. If that is the company's practice, however, banks will look to the quality of guarantors presented by the prospective borrower. In other words, if the borrower does not typically have enough cash on hand to weather significant gaps in cash flow, will the guarantors have enough capital to step in? In the bank's analysis, someone responsible for the debt must be able to repay the loan even under less than optimal economic conditions.

Financial Metrics. Different industries are characterized by different measures of financial success. Some companies can be judged by the ratio of income to personnel. Others are better assessed by return on equity, debt-to-equity, or simply EBIDTA (earnings before interest, depreciation, taxes and amortization). Know your industry's financial metrics and present them (if your company's results present favorably) in your materials.

Comparative Results. Underwriters do not simply want to review companies in a vacuum. Results happen in context. How is the company doing now as compared to recent years? Materials helpful (and likely to be requested) include projected vs. actual results as well as last year vs. the current year (actual and projected for the balance of the year).

Good Business Decisions. Bankers want to lend money to companies and people they can trust to take care of it. After the loan closes, your business will be responsible for some, perhaps a great deal, of the bank's money. A solid, well-presented business plan, backed by a history of responsible growth and well-chosen advisors will give any bank comfort that its loan is in good hands.

Candor. Convey good news fast and bad news faster. The typical commercial banker spends a great deal of his or her time on the street trying to drum up business. As a result, bankers tend to have their collective fingers on the pulse of the local economy. Translation: your banker will know if your business is facing a challenging economic time.

The worst thing you can do when your company is struggling financially is nothing. In my experience, most banks are willing to expend a lot of energy working with business owners who are upfront and candid about economic challenges. After all, banks do not want to lose customers and they do not want to lose money when customers go out of business.

If, however, a business owner sticks his head in the sand and refuses to communicate, ducks calls, or immeasurably worse, submits false reports or documentation, the bank will have no choice but to land on that business owner with both feet. You do not want to be that business owner.

ASSEMBLING A TEAM

Any banker or venture capitalist will tell you: one of the biggest, early challenges faced by the founder of a business is coping with the realization that his or her skill set is no longer adequate to ensure the success of the business. Business is a team sport.

While the players may change depending upon the individual company and industry, successful companies almost uniformly get to be that way by assembling a team consisting of:

- An accountant;
- A lawyer;
- A banker;
- A financial advisor; and
- An insurance advisor.

The question is, ***“How does one go about selecting the right people to fill these roles?”***

Consider the following:

1. ***Do they understand my business?*** Expertise is not one-size-fits-all. Just because a consultant understands the construction industry does not mean he or she knows restaurants.

Key Point: Growing a business requires outside expertise in the sector in which that business is engaged.

Too many businesses stunt their own growth or worse, get themselves in real trouble because they decided to go with an attorney because he helped in a relative's divorce or a neighbor who happens to be an accountant. Advice is only worth something if it is based on relevant expertise.

2. ***Can you communicate well?*** All the expertise in the world means nothing if you can't understand or put into action what your consultant is saying. People have different communication styles. If you've ever found yourself frustrated because you're just not connecting with the person on the other end of the conversation – either because your questions are being misunderstood or because the answer is not fully responsive to your inquiry – you know the importance of avoiding these problems with your chosen consultant. Find someone who speaks your language – someone who is able to break down technical matters into terms that relate to your business and your experience. And if you find yourself in a meeting with a highly recommended consultant who does not make communication easy, keep looking.
3. ***Are they known to my industry?*** Ask around. Use your trade and industry groups. Find business owners you respect (preferably in your industry) and gather a list of referrals. Ask professionals you trust to refer you to consultants in other fields who could compliment their work on your team. For example, your accountant probably has a list of business attorneys and bankers of whom he or she thinks highly.
4. ***Have you used your consultants to your maximum advantage?*** If you are only using your accountant to prepare tax returns, only turn to your lawyer if you have to go to court, or only talk to your banker if you need a loan, you are doing your business a grave disservice. When selecting professionals, ask them how you can best tap into their expertise. Their answers will tell you a lot about their industry knowledge and business experience.

5. ***Are you being nickel-and-dimed to death?*** Do you always feel that you're "on the clock" when you're talking to your lawyer or accountant? If so, you're probably using the wrong professionals. A good professional will understand that his clients often have issues that they want to discuss on an informal basis and knows that generating this type of goodwill benefits not only the professional's client, but the professional as well.

Key Point: You should be able to trust your advisors to tell you when you should not be paying them.

6. ***Are you being given problems or solutions?*** It is often said that a corporate lawyer is someone who keeps exciting things from happening. If this is the way you feel about your lawyer (or any other advisor for that matter), it's time to make a change. Advisors should certainly counsel you on the risks inherent in any course of action. If all they give you is a list of problems, however, then they are the wrong type of advisor. Just like any employee, an advisor should not only lay out the risks, but should also provide the solution. If a given plan won't work, they should, of course, tell you. But -- and this is important -- if it *can* work, a good advisor will not only point out the obstacles, but will also help you strategize your way around them. Those are the keepers.
7. ***Are you being kept in the loop?*** A good professional will keep you apprised of the progress of the matters you have placed in his or her hands. If you're not hearing from your accountant or lawyer on a regular basis about the progress being made on the corporate acquisition you've asked him to work on, then you're not only opening yourself up to a surprise when you receive your next

bill, but you're being left in the dark about matters vital to your company.

8. ***Are you paying through the nose?*** Hourly rate matters. Ask other businesses what they pay for lawyers, accountants, and other professionals. Generally speaking, hourly rates will increase with experience, specialty, and even a firm's location. (An attorney in a large firm in Washington, D.C. will likely charge significantly more per hour than an attorney with comparable experience in Columbia, MD.)
9. ***Is the person you hired really doing the work?*** Find out who will be doing the work. It is fine to have a rapport with and respect for the senior partners, but if the work is going to be shipped off to a second-year professional the minute you walk out the door, you should know that in advance. The ideal situation is one in which the senior professional (i.e., the one you hired) will give personal attention to those aspects of your file which demand his or her experience, while utilizing more junior (and lower cost) support as appropriate.
10. ***Will anyone tell you when not to write a check?*** A good professional will tell you when his or her services *are not* needed. Telling you when it is not in your best interest to pay shows that the professional has your best interests at heart.

EVALUATING THE OTHER GUY'S CONTRACT

Before signing someone else's contract, every business owner should train his or her staff to S.T.O.P. and L.O.O.K. This stands for:

Scope of Work

Termination

Other Documents

Payment Terms

Liabilities

Other Obligations

Outside Factors

Keeping it Simple

Scope of Work. What is it you are obligating your business to do by signing the contract? The vast majority of problems on a project can be avoided by a precise and well-drafted scope of work. Alternatively, if the scope of work is vague or contains items for which you do not intend to be held responsible, no amount of verbal assurances or agreements can make up for the problems lying-in-wait as a result of a signed contract containing an imprecise scope of work. Do not sign a contract until you are pleased with, and intend to be held to, the letter of this provision.

Termination. What are the circumstances under which each side could get out of the contract? In other words, are the exits clearly marked? Depending upon the duration of the work to be performed under the transaction, this can be one of the most important provisions in the document. Often, one party or another can elect to terminate the agreement if one or more key assumptions are not met. For example, a commercial lease may be amended to provide that the prospective tenant may terminate the agreement if

the space is not fully ready for occupancy by a date certain. Similarly, an obligation to perform work may be nullified if the other side fails to provide all necessary materials by an established deadline. In deals gone wrong, termination provisions are often the only way to stop the bleeding.

Other Documents. Contracts often make reference to other documents containing information or terms to be included as part of the parties' agreement. As an example, this is typical in the construction industry where an agreement between a subcontractor and the general contractor specifically states that the parties are also to be governed by the terms in the general contractor's contract with the owner, the project plans and specifications, and other documents such as the General Conditions. Outside of the construction industry, many standard contracts refer to terms and conditions in so-called master agreements, or even those posted on websites. Make sure you know all of the terms of the deal before signing on the bottom line.

Payment Terms. This is, of course, where the rubber meets the road. Few questions in business are more important than:

- Who is responsible for paying you?
- How much will you get paid?
- When is payment due?
- What are your rights if payment in full is not received?

Liabilities. What are you responsible for if something goes wrong? Often addressed through a provision called "Indemnification," many contracts contain a laundry list of things for which the other party can be held responsible. As an example, imagine a contractor who was late installing carpeting in a hotel. The contractor may be penalized \$1,000 per day for his lateness or the hotel owner could

even claim hundreds of thousands of dollars (or more) as lost profits resulting from the postponement of the grand opening. It's all in the contract. A prudent business person will have experienced counsel review significant contracts to reduce potential liabilities.

Other Obligations. Contracts often impose requirements and deadlines concerning notification, claims, reporting, and the execution of subcontracts. While the eyes may glaze over trying to review these portions of the contract, they are extremely important. Failure to provide timely reports, send written notification of unexpected conditions, or document additional expenses could cost your company money. Know your obligations before you sign and, more importantly, work to delete those requirements which you know to be unrealistic or difficult for your company to meet.

Outside Factors. Sometimes factors beyond your control have the potential to cause you to miss deadlines. If, for example, the other side is selecting its own supplier of materials you will have to use, or must obtain permits before you can get started, you may find yourself behind schedule through no fault of your own. Understand these outside factors and insert language into the contract to protect you from claims arising from someone else's error or delay.

Keep it Simple. Many contracts seek to impose complicated procedures, accounting requirements, or reporting schedules. Whenever possible, try to eliminate the bureaucracy involved in getting your work done. Take a careful look at all of the administrative requirements necessary for completion and try to pare them down to the absolutely essential.

Surprisingly, many business owners assume that price and possibly delivery time are the only points of negotiation. Don't be fooled. It is the other terms – often overlooked – which can make or break a project...or a company.

WHAT YOU WANT IN YOUR CONTRACT



Contracts can be incredibly lengthy and complex or they can boil down to one sheet of paper. Regardless of length, a contract must address the four mandatory terms listed below in order to be worth the paper it's printed on. More importantly, a contract should also contain a number of recommended protections which can prove vital to any business in the event of a dispute.

Mandatory Terms

Whether your business works best by preparing estimates, purchase orders, account agreements, or simply letters of confirmation, you should always do your best to get something in writing from your customer which spells out:

1. What do you have to do to get paid?
(Scope of work)
2. When are you going to get paid?
(Specific dates or trigger events)
3. By whom are you going to get paid?
(Know your client – person or company)
4. What are your rights if you don't get paid?
(Interest, attorney's fees, etc.)

Recommended Terms

- **Limitation of Liability.** A business should try to limit its liability to the amount it has already been paid, meaning a full refund, while excluding other damages such as penalties, consequential damages such as lost profits, or replacement costs.
- **Jurisdiction and Venue.** These are legal terms meaning where claims – either yours or a claim filed against

you – must be brought. This is particularly important if your company works with clients in other states. The contract should specify that, in the event of a dispute, claims can only be brought in your home state or county.

- **Waiver of Jury Trial.** A provision which prevents a customer from seeking a jury trial in any claim arising out of the contract can save your company serious money if you find yourself in litigation.
- **Personal Guarantees.** A personal guaranty from the owner of a corporate client not only provides someone to go after for payment beside the corporation, but it also provides an extra incentive for your customer to pay you first. While business owners often resist signing personal guarantees, they become especially important if you decide to take on a newly-formed business or an unfamiliar business as a customer.
- **Restocking or Cancellation Fees.** If applicable to your industry, consider a charge for cancellation of an order after a certain period of time has elapsed.
- **Cross-Default Provision.** This provision would authorize you to cancel all contracts with a customer if that customer defaults on one. This may prevent you from facing a breach of contract claim from a non-paying customer.
- **Claim Notification Deadline.** Requiring the customer to provide you with a written claim notice within a limited period of time – say 30 days – may wind up leaving the customer out of luck in pursuing a claim against you down the road, having failed to provide timely notice.

While this list certainly does not exhaust all of the different types of protection which can (and should) be built

into your contracts, it's a start. When drafting your contracts or, preferably, when sitting down with your attorney to draft a contract, think about the problems your business has experienced in the past, and then see if you can work some protections into your contracts going forward that you wish you had had back then.

Trust in God but Lock Your Car

Assume that your customers will lie to you. Believe me, having given this lecture before enough audiences, I know how foreign and even offensive that notion can be. So let me state here for the record (do you know any non-lawyers who actually say “for the record?”) that I believe most people to be honest. Unless shown otherwise, I assume that each new person I meet is a person of integrity. That assumption should not, however, prevent one from preparing for the occasional cheat.

There is an old saying that any ounce of dishonesty in a person's heart will make its appearance while playing golf. I think it's more true in business. There is no more desperate creature than a business person with poor cash flow. When pushed to the wall, even honest people will sometimes seek refuge in the gray areas of a transaction. That is why I embrace the philosophy best summed up by the saying “trust in God, but lock your car.” Believe the best of people, but prepare for the worst.

So, if it is important to you...get it in writing.

TAKING ON A PARTNER OR INVESTOR

I never cease to be amazed by the number of people who devote their blood, sweat and tears to building a business, only to give part of it away on the hope that the new partner or investor will perform as promised. Just as one would counsel a friend to **“date before you get married,”** so too do I advise companies to begin a relationship on a non-equity basis whenever possible before divvying up shares.

There are a number of so-called “equity alternatives” which can be explored in lieu of transferring a stake in the company. These include:

- Phantom stock arrangements through which one could realize all of the gain of being a stockholder in a growing business without actually owning stock;
- Stock options through which a person will have the option to purchase stock at a specific price at some point in the future – either by a date certain or upon the occurrence of one or more trigger events.
- Rights of first refusal, which offer assurances that the grantee will be given the opportunity to match any offer before someone else buys in.
- Vesting rights, under which a person or entity can become a stockholder with an increasingly larger share in the company over time.
- Stock pledge agreements, which would provide a lender or investor with control over certain major company decisions, including sale of stock or assets outside the ordinary course of business, until the loan is paid in full; and

- Traditional secured loan/repayment agreements for prospective investors, which may protect the principal by not providing for personal guarantees in exchange for promising a higher rate of return.

If a partner is brought into the picture as a co-owner, there are certain issues which must be explored *and reduced to writing* before money and/or stock changes hands:

- Responsibilities – who is supposed to do what?
- Governance – What is the voting structure? How are major (and minor) decisions to be made? How much ownership is needed to veto a decision?
- Termination – If the stockholder (or “member” in an LLC) is an employee, can he or she be fired? Is there a mechanism to force a co-owner to relinquish his or her ownership share?
- Exit strategy – When and how can a principal go about leaving the company voluntarily? What are the terms of the buy-out? Is there an agreed valuation or valuation strategy?
- Post-separation obligations such as non-competition agreements, consulting arrangements, or covenants prohibiting solicitation of employees or customers.

A company’s failure to address the hard questions *before* bringing on a new principal virtually guarantees that it will be faced with even harder and more expensive questions down the road.

WHAT YOU SHOULD KNOW ABOUT MBE, SDB AND WBE CERTIFICATION

OVERVIEW

MBE (Minority Business Enterprise), SDB (Small Disadvantaged Business) and WBE (Woman-Owned Business Enterprise) are business classifications used to provide avenues for smaller businesses to secure work on federal, state, and local projects. Classifications used and certification qualifications differ, depending upon whether the inquiry is being made at the local, state or federal level.

Typically, in order to obtain certification, a business must be at least 51% owned by one or more persons defined as belonging to a minority or a disadvantaged class. While definitions differ depending upon the level of government, such persons are usually defined as members of a socially or economically disadvantaged minority group, including African-American, Hispanic, Native American, Asian, women and the physically or mentally disabled.

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WHAT CERTIFICATIONS ARE AVAILABLE?

Minority certifications can be obtained on the federal, state, and city levels in Maryland. Certifications offered are: the federal 8a certification, the federal SDB, the state MBE/WBE certification, the state SDB certification, and the Baltimore City Minority certification. Each certification has different criteria set by each levels of government.

WHAT ARE THE BENEFITS OF OBTAINING CERTIFICATION?

Minority certification brings opportunity and the potential for growth. Many public and private projects in-

corporate goals or quotas for MBE, WBE, and/or SBD participation. Certified companies often have an advantage over their non-certified competitors as general contractors, developers, and prime subcontractors, in addition to governmental agencies, actively seek certified companies to work on a wide variety of projects.

FOR FURTHER INFORMATION

Baltimore City: Office of Minority and Women-Owned Business Development (410) 396-3818.

www.ci.baltimore.md.us/government/minority

State of Maryland: Maryland Department of Transportation Office of Minority Business Enterprise (800) 544-6056 or (410) 856-1269. www.mdot.state.md.us/MBE_Program

Federal government: www.sba.gov

Small Business Resource Center: www.sbrc-baltimore.com

WHAT YOU SHOULD KNOW ABOUT 8(A) CERTIFICATION

The Small Business Administration's 8(a) Program was created in 1974 to help minority and other disadvantaged businesses grow through a program of federal contracting preferences and set-asides. Through the program, eligible firms can be awarded federal government contracts on a sole-source or non-competitive basis. In addition, qualifying firms will also be eligible for participation in limited competitions where competitors will be other similarly situated companies. The federal government sets aside over \$6 billion in contracts for 8(a) certified firms each year.

New regulations permit 8(a) companies to form beneficial teaming partnerships and allow Federal agencies to streamline the contracting process. New rules make it easier for non-minority firms to participate by proving their social disadvantage. The SBA has also implemented the new Mentor-Protégé Program to allow starting 8(a) companies to learn the ropes from experienced businesses.

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The 8(a) Program has become an essential instrument for helping socially and economically disadvantaged entrepreneurs gain access to the economic mainstream of American society. Participation is divided into two phases over nine years: a four-year developmental stage and a five-year transition stage. It is estimated that, in the past fiscal year, almost 6,000 firms participated in the 8(a) Program and were awarded close to \$6 billion in federal contract awards.

There is a wealth of useful (and free) information available on obtaining 8(a) certification from trade associations as well as from organizations such as the Small Business Resource Center.

GETTING TO THE NEXT LEVEL

Every successful company reaches a point at which management is no longer scrambling merely to make payroll and ensure the company's survival. It occurs at different times for each company – sometimes 3 years in, sometimes 10 years in. Either way, there will be a time when management can finally take a breath, look around, and see a solid customer base, industry reputation, and a core of loyal employees of long standing. That's the point when really good managers look toward charting a path to the company's future.

There are many ways to chart a path, ranging from company retreats to 360 degree consultant reviews. While methods differ by industry, if not by company, certain constants remain:

- The company should emerge with a written plan;
- The plan should contain a well-thought out S.W.O.T. (Strengths, Weaknesses, Opportunities & Threats) analysis.
- The plan should be created with the idea of gaining employee buy-in
- The plan should be fluid, referred to often, and built into the company's culture.
- The plan should be created with the help of a qualified outside professional with no political or jurisdictional axes to grind.

Next-level planning is not for everyone. A company earning just enough to pay its principals should not divert valuable resources to this exercise. If it cannot be assured of survival over the next 5 months, it does not have the luxury

of financing a plan for the next 5 years. But if the company has reached maybe \$3,000,000 in sales, perceives certain bottlenecks preventing it from hitting its targets, and/or sees flat-lined revenue or growth after years of upward trends, an independent analysis may well be indispensable.

III. EMPLOYEES



EMPLOYEE OR INDEPENDENT CONTRACTOR?



Employees are expensive. Misclassifying them as independent contractors is more so.

At a minimum, most state laws require employers to pay for their employees' workers' compensation coverage and unemployment insurance. The Federal government imposes additional (and very expensive) requirements. Specifically, employers must:

- Pay Social Security contributions of 6.2% of salary up to \$106,800 (in 2009),
- Withhold 1.45% of all earnings for Medicare,
- Pay overtime to eligible employees, and
- Provide unpaid leave under the Family and Medical Leave Act for those companies to which the Act applies.

Independent contractors, on the other hand, receive 1099 forms at the end of the year and are responsible for their own taxes. Employers contribute nothing.

It is tempting, therefore -- particularly in difficult economic times -- for employers to classify people as independent contractors and save both the money and the headache of withholding taxes insurance payments, and contributions. But it's not that easy. The IRS looks very carefully at each situation to determine the exact nature of the relationship between the company and the individual. For the most part, it comes down to a question of control.

The IRS and most states examine the following factors to determine the nature of the relationship:

1. The company's right to direct or control how the work is being performed

2. Who establishes training programs and whether they are mandatory
3. The source of the tools (including computers and software) used to perform the work
4. The location where the work is performed
5. Whether the company has the right to assign additional projects
6. Whether the hired party hires and pays his or her assistants or support staff
7. The company's right to determine when the work is performed and/or set certain hours

Bottom line: if your company has the right to control or direct what is being done, how it is being done, and when it is being done, your company is most likely an employer.

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Most importantly, a wrong answer can be extremely expensive. Companies which misclassify employees and independent contractors can be subject to huge tax bills for unpaid taxes as well as penalties for failure to file required tax forms and, in certain circumstances, failure to adhere to Federal and State statutes such as the Family and Medical Leave Act and Title VII of the Civil Rights Act of 1964, as amended (applicable to employers who have 15 or more employees). In addition, misclassified employees can pursue their own claims against the company for any losses they may have sustained.

Both companies and individuals can ask the IRS to make a determination of employment status by filing with the IRS Form SS-8: Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding.

THE HIRING PROCESS – AN OVERVIEW

In *Mastering the Rockefeller Habits* Verne Harnish emphasized the importance of **“having the right people doing the right things right.”** While much of his book focuses upon the need for each company to determine its most important functions and the best practices for getting them accomplished, the first step is to make sure that the right people are in place.

It all starts with the hiring process.

Hiring employers not only face the challenge of finding the best person for the job, but they must avoid even the appearance of unlawful discrimination. Every company’s hiring process should be formulated with both result and process in mind.

Employment Applications.

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For many companies, the written employment application serves as the first interaction between the company and prospective employees. It is best to standardize applications even if the nature of the company’s business requires the use of several different standardized forms, depending on the nature of the position. Each application should be tailored to suit the company’s needs by gathering information relevant to the position being filled.

A number of federal and state statutes are applicable to the formulation of proper written applications including Title VII of the Civil Rights Act of 1964, as amended (“Title VII”), the Americans with Disabilities Act (“ADA”), the Age Discrimination in Employment Act of 1967, as amended (“ADEA”), and the Immigration Reform and Control Act of 1986.

Great care should be taken in formulating a written employment application to avoid running afoul of any of these

statutes or those enacted under state law to expand upon these laws. In essence however, compliance with these statutes means that employers should:

- affirmatively state on the first page of the application that the employer is an equal opportunity employer;
- refrain from asking questions relating to personal characteristics such as race, gender, age, national origin, and marital status;
- avoid requesting the submission of applicant's photographs;
- focus on gathering information pertaining to skills and interests directly relevant to the position's duties and responsibilities.

Trade associations are often a great source for standardized applications relevant to a particular industry. Before sending them out *en masse*, however, companies would be well advised to pass them by and experienced employment attorney for final review.

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Interviews.

Steve Allen once noted that television is called a “medium” because it is neither rare nor well done. Much the same could be said about job interviews. Virtually every company conducts them; few conduct them well.

For those positions for which the hiring decision is based upon more than just a written application, I recommend that you do what you can to eliminate the guesswork by considering the following:

Have the Right People Conduct the Interview. When I hire an attorney, that person is interviewed by secretary and staff with whom they will be working. Have people you trust – regardless of title – sit in on interviews for people with whom they'd be working. Listen to their impressions.

Ask the Right Questions. Depending upon the position, questions such as the following can offer better and more interesting information than the standard “Where do you see yourself in 5 years?”

- “Describe a time when you really shined or went above and beyond”
- “Think of the best job you ever had and then tell me the thing you disliked most about it”.
- “If I hire you today, what will you do for me tomorrow?”

Use Experience to Refine the Hiring Process. Talk to other businesspeople who may have hired for similar positions. What do they wish they had known about their hires? Think back on your experience: What do you wish you had known? Too many companies lack people able to conduct a substantive, insightful interview and continue to flounder because of the absence of this necessary skill. There are many resources out there...and probably even an *Interviewing for Dummies* if you get right down to it. Spend some time learning how to do it right.

If interviewing is part of your company’s employment process, it is worthwhile to explore resources for improvement in this area. Books such as *High-Impact Interview Questions: 701 Behavior-Based Questions to Find the Right Person for Every Job* by Victoria A. Hoevemeyer, *Interviewing and Selecting High Performers: Every Manager’s Guide to Effective Interviewing Techniques* by Richard H. Beatty, and *Hiring the Best: Manager’s Guide to Effective Interviewing and Recruiting* by Martin Yate are excellent resources.

Personality Screening

Many companies, particularly those experiencing significant growth as well as the need to fill key management positions are turning to pre-employment testing such as personality surveys to match the right person to the right position. Proponents claim that these types of comprehensive tests allow the hiring company a window into an applicant's personality, outlook, and managerial style that a typical interview does not. There are many types of pre-employment testing. I strongly recommend researching local forums offering these services to determine the level of experience in your particular industry before proceeding down this road.

AVOIDING LANDMINES

At the end of the day, it may not matter that the hiring company did not intend to be discriminatory. What matters is that nothing in the process -- the written application, the interview, or even the initial advertisement -- creates the impression that the hiring process is based, even in part, upon unlawful discrimination.

As a first step, both the employment ad and the written application should affirmatively state that the hiring company is an equal opportunity employer which does not discriminate against federally protected characteristics or classes of people.

Now for the tough part -- the employer must ensure that each part of the process follows this guideline. This means the absolute avoidance of questions concerning race, gender, age, national origin, marital status, sexual orientation, or religion. As an example, absent a compelling reason, we strongly recommend that companies refrain from asking applicants to submit photographs with their applications.

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Key Point: For many employers, the real problem arises during the interview when seeking to put applicants at ease by asking a series of seemingly harmless "get to know you" questions.

What may seem innocent and well-meaning to you can be a loaded question to an applicant. Any question which may elicit responses concerning marital status, family plans, or worship can draw fire down the road.

The issue of disabilities is particularly difficult. Questions concerning disabilities should be avoided unless per-

taining directly to a material aspect of the job. Even in this case, questions would be better framed by asking how the applicant would handle certain job requirements, rather than asking more general questions concerning the disability.

As always, if your company engages in significant or seasonal hiring, using standardized applications, it is imperative to consult with experienced counsel rather than pressing a “home cooked” application into use. We also recommend looking to industry or trade groups for resources such as standardized forms, which can then be reviewed for very little cost.

DRUG AND ALCOHOL TESTING

Maryland law allows prospective employers to require that an applicant submit for drug testing provided there is a job-related purpose. The Maryland statute contains detailed procedures for alcohol and drug testing. The statute allows employers to use “preliminary screening procedures” to test applicants for controlled dangerous substances.

It is extremely important that prospective employers follow the statute to the letter in order to avoid potential legal problems.

Among the requirements are:

- Use of a certified laboratory or recognized testing device
- Employee/applicant notification procedures; and
- Re-testing procedures

If alcohol and drug testing are part of your company’s hiring protocol, it is wise to have standardized forms attributable to each stage in this process ready to go. In addition, you should have already established contacts with an experienced testing facility prior to placing the policy into effect.

EMPLOYMENT CONTRACTS

Maryland recognizes three kinds of employment contracts: (1) oral; (2) implied; and (3) written.

The At-Will or Oral Employment Contract

Most employees go to work each day as parties to an oral contract known as an “at-will” contract. The contract is formed when the employee is hired to perform a service and accepts an offer of payment. In most cases, no written contract ever makes an appearance.

At-will employment means that an employer can fire the employee at any time and for virtually any reason...or for no reason at all. In turn, employees can quit for any reason, or for no reason at all. The only limitation on an employer’s right to fire an at-will employee is that employment-related decisions may not be made on a discriminatory basis (i.e., discrimination on the basis of race, gender, religion, sexual orientation, or non-job-related disability).

The Implied Contract

Knowing that oral or “at-will” contracts give them very little protection, some employees attempt to claim that certain documents from the employer or company policies formed an **implied contract**. An implied contract is often one that the employer never meant to create. Nevertheless, if successfully argued, an implied contract could severely limit the employer’s right to fire someone or take other adverse action. For this reason, companies should consult with a business or employment attorney before distributing employment policies or personnel manuals.

The Written Contract

Written contracts can be extremely beneficial to both employers and employees. A well-drafted agreement protects both parties by defining salary, the work to be performed, benefits, “perks,” the circumstances under which the employment could be terminated or the salary could be changed, and each party’s responsibilities following termination. In fact, well-drafted employment agreements are often one of the first things a prospective acquirer looks at before making a bid to buy a company.

Drafted poorly, however, even the most well thought out agreement could expose an employer to significant damages such as the payment of a substantial salary—even to an employee who no longer shows up for work!

RESTRICTIVE COVENANTS (OR NON-COMPETITION, NON-SOLICITATION, AND CONFIDENTIALITY AGREEMENTS)



A “covenant” is a promise concerning future performance. Employers often seek to protect their interests by placing what are known as “restrictive covenants” in Employment Agreements. True to their name, restrictive covenants prohibit the employee from taking certain actions or engaging in certain activities during or subsequent to employment.

Courts hate restrictive covenants. The reason is simply that public policy favors helping people get jobs and restrictive covenants limit those possibilities. For this reason, care must be taken to draft each restrictive covenant with the limitations established by each state’s statutes and prevailing case law. These limitations include time restrictions and geographic limitations. The restrictive covenant must also be tailored so as to protect the employer’s interests while not acting as an unreasonable restriction on the individual’s ability to obtain a position within his or her field.

There are three primary types of restrictive covenants:

- Covenants not to compete (also referred to as Non-Competition Agreements if they are stand-alone, as opposed to being included in an Employment Agreement) are used to prevent employees from taking customers or revenue away from their employer after they leave. Non-Competition Agreements or covenants must be restricted in terms of time and geographic area.
- Non-Solicitation covenants are used to prevent a departing employee from taking specific customers and/or other employees with them to their new enterprise. These are much more narrowly focused than non-competition agree-

ments and, hence, are often found to be more acceptable by the employee. A non-solicitation covenant does not say to the employee “you can’t be in this business,” but rather it says “you can be in the business, just don’t steal these customers or my other employees.”

- Confidentiality Agreements are used to protect trade secrets or in-house information such as pricing formulas, procedures, customer lists, or policies. These are the least objectionable of the three types of restrictive covenants... and often the hardest to enforce when a suspected violation occurs.

Other than salary, restrictive covenants are usually the most heavily negotiated employment agreement terms. There are many gray areas, meaning there are many areas ripe for compromise and creative solutions. A word to the wise: If it is important to you, as a business owner, to negotiate a restrictive covenant to protect your company, work with an experienced attorney to draft it.

EMPLOYEE HANDBOOKS



Also called “Personnel Manuals,” Employee Handbooks are an excellent way for employers to ensure that all employees are notified of company policies and expectations. Comprehensive manuals address such topics as vacation and sick-leave policy, holidays, overtime, benefits and complaint/disciplinary procedures.

A well-drafted handbook can serve as an employer’s best defense against employment-related claims, such as claims for wrongful discharge, discrimination, or unlawful retention of salary, commissions or accrued vacation pay. It should lay out the company’s policies and provide compelling evidence for a judge or administrative agency that the company has clearly communicated its policies and has taken all appropriate actions.

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A case in point:

An employee quits without providing notice. Employer A has no Employee Handbook, while Employer B has a Handbook which clearly states that employees must provide a minimum of two weeks notice or forfeit their accrued but unpaid vacation pay. Both employers pay the employee through her last day but refuse to write a check for untaken vacation. If challenged, Employer B – the one with the handbook – keeps his money. Employer A writes a check.

This is just one small example of how judges and administrative agencies will uphold clearly communicated policies, while an employer’s failure to ensure that all policies are disclosed in writing may very well cost him in the end.

As with most things in life, there is a trade-off. While a well-drafted Employee Manual can be of great benefit to a

business, a poorly thought-out one carries significant risks. By spelling out policies and procedures, Employee Handbooks are often cited by disgruntled (former) employees as having formed all or part of an *implied contract* of employment. And while Maryland courts have certainly not always found in favor of the employee on this question, they have almost uniformly held that the decision is “a question of fact” which, absent settlement, would not be resolved prior to trial.

A second risk imposed by Employee Manuals is wishful thinking. A Manual should specify policies *actually followed* by the company, rather than policies the company wishes it had enforced. In other words, a company’s failure to follow disciplinary, complaint, or review procedures spelled out in the Manual may land it in hot water.

DISCLOSURE AND CONSENT

Personnel manuals can be excellent tools for providing disclosure to employees about company policies, procedures, and expectations. There are, however, certain policies as to which the Company would be best advised to obtain specific acknowledgment from its employees.

In each instance listed below, your company should consider supplementing its personnel manual (or other employee memos) with a full policy statement to be distributed to, signed by, and returned by each employee. Copies of the forms dated and signed by each employee should be kept in the employee's personnel file. It is important to note that the employee's signature does not indicate his/her agreement with the policy; but rather that the policy had been disclosed.

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Communications. Logically, no employee would have a reasonable expectation that his or her communications, conducted during business hours on company equipment, would be confidential. Nevertheless, the law is less than 100% clear. If your company wishes to reserve the right to monitor employees' e-mail or telephone conversations conducted on company equipment/networks, your best practice would be to distribute a brief, easy-to-understand memo explaining the policy to each employee. The policy statement should be signed, dated, and returned to each employee's personnel file.

Property. Just as with Communications in the previous paragraph, if your company wishes to retain and exercise a right to search employees' lockers or even personal belongings, the policy should be specifically disclosed in writing and acknowledged by each employee. Moreover, it is important for there to be a legitimate business purpose, especially as the perceived invasion of privacy becomes more significant.

Payroll Deductions. If your company takes any deductions from payroll other than withholding taxes, you should have a separate written document on which the employee has provided his or her express permission to deduct the money. Common situations include repayment of loans or salary advances and the employee's share of health insurance premiums.

Social Policy. There is no such thing as a private conversation anymore. In an age where just about everyone is seeking an audience -- whether through Facebook, Twitter, or some other social network -- confidentiality, trade secrets, and good judgment in outside communications are paramount. For this reason, it is a good idea to "call out" your social media policy, even if it is already contained in your personnel manual, to bring it to the focused attention of your employees and to obtain their acknowledgement of the issue's significance.

EVALUATIONS-ON-THE-JOB

Maryland law does not require formal performance evaluations. Practice should follow policy, however, and if a company establishes a formal policy of periodic reviews (in a personnel manual for example), then the company faces potential liability for failing to follow through. Periodic evaluations are no substitute for day-to-day supervision, training, and if need be, criticism.

A performance review should consist of both a written piece and a face-to-face meeting. The areas reviewed will depend almost entirely upon the nature of the job and the company. Nevertheless, each review should focus on the important elements of each employee's job. Written copies should be provided for the employee.

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Key Point: Employees should be asked to sign a copy of their evaluation for the company to retain in its personnel files.

Note that the employer should explain that the employee's signature is not being used to show agreement with the appraisal, but simply to indicate that the employee received a copy of the review and had an opportunity to discuss it.

Reviews should be conducted by the individual(s) with the best opportunity to evaluate the employee's performance first-hand. The assessment should be fair and complete. It should not be written to spare feelings or to whitewash problems. While it should not focus on every minor issue which may arise during a workday, it should not spare documentation of issues...or matters that could become areas of concern.

Equally as important, the employee should be given an opportunity to discuss his or her concerns or rebuttals. We recommend that the company also enable the employee to place written comments or rebuttals in the personnel file, clipped to the review.

When issues arise concerning a claim of wrongful termination or an improper denial of advancement, one of my first questions is whether or not the personnel file contains written records of performance appraisals. Needless to say, I breathe much easier if the problems which gave rise to the dismissal were documented early and often by the employer.

THE PERSONNEL FILE

I usually think of what is typically known as “the personnel file” as two separate files: (1) Confidential information; and (2) Hiring and job performance.

Maryland and Federal law dictate that the utmost care must be taken to protect the confidentiality of certain records. First among these are employees’ medical files and information. Federal law and the Maryland Confidentiality of Medical Records Act (really!) require employers to keep employees’ medical information confidential and separate from their personnel files. This information is only available to other employees on a need-to-know basis (i.e., when necessary to perform their jobs) and should be kept locked or otherwise secured.

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Per the Maryland Personal Information Protection Act, the same protections that apply to medical records should apply to other personal information such as social security numbers, drivers’ license numbers, other I-9 information, and any financial account information, such as that maintained for direct deposit.

Hiring and performance-related documentation form the other portion of the personnel file. While not subject to the same level of security as medical and personal information, care should also be taken to ensure that these materials are not publicly available. The content of the file, however, is really the most important consideration. Companies should maintain a personnel file on each employee which contains, at a minimum:

The employee's application and resume, if applicable;

- Any offer letter or employment contract;
- Job related correspondence;
- Performance evaluations;
- Documentation concerning raises, promotions, bonuses, etc.;
- Disciplinary documentation (warnings, etc.); and
- Executed Acknowledgements and Consents (see previous section).

The most overlooked among the above list is, by far, disciplinary documentation. Every employer should take care to document the reasoning behind any adverse employment decision such as suspension, demotion, denial of a promotion, or termination. The employer should also document meetings with the employee in which infractions or adverse decisions are discussed.

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How long records must be kept depends upon the type of record and the nature of the business. Nevertheless, it is a good practice to retain records for at least the length of the applicable statute of limitations for adverse claims. In Maryland, the typical statute of limitations is three years. Thus, in most cases, it is advisable to maintain employment records for a minimum of three years after the cessation of employment.

UNEMPLOYMENT COMPENSATION

Like most states, Maryland requires employers to pay unemployment insurance premiums and comply with certain reporting requirements.

Do not assume that unemployment insurance is automatically paid from withholding taxes. They are two separate things. Employers must obtain unemployment insurance upon the hiring of their very first employee.

Unemployment insurance provides benefits for individuals who are out of work through no fault of their own. When terminated employees file for unemployment benefits, employers will be asked to respond to questions concerning the reason(s) for dismissal, the inclusive dates of employment, the terminated employee's position, and the salary at termination. Unemployment compensation is not available for an employee who voluntarily resigned or quit and will also be denied employees fired due to certain types of misconduct or willful policy violations. This kind of misconduct is defined by statute and should also be detailed in employment contracts and personnel manuals issued by the company.

SEVERANCE

There is no obligation under Maryland or Federal law to provide severance to departing employees. Absent a written contract to the contrary, the issuance of severance payments is something entirely within the discretion of each individual employer.

Employers may choose to offer severance for any number of reasons, including philanthropic, employee's length of service, or the basis for departure. Some firms condition severance on post-termination assistance with the transfer of customers or accounts.

My recommendation is that, absent a contractual obligation to provide severance, no severance should be provided unless the employee provides the company with a comprehensive release of claims. Now, you should note that Maryland law will not permit a departing employee to release certain claims, such as a claim for unemployment benefits, but it can release most of the claims which form the basis of post-employment lawsuits. Because of the need to comply with a number of Federal and State statutes, a company should consult with a qualified commercial or employment attorney to craft a binding release.

Employers should take pains to treat equally employees departing under similar circumstances in order to avoid the appearance of discrimination.

Key Point: Severance should never be provided unless the employee executes a comprehensive release of claims.

PROVIDING REFERENCES

References are what is typically known as a “slippery slope.” By far, the best policy from an employer’s point of view is to provide “name, rank and serial number.” In other words, the employer’s safest move is to respond to inquiries only with confirmation of the former employee’s association with the company and his or her inclusive dates of employment.

While Maryland allows employers what is known as a “qualified privilege” to disclose information concerning former employees, there is no guarantee that a former employer will not be sued for defamation arising out of an improper reference.

With that said, if a company wishes to give references, we recommend the following:

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1. Employees be treated equally given similar circumstances – meaning that one should not adopt a name, rank and serial number policy for some, while providing comprehensive references for others; and
2. Employers obtain a reference release from departing employees who wish to receive the benefit of comprehensive post-employment references.

HOW TO PROTECT AGAINST FRAUD AND EMBEZZLEMENT

It's every business owner's worst nightmare: the company bookkeeper, who has been a loyal employee for eight years, has suddenly disappeared – along with \$250,000 of the company's money. Unless the company has the resources and know-how of the FBI, there is little that the company can do in such a situation. For the year, the company will end up taking a charge against earnings (which will affect its bottom line), and may have some explaining to do to agitated shareholders (who will wonder where their annual dividend is) and upset employees (who will not be receiving Christmas bonuses).

Yet as bad as this situation may be, it could be worse. In fact, having a one time fraud committed by an employee or officer who then disappears will at least provide the business owner with a finite loss and a red flag with respect to gaps in company procedures that need to be remedied. Infinitely worse is a “creeping fraud”: a situation where your company's Chief Financial Officer has been quietly diverting \$5,000 each month into an out-of-state bank account which he controls, and after 10 years retires and buys himself a villa in Italy. In a creeping fraud, a dishonest employee exploits a continuing company weakness over an extended period of time, which is a bigger violation of the company's trust, not to mention its financial position.

However, it is not only a company's employees who can commit fraud or embezzlement. Often, fraud is committed by other entities with whom the company does business, including the company's contractual or transactional partners, vendors, and even customers and clients.

It doesn't have to be this way. In fact, it should never be this way. With proper planning and certain simple and easy-to-implement procedures, a business can make itself virtually "fraud-proof." Here are five ways to do it:

- 1) Ensure that all disbursements over a certain amount (say, \$1,000) require the signature of more than one company officer;
- 2) Check (and re-check) your company's numbers every month with your accountant to ensure there is no "creeping" fraud or unexplained irregularities;
- 3) If you receive payments by mail, make sure that the person who opens the mail is not the same person responsible for banking or maintaining the books.
- 4) Eliminate any electronic or scanned signatures of those individuals with check signing authority. A signature printed on even a medium quality laser printer is almost impossible to distinguish from the real thing.
- 5) Have different people enter invoices and approve payment. Many businesses have been bilked out of hundreds of thousands of dollars by the schemes of one well-placed individual who was able to process payments to false vendors.

IV. EXIT STRATEGY



SUCCESSION PLANNING

Successful succession plans differ greatly depending upon the nature of the company. They do, however, have certain characteristics in common.

Preparation is the key. One cannot initiate a successful succession plan two weeks or even two months before it will be put into practice. In fact, for many businesses, two years would be rushing things. The ideal plan will be put into motion five years out. Granted, circumstances and personnel may, and probably will, change during that timeframe, but it is absolutely vital to put together the elements of a plan well in advance.

Second, one must identify what the company will lose with the departure of its principal(s). In other words, what skills and knowledge is the plan being designed to replace? While consideration of this question may seem easy, a complete answer requires quite a bit of reflection on how the company got where it is, and where it has the potential to go in the future with the right leadership. This consideration will form the basis for training the prospective successor.

The third step is evaluation of the talent pool – both within and outside the company. The company must decide whether it can draw on and groom current employees to fulfill the plan or if it should look outside, perhaps, to another industry professional, to carry out its plans. Either way, the company will have to take pains, once having identified the successor(s), to secure their continued involvement in the company without incurring any unwise contractual obligations in the event things do not work out as planned.

Finally, the company must chart the path to be travelled by the chosen successor in order to step into the shoes of the departing principal. What is the time frame? What kind of training will be required? What can the company offer in terms of compensation, benefits, and job security? Each of these questions must be answered, in writing, after consultations within and outside the company, in order for a succession plan to work.

PREPARING YOUR COMPANY FOR SALE

(A.K.A WHAT I WISH MY CLIENTS KNEW BEFORE THEY WALKED INTO MY OFFICE)

"Everyone wants to get to heaven but nobody wants to die."

It has been nearly 20 years since I sat in bankruptcy court and listened to a judge use this phrase to express his frustration as to why companies routinely fail to do the advance planning necessary to enhance their value—even in a bankruptcy situation. I have yet to hear what I consider to be a universal sentiment better expressed.

Each year, our law firm is approached by companies and brokers across the country seeking to engage us to assist them in transactions involving mergers and acquisitions ("M&A"). I have come to the realization that the negotiation and drafting of the legal documents is the easy part. The most challenging aspects involve the selling of a company that was not prepared for sale.

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Most reasonably savvy people, when preparing to list a home, would touch up the paint, engage a landscaper, and perform all repairs necessary to enhance the property's curb appeal. This is because a relatively small up-front investment can reap dividends at the settlement table.

Unfortunately, many of these same people—should they happen to own or manage a company—fail to adopt the same principles when millions more dollars are on the line.

What follows are some basic and crucial steps any company preparing itself for sale should consider before putting itself on the block:

Due Diligence. There is a due diligence process in every transaction. The term “due diligence” means the investigation of the seller that the buyer undertakes prior to Closing. The buyer conducts this investigation in order to ensure that the seller is who and what the buyer thought it was. Depending upon the size and nature of the transaction, due diligence can be a brief process or one that makes an exhaustive IRS audit look like a cake walk.

A well-advised seller will not wait for a buyer to uncover problems. Instead, a wise seller will engage in its own due diligence process long before a prospective buyer ever makes contact. Pre-sale due diligence run by a qualified advisor can point out potential purchase price reductions or even deal killers before they arise, thereby enabling a would-be seller to make timely repairs.

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Second Tier Management & Key Personnel. A prospective buyer must have confidence that the value of the purchased company can be preserved and enhanced once the owners cash out. Even if the purchasers envision placing their own personnel on the acquired company’s management team, the ability to effectuate a smooth transition without a cash flow interruption will always enhance value.

An increasing number of companies are showing the foresight to identify key personnel at every level of their enterprise (rather than just the CXO’s) in order to create bonus programs which reward the employee at closing of any prospective sale, upon the execution of an employment agreement with the purchaser. These agreements may be crafted well before any possible transaction is even a glimmer in the CEO’s eye. Having them in place when the time comes can be worth their weight in gold.

Lock Down Your Revenue Streams. Too many companies fail to secure revenue generated by their top salespeople with non-competition agreements and other restrictive covenants. A company's failure to protect significant streams of revenue can be a non-starter in any purchase discussion.

Clean Up the Balance Sheet. If there is write-down required on certain assets, do it before the company is put up for sale and the lawyers get involved. Negotiations on obsolete inventory, old equipment, or uncollectible accounts receivable often prove to be an expensive, time-consuming, and frustrating exercise.

Prepare Audited Financials. Audited financials are expensive. Depending upon the value of the transaction, they may not be worth it. If, however, the sale of the company is expected to yield substantial proceeds, audited financials often end up saving the seller hundreds of thousands or even millions of dollars during the course of the transaction. It is not unusual, in the absence of audited financials, for a buyer to begin negotiating deductions from the purchase price based upon financial inaccuracies in the seller's documents. Sellers which obtain audited financials in advance will eliminate these mid-stream negotiations.

Clean Up the Corporate Documents. Like it or not, corporate record keeping, including up-to-date minutes from stockholders' and board of directors' meetings, will play a role in the transaction. It is best to blow the dust off the records, pay the freight to bring them up to date, and have a clean set with a current slate of directors and a complete stock transfer ledger ready for inspection.

Control Your Inventory. Lack of inventory control kills deals. Purchases and sales of inventory-focused companies often rise and fall on the quality of the inventory controls put in place by the seller. While the buyer will conduct an inventory (spot check or full, physical) as part of its due diligence, the integrity of the seller's inventory numbers will often determine the extent to which the buyer trusts any of the seller's numbers. It is, therefore, imperative, that a prospective seller perform a full, physical inventory prior to even placing the company on the block. If the reports are accurate, great. If not, fix the reports and the problems that resulted in the errors in the first place.

Give it Time. Most experienced trial lawyers write their closing argument first and then work to prepare a case to support it. The same goes for M&A negotiations. If you believe that your company's value has been enhanced by a material change in operations (i.e., a new product line, a new distribution facility, etc.) allow time for the change to demonstrate its impact so that you can support your argument for an enhanced value. Few people will pay good money for what is to them sheer speculation.

Selling a company is something most people do only once in their lifetimes. It can be difficult not only from a planning perspective, but from an emotional one as well - especially if the management team has devoted decades to building the business. As with any other endeavor, thorough advance planning in the early involvement of experienced professionals guarantee a faster sale for a higher value.

I just wish more of my clients knew that before they walked into my office.

WHAT YOU SHOULD KNOW ABOUT ... WAGONHEIM LAW



WAGONHEIM LAW...

- Offers value-driven, personal attention which combines large firm expertise with small firm economy and responsiveness. We have counseled companies and closed transactions across the country – from Portland, Maine to Seattle, Washington – from our home base right here in Maryland.
- Serves as general counsel to businesses of every size and description, from small, local establishments and large regional enterprises, to some of the most successful and recognized companies in the country.
- Has a track record of excellence in commercial, construction, and insurance defense litigation in matters ranging from employment and collection matters to complex fraud, IP, and commercial claims.
- Looks for ways to help its clients grow – at no cost to them – from facilitating timely introductions to strategic vendors and prospective partners, to keeping our clients up-to-date on critical areas of the law.
- Advises our clients on general business issues including succession planning, contractual formation and enforcement, mergers & acquisitions, stockholder issues, employment, collection, and general litigation.
- Is a business law firm rated AV (excellent to pre-eminent) by Martindale-Hubbell, the country's most prominent and respected law firm rating service.



Scan here to read
Eliot's Bio

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- ▶ Over 20 years of practice focusing on the representation of businesses and institutions in transactional work and litigation.
- ▶ Frequent presenter to attorneys, accountants, business owners, bankers, and other professionals.
- ▶ Extensive track record of success in commercial, construction, and general litigation in jury and bench trials throughout Maryland, as well as in arbitration, mediation, and a variety of ADR formats.
- ▶ Published author of *The Art of Getting Paid*, the *Contractor's Pocket Guide*, the *Commercial Banker's Pocket Guide*, and articles for *The Daily Record*, *The Baltimore Sun*, and *The Baltimore Business Journal*, as well as other local and regional publications.
- ▶ AV-Rated (excellent to preeminent) by Martindale-Hubbell

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DID YOU KNOW...

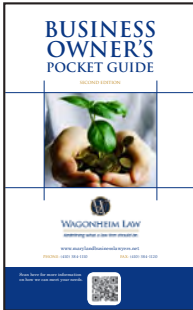
Wagonheim Law offers more than just legal services. Our firm is the product of decades of experience, relationships and contacts formed throughout the Maryland business community. Every day, we put our Rolodex® to work for clients and friends of the firm.

How can we help you?

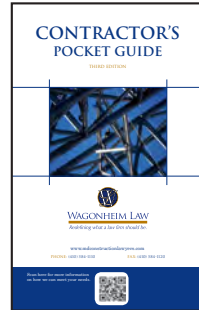
- The purchase or sale of an ownership interest in a company is an excellent opportunity to review your estate planning. Contact us if you'd like a referral to one of our **trusted estate planning advisors**.
- Selecting the type of business entity often has just as much to do with accounting and tax strategies as it does legal protection. Contact us if you'd like a referral to one of our **trusted accounting and tax advisors**.
- One should never sell an interest in a business without appropriate and comprehensive financial planning. Contact us if you'd like a referral to one of our **trusted financial planning advisors**.
- In order to thrive, growing businesses require comprehensive and timely advice from accounting professionals experienced in their particular industry or niche. Contact us if you'd like a referral to one of our **trusted accounting and tax professionals**.

- An experienced commercial banker, knowledgeable about the financial landscape of the company's particular industry is essential to see the company through the long term. Contact us if you'd like a referral to one of our **trusted banking contacts**.
- Growing companies must manage risk. Experienced and creative insurance advisors are essential to this effort. Contact us if you'd like a referral to one of our **trusted insurance advisors**.
- Buying and selling companies requires more than just sound legal advice. The input of an experienced valuation professional can ensure knowledgeable decision-making no matter what side of the table you're on. Contact us if you'd like a referral to one of our **trusted business valuation professionals**.
- There are business-oriented accounting firms which have formed departments geared exclusively to the bookkeeping, tax and accounting needs of small businesses. These departments offer lower rates, training, and even data entry services specifically tailored to the needs of companies without in-house accounting expertise. Contact us if you'd like a referral to one of our **trusted small business accounting professionals**.

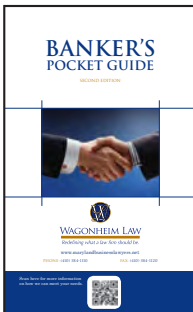
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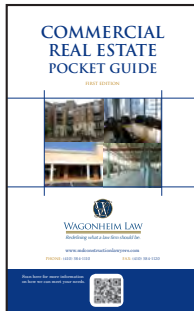
BUSINESS OWNER'S POCKET GUIDE



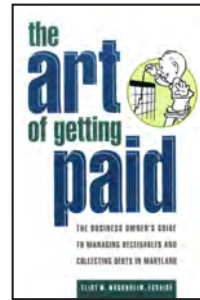
CONTRACTOR'S POCKET GUIDE



BANKER'S POCKET GUIDE



COMMERCIAL REAL ESTATE POCKET GUIDE



THE ART OF GETTING PAID



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