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Creating an LLC? What you need to know

Many business owners think it's easy to set up an LLC. That's partly the result of companies and websites that claim to offer simple, "standardized" LLC operating agreements. Just fill in the blanks and you're off!

In reality, there's no such thing as a "standard" LLC operating agreement. You have a lot of choices to make, and even if you're starting a very simple business, your choices will have a profound effect on you down the road if the business takes off.

Unlike a traditional corporation, an LLC is designed to be very flexible and give you a lot of options. But unless you specify an option, you may be stuck with a legal "default" rule that you never considered and that isn't to your advantage. This could lead to problems that are very difficult and costly to resolve.

Here's a very brief list of things to consider (among many others):

Ownership percentage. The most common way to divide ownership is in proportion to the capital contributed by the members, but this might not make the most sense. For example, what if one member contributes in the form of services or plays a greater role in operations?

Management. Who will be in charge and make operating decisions? What types of decisions will be left to a manager, and what types will be subject to a member vote? If there's a vote, will it be by a majority of the members, a majority of the percentage interest, or a majority of those in attendance? Should a two-thirds or other super-majority be necessary for certain important decisions? If so, which ones?

Voting rights. An LLC can assign different voting rights to mem-



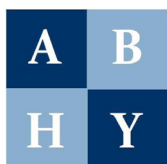
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bers. A person with a 10% membership interest could have a 30% voting interest, for instance, while other "passive" members could have no voting interest. Or one or more members could have a veto power over certain decisions.

Be careful: A lot of "form" LLC agreements require 100% of members to constitute a quorum – which means that a disgruntled owner could stymie a vote on an important matter simply by not showing up at a meeting.

Representations and warranties. Are the members making promises about what they're bringing to the table, for which they can be held legally responsible?

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Beware of trademark scams

The U.S. Patent and Trademark Office has put its records online, including trademark owners' full addresses. As a result, many shady but official-sounding businesses are now contacting trademark owners

and offering scam services.

For instance, such businesses may offer to arrange third-party publication (which is unnecessary), or they may offer legitimate services such as filing a record with the Customs Office at exorbitant prices.

The most dangerous scams offer to

renew a trademark registration without properly updating the declarations as to identification and use. Trademarks that are renewed in this manner may later turn out to be invalid, and may be cancelled or successfully challenged by competitors.

If you receive any unsolicited correspondence about your trademarks, be sure to speak with an attorney to find out if it is legitimate.

"Red flags" of a possible scam include any bill, invoice or request for prepayment from the Patent and Trademark Office. (The Office only accepts online payments at the time of filing.)

The Office is located in Alexandria, Virginia and its domain is uspto.gov. Any correspondence from a different city or directing you to a different domain is likely fraudulent.

Also, by law the Office can communicate only with the "attorney of record" on your trademark filings. Any communication addressed to someone other than the attorney of record is almost certainly a scam.

Businesses can't agree not to 'poach' employees

It might be tempting to informally agree with other business owners in a niche field not to poach one another's employees, but it's illegal – and recently, some businesses have paid a high price.

For example, the Department of Justice went after several tech companies that allegedly had an informal "no-poach" understanding. The employees themselves then filed a class action, which resulted in a \$415 million settlement.

In another case, eight hospitals in the Detroit area paid \$90 million to settle claims that they had exchanged information with one another about how much they paid their nurses. The hospitals had allegedly conspired to limit the nurses' salaries, rather than competing with each other by raising wages.

And a class action has now been filed against Duke University and the University of North Carolina, alleging that the schools secretly agreed not to recruit each other's faculty and staff.

The antitrust laws include severe penalties for conspiring to restrain trade, which is what all these businesses were accused of doing.

Some companies have even gotten into trouble after sharing information in salary surveys.

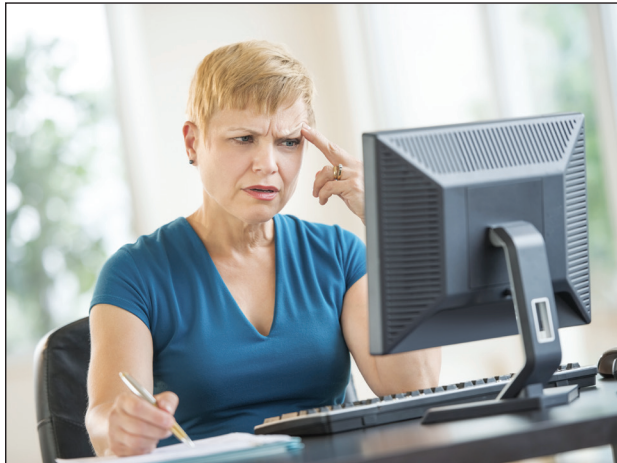
New rules are resulting in faster union elections

Many businesses have predicted that new federal rules that took effect last year could result in "quickie" union elections in which the employer wouldn't have time to campaign effectively and get its message across. It now looks like those fears might be justified – the average time before a private-sector union election is now only three weeks, compared to five weeks previously, according to the National Labor Relations Board.

The new rules allow election petitions to be filed electronically instead of by mail, force businesses to wait until after a vote to raise most legal challenges, and require companies to provide unions with employees' personal e-mail addresses.

Many companies have complained that unions can now spend months getting ready for a challenge, and then spring it on the employer without giving the employer adequate time to respond.

The Board said it hasn't yet compiled data on whether unions are winning a greater percentage of elections under the new rules.



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It might be tempting to informally agree with other business owners in a niche field not to poach one another's employees, but it's illegal – and some businesses have paid a high price.

Creating an LLC? Here's what you need to know

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Profits and losses. How will these be distributed to the members? Will profits be distributed on a regular basis, such as quarterly, or at will? If they're distributed at will, who will decide? If they're distributed on a regular basis, how will it be determined how much should be distributed and how much should be retained as operating capital?

Taxes. LLCs don't pay taxes; the members do. But because the operating agreement determines how income and losses are allocated for tax purposes, these provisions are very important. As an example: Some people who receive an LLC interest in return for providing services are surprised to discover that, under the agreement, the LLC interest is taxable to them. And some people are surprised to discover that they owe taxes on an LLC's undistributed profits.

Accounting. What method of accounting will you use? What will be your fiscal year? What rights will the members have to inspect the books and have them audited?

Capital calls. What are the rules if the LLC needs more cash from the members?

New members. What are the provisions for bringing in a new member? Is there a way that current members can prevent the dilution of their ownership or voting share?

Member withdrawal. What happens if a member wants to leave, or cash out? Must the member sell his or her interest to the other owners, or can it be sold to a third party? If it can be sold to a third party, must the other members approve the sale? Can they have a right of first refusal? If the withdrawing member had

management rights, can the sale exclude those rights? Must the departing member sign a non-compete or confidentiality agreement?

You might also want to limit the members' ability to use their LLC interest as collateral, since a foreclosure could result in an involuntary withdrawal – and an unwanted new member.

Buyouts. Can a member be forced out? How, and under what circumstances? For instance, a buyout may be mandated if a member dies, becomes disabled, files bankruptcy, or is terminated by the business. Also, how will the value of the member's share be determined for buyout purposes?

Disputes. You might want to provide that any disputes among members must be settled by mediation and/or arbitration.

Amendments. If the operating agreement needs to be changed later, what is the process for this? You want to make the amendment provisions as friendly as possible. Beware: some "form" agreements and state default rules say that an agreement can't be altered without the consent of *all* the members.

Dissolution. If you need to dissolve the LLC, you'll want a rule that says how a dissolution vote will be taken and how the LLC assets will be divided up. Not having such a provision can lead to nasty disputes if things don't work out.

As you can see, simply using a "standard" LLC agreement without considering all the issues with an attorney can be a recipe for disaster down the road.



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Managers' ability to keep investigations secret is limited

Can a company that conducts an internal investigation tell the employees it's interviewing not to talk about the matter while the inquiry is pending?

Not necessarily, according to a new decision by the National Labor Relations Board. The ruling applies to all businesses, regardless of whether they have a union.

Companies can insist on confidentiality only if certain conditions are met, the Board said.

The case involved an investigation by an Arizona medical center into how surgical instruments were being cleaned after a water main broke.

The medical center had a blanket policy in which it told interviewees not to discuss a matter while an investigation was going on. It explained that "when

people are talking, it is difficult to do a fair investigation and separate facts from rumors."

But the Board said this blanket policy violated employees' legal right to communicate with each other about workplace issues.

According to the Board, a company can insist on confidentiality only if it is truly necessary to prevent a cover-up (including witnesses agreeing to lie or destroying evidence), or to stop a witness from being harmed. Further, the company must show that without confidentiality, these things are *likely* to happen, not just possible.

The Board said it didn't matter in this case that the company merely requested confidentiality and didn't actually threaten any discipline for talking.



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What business entertainment expenses are deductible?

As a general rule, you can deduct 50% of what you spend on business entertainment on your federal taxes. Although the IRS is very strict about requiring you to document the expenses and their business purpose, it can be surprisingly generous about what counts as a business expense. For instance:

- ▶ The deduction is not just for meals. You can often deduct the cost of entertaining clients at nightclubs, theaters, sporting events, and athletic clubs, and on hunting, fishing and vacation trips.
- ▶ The deduction can include money you pay for a client's personal needs on a trip, such as a hotel suite or a car.
- ▶ You don't have to actually discuss business during the meal or other entertainment, as long as you engage in a business discussion before or after. In some unusual cases, the business discussion could even take place on a different day.

- ▶ You can deduct not only the basic cost of the entertainment, but also any taxes and tips.

- ▶ You can generally deduct the cost of entertaining a client's spouse, if the event is one where a spouse would normally attend (such as if the client is traveling with his or her spouse). You might also be able to deduct the cost of entertaining your own spouse, if the event is one where everyone typically brings a spouse.

- ▶ You can often deduct the full cost (not just 50%) of tickets you buy to an event if it's a charitable fundraiser.

- ▶ You can take the deduction as long as the purpose was to encourage business – you don't have to show that the entertainment actually resulted in any business. If you take someone for a round of golf to discuss a deal, and the deal falls through, you can still deduct the cost of the round.