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THE WORTH OF A BUSINESS LAWYER:

ADDING VALUE TO THE NEW BUSINESS

BY BENJAMIN J. COMIN, ESQ.

Starting a new business can be really exciting. We are all familiar with the iconic image of the intrepid entrepreneur, armed with a new idea or promising opportunity and full of fire and enthusiasm for a new venture. There are so many things to do to get a new business off the ground: developing products, hiring employees, locating suppliers, negotiating leases, coordinating tenant improvements, raising capital, marketing and the list goes on. In the excitement of building the business and dealing with pressing concerns, there is a tendency to neglect or defer dealing with the myriad legal issues facing a new business.

Business owners and managers hire business lawyers to help deal with these abundant legal concerns and, if only subconsciously, expect the legal services to, in some way, add value to the new business, even after deducting the lawyer's fees.[1] But can a transactional lawyer really add value to a business? Articles and academic literature have suggested a number of ways in which transactional lawyers can create value, including:

1. Minimizing the potential for ex post litigation;
2. Reducing transaction costs; and
3. Reducing regulatory costs.[2]

A recent transaction in which I was involved reminded me that the "value" referred to can often translate into real economic value to the business and its owners. A closely held family business was being acquired by a large multi-national corporation. The seller's value was almost exclusively represented by its intellectual property assets. In the process of the buyer's due diligence, it came to light that one of the seller's independent contractors, the one responsible for manufacturing the seller's most valuable proprietary formulas, had never executed an intellectual property assignment.

Although the seller was confident the contractor would provide the assignment based on their longstanding hand-shake understanding, the contractor's new management ultimately balked and put the entire acquisition in jeopardy. The buyer eventually agreed to move forward, but with a seven-figure discount to the purchase price.

Unfortunately, stories like this are not uncommon. It is easy to see how the seller's attorney could have added significant value to the business by advising the seller to obtain intellectual property assignments early in the relationship, when expectations and understandings were clear and unclouded by the years, new management and now-lucrative assets. The difficulty is that clients frequently do not want to spend money on comprehensive legal advice that would lead to value creation; as a result, they end up in a very transaction-oriented relationship with their business attorney. In this type of relationship, the attorney gives legal advice only on discreet matters about which the client has inquired, without addressing the multitude of issues that may be more urgent or are simply not considered by the client.

At the outset of a new business, there is a tendency for managers and owners to only want the attorney to do the bare minimum, because startup capital is scarce and clients are price-sensitive. In an effort to curb this, and as a mental checklist for myself, I developed a very basic outline that helps me and the client think comprehensively about the legal issues facing the business. This is the value proposition of a business lawyer: add value by helping clients broaden the way they think about their businesses, teaching them to assign a priority to each legal risk and opportunity they face in relation to their overall strategy, formulating a plan to address each need as the budget allows and then executing the plan in partnership with the client.

The business lawyer who proactively advises a client, as described above, becomes a forward-looking partner in developing and implementing measures that build enterprise value, as opposed to merely being a source of legal documents. The starting point in this process, and the focus of the remainder of this article, is the check-list I use to help clients think broadly about their businesses in order to identify legal risks and opportunities. I review this checklist with each new business client and periodically with existing businesses.

1 Corporate Structure

Assessing the corporate structure of a business broadly refers to the choice of entity, ownership structure and management structure of the business. This has been referred to as enterprise design.[3] A business lawyer can add value here by helping the client consider the liability and tax implications of the entity, the governance mechanisms in the corporate documents, how ownership is held, the rights of different classes of owners, the appointment or election of management and the limitations of management. These choices, while sometimes viewed as routine by the client, can have significant implications for the enterprise. For example, it is not uncommon among closely held corporations to see majority shareholders retain near-exclusive control of governance. However, there is evidence suggesting that firms with diluted control, in which no shareholder can take unilateral action, perform substantially better than firms with one controlling shareholder.[4] Clients may remain unaware of the benefits of diluted control unless the business attorney raises the issue.

2 Critical Assets

Certain assets are so critical to a business' performance and success that attention must be paid early in the process to protecting them. These assets generally fall into the categories of cash, equipment, real estate or intellectual property. Documenting the business' ownership of these assets is an important first step. Is there a subscription agreement documenting the initial capital contributions of owners? Has cash been deposited in an account titled to the business? Has real estate been titled in the name of the business? Has the purchase of equipment been properly documented? Has intellectual property been patented, trademarked, copyrighted or otherwise protected? Have measures been put in place to protect trade secrets?

3 Key Relationships

Just like assets, there are certain relationships that are so important to a business that they should be documented and formalized. This will largely depend on the nature of the business conducted by the enterprise. These relationships generally fall into the categories of employee, independent contractor, vendor and customer. Perhaps the business is dependent on a supplier to provide parts, a few large customers for a substantial portion of its business or on one key salesperson. If the business' success (and perhaps its very existence) is dependent upon one of these relationships, the business should have contracts in place to formalize the relationship and provide recourse in the event of breach. Additionally, this may help managers identify concentration issues that can be rectified.

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4 Risks to the Business

A business lawyer can add substantial value when it comes to identifying and mitigating risks to a business, because this planning is frequently neglected in early-stage businesses. Risk commonly arises from employees, industry regulation, operations, and products or services. Assessing risk in these categories may lead to a wide variety of conversations, including: the company's employment, hiring and termination practices, its operational safety and incident reporting procedures, or its product design. The important thing is to identify the risk and then provide recommendations, such as contract terms, insurance or formalizing processes and procedures, to mitigate the risk.

5 Strategic Planning

Clients frequently meet the final point on my checklist with surprise and a tinge of bewilderment. As an advisor to the business, it is important to understand the nature of the managers' and owners' ultimate goals for the business. This discussion may address areas in which the business can expand, competitors that may be good acquisition targets, evolution in the industry or complimentary product offerings. Additionally, have the owners thought about how they intend to exit this business? Many of the decisions made at the outset will have implications when it comes time to depart. For example, if the owners of a high-growth technology company want to scale and exit quickly, what are the tax implications of choosing an LLC over a corporation, and how might the entity's choice be perceived by potential acquirers? By having this conversation early, the business lawyer can align his or her advice with the goals of the company and its owners.

In this world of constrained legal budgets and competitive markets, businesses want lawyers who add value to their enterprises. The worth of a business lawyer depends on that attorney's willingness and ability to proactively identify legal issues and skillfully navigate the business through those issues. **NL**

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2. Steven L. Schwarcz, "Explaining the Value of Transactional Lawyering," 12 *Stanford Journal of Law, Business & Finance* 486 (2007).
3. George W. Dent, Jr., "Business Lawyers as Enterprise Architects," 64 *The Business Lawyer* 279 (2009).
4. Venky Nagar, Kathy Petroni, and Daniel Wolfenzon, "Governance Problems in Closely Held Corporations," 46 *Journal of Financial and Quantitative Analysis* 943 (2011).

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