

LEGAL ISSUES TO CONSIDER WHEN STARTING A BUSINESS – Beyond *LegalZoom.com!*

DAVID J. SCHWAB
SHARANYA GURURAJAN
RALPH, SCHWAB, GARTNER & SCHIEVER, CHTD.
175 E. HAWTHORN PARKWAY, SUITE 345
VERNON HILLS, IL 60061
PHONE: (847) 367-9699
FAX: (847) 367-9621



David J. Schwab. Since 1990, Mr. Schwab has developed a law practice with a focus in bankruptcy and creditor/debtor rights, business planning and restructuring, and commercial litigation. He and his law firm, Ralph, Schwab & Schiever, Chtd., are recognized by Martindale Hubbell's *Bar of Preeminent Lawyers* in the areas of Bankruptcy Law, Business Law, and Commercial Litigation. As a trained CPA and practicing attorney, Mr. Schwab is uniquely qualified to assist financially troubled companies, analyze their legal options, and assist them toward a successful resolution of their legal/financial issues.

Mr. Schwab received his law degree from the DePaul University College of Law. While in law school, he was an executive editor of the DePaul Business Law Journal. He also served as an "extern" for the Hon. Robert E. Ginsberg, United States Bankruptcy Judge. In that position he researched the law and drafted legal opinions for cases being heard by Judge Ginsberg.

Prior to law school, Mr. Schwab worked as a business consultant for Coopers & Lybrand (now PriceWaterhouseCoopers). He obtained his undergraduate degree in accounting from Indiana University.

Recognized by his peers as an experienced lawyer in bankruptcy and financial workouts, Mr. Schwab has served as a lecturer for the Lake County Bar Association (Bankruptcy Committee), the Association of Illinois Attorney-Certified Public Accountants, the Milwaukee County Bar Association and the Federal Reserve Bank of Chicago. He is a co-author of "Assignment of Rents in Bankruptcy" for the Commercial Law League of America (Seminar in Advanced Bankruptcy Practice). Mr. Schwab has served as past President of Illinois Association of Illinois Attorney-Certified Public Accountants, a member of the Board of Directors of Northwest Community Bank, and has served on the DePaul University College of Law Alumni Board. He is also an active member of the American Bankruptcy Institute and the Chicago Bar Association Bankruptcy Committee.

Mr. Schwab is admitted to practice in the State of Illinois and the U.S. Bankruptcy and U.S. District Courts for the Northern District of Illinois.

Sharanya Gururajan received her law degree from the University of Illinois College of Law, Urbana-Champaign, IL, Cum Laude, in 2005. She received her undergraduate degree in Economics from the University of Illinois at Chicago, IL where she graduated with honors.

Ms. Gururajan has represented numerous debtors in bankruptcy court along with representing a Chapter 7 Trustee on routine and contested matters involving the liquidation of a bankruptcy estate. She co-authored an article for the American Bankruptcy Institute Journal entitled "*An Overview of the Form 22 Vehicle Operation Expense: Allowance or Cap on Actual Expense*". She has been involved in mortgage foreclosure defense litigation in state and federal court along with contributing to the research and drafting of an article for the Lake County Docket entitled "*Fundamentals of Illinois Mortgage Foreclosure Defense*".

Ms. Gururajan is admitted to practice in the State of Illinois and the U.S. Bankruptcy and U.S. District Courts for the Northern District of Illinois.

The Beginning of a Dream....

- Starting your own business can be a very exciting and nerve wracking process.
- It is important for business owners, especially first time business owners, to be well educated on the do's and don'ts of business ownership.
 - ❑ Internet is full of resources -
 - Word of Caution: - Use reputable sites and be aware of any state specific laws that may affect your business;
 - Recommend starting with the *U.S. Small Business Administration* website: <https://www.sba.gov/starting-business>

Some Factors That Fuel the Creation of New Businesses:

- ❑ Poor economy that has shrunk employment opportunities;
- ❑ Desire to be your own boss, driven by independence;
- ❑ Desire to continue in a family business/trade;



THINGS TO CONSIDER FOR STARTING A BUSINESS:

1. Come up with business idea.
2. Decide who will be owners/operators – by yourself or with others (minority/women owned).
3. Come up with a business plan.



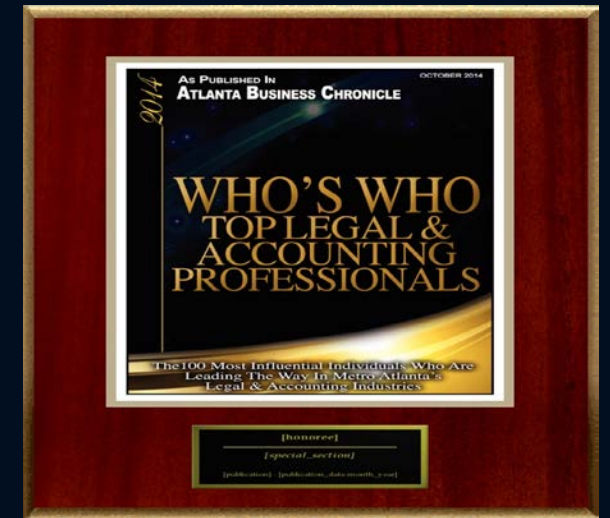
EXPENSES TO BE AWARE OF...

- legal expenses;
- accounting;
- insurance;
- security deposit and prepaid rent;
- build out of space;
- marketing/advertising/website;
- stationery/phone/equipment/computers;
- inventory;
- bank account – separate from personal accounts
- initial capital for operations;
 - rent;
 - wages for employees;
 - office supplies;
 - nest egg for unexpected costs or not enough income



SURROUND YOURSELF WITH COMPETENT PROFESSIONALS

- Accountant;
- Attorney;
- Banker;
- Insurance Agent;
- Commercial Broker/Architect/Contractor, if a build out is involved.



WHAT KIND OF CORPORATE ENTITY IS RIGHT FOR YOU?

- Sole proprietorship/general partnership;
- Limited liability company;
- Corporation;
- Limited Partnership;
 - Most entities file with the Illinois Secretary of State – same agency which issues drivers' licenses.
 - Discuss with management professionals, considerations include:
 - Liability;
 - Taxes;
 - Costs.

Filings with the Illinois Secretary of State, if necessary
– Articles of Incorporation – Articles of Organization.

- Complete balance of organizational document and records;
- Obtain FEIN from IRS – like social security number;
- In Illinois, register if sales or other taxes necessary, need to file paperwork to register with Illinois Department of Revenue;
- If employees, register with Illinois Department of Employment Security.

Maintain Company

- On an annual basis need file annual reports for corporations and limited liability companies.
- Maintain business formalities, maintain business records, file tax and related returns.
- Separate personal from business
- If do not take action to maintain, you may lose the personal liability protection and may assume the liability personally.

Importance of Corporate Formalities..

- Primary purposes of doing business as corporation is to insulate shareholders from unlimited liability for corporate activity.
- Certain situations may result in court finding officers and directors personally liable for corporate obligations through remedy commonly known as piercing corporate veil.
 - ❑ inadequate capitalization
 - ❑ failure to issue stock;
 - ❑ failure to observe **corporate formalities**;
 - ❑ nonpayment of dividends;
 - ❑ insolvency of debtor **corporation** at time;
 - ❑ nonfunctioning of other officers and directors;
 - ❑ absence of **corporate** records;
 - ❑ whether **corporation** is mere facade for operation of dominant stockholders; court may also consider whether dominant individuals commingled **corporate** funds with personal funds or preferred themselves as creditors.



Ted Harrison Oil Co. v. Dokka, 247 Ill. App. 3d (1993); *Gallagher v. Reconco Builders, Inc.*, 91 Ill. App. 3d 999 (1980)

Exit and Merger Strategy

“Nirvana or Nervous Breakdown?”

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Exit - Merger Overview

1. The Decision
2. The Process
3. Valuation
4. Negotiating the Deal
5. Documentation
6. Due Diligence and Closing
7. Things to Consider
8. Q&A

1. The Decisions: Why Exit or Merge Your Business?

- Part of Your Strategic Plan
- Market Pressure
- Attractive Offer
- Partnership Challenges
- Lifestyle Considerations
- Tired / Time to Go

The Decisions: What are the options?

- Asset/Stock Sale
- Partner Buy-Out
- Partial Interest
- Private Equity

2. Process

- How long does it take?
- How much does it cost?
- What are success rates?
- What happens when a party walks away?
- Is your business built to sell...or fall apart?

3. Valuation: Risk / Intangibles / Reputation

- Nature of Business / Industry (High Tech, Food Industry, Retail, Service or Mfg. Etc.)
- Customer List and Concentration
- Recurring Revenue / Guaranteed Contracts
- Quality of Management Team
- Large Future Projects / Deals
- Proprietary Systems - Technical Talent
- Vendor Partners

3. Valuations

- Earnings (Multiples of EBITDA)
- Tangible Assets – Condition/Life
- Risk / Intangibles / Reputation
- Industry Trends – Ratios/Comparable Sales
- Discounted Cash Flow
- Economic Comparison

Valuations, cont.

- Add-Backs/Normalization Adjustments
 - Officer's Comp.
 - FMV Rent
 - Non operating/Non recurring expenses
 - Non productive family members on payroll.
 - Extraneous non business expenses.
- Past 5 year analysis – trends
- Projections – Accurate, Realizable, Realistic

4. Negotiating the Deal - Business Package for Buyers and Investors

1. What You Sell
2. Who You Are
3. Your Competitive Advantage
4. The Market Opportunity
5. Target Market
6. Marketing Plan
7. Development Timeline
8. Business Strategies
9. Capital Required
10. Financial Projections

Negotiating the Deal

- Your Post-sale involvement and obligations
 - Terms – Seller financing; Stock; Cash; Earn-out's
- Multiple suitors - advantages and disadvantages
- Don't make first offer
 - Understand their valuation
- Know what is important to you & the buyer
 - Know when to hold firm and when to give
 - Know your bottom line
- Documentation and Contract Review

The Deal, Continued

Deal Stoppers

- Poor Planning
- Poor Presentation
- All about your product/service
- Hidden Secrets – Undisclosed Issues

5. Documentation

- ▶ Non-disclosure Agreement
- ▶ Letter of Intent
 - Principal elements of the offer
 - Pricing Structure
 - Exclusive Negotiation Rights
 - Schedule for closing
- Does not include:
 - Specific Representations
 - Contractual Terms

6. Due Diligence

- ▶ Key Agreements are:
 - ▶ Purchase Agreement
 - ▶ Reps and warranties
 - ▶ Resolution Process
 - ▶ Employment Agreements/Non-competes
 - ▶ Lease/Purchase Agreements
 - ▶ Earn-outs
 - ▶ Consulting Agreement (if appropriate)
- ▶ Obtain necessary approvals
 - ▶ Financing
 - ▶ Governmental
 - ▶ Third Party
- ▶ Assurance that seller can meet the commitments in the contract

Summary

- Learn the Process
- Understand Your Value-Add
- Package Your Business Properly
- Surround Yourself with GREAT Counsel
 - Knowledge & relationships are critical
 - The right resource can always bring value
 - The wrong resource can cause nightmares