THE SMALL BUSINESS GUIDE TO PROTECTION *FROM LAWSUITS*

Eduardo A. Maura

AYALA
A LAW FIRM

I've represented dozens of small businesses throughout the years. The main concern or question I am asked is still: ***How do I protect my business from lawsuits?***

INDEX

COMPLIANCE

The first thing that comes to mind is compliance. It is extremely important that businesses comply with all laws, regulations, and codes. Oftentimes, during litigation, litigants will use any violations of the law, ordinances, local codes or the like, to their advantage. They will try to paint you as the most non-compliant business in the world—the most "law-breaking" entity. They will argue that they breached their contract with you because you breached first by "breaking the law." It will not matter how small this violation was, they will skillfully paint you as a lawbreaker, argue that violations of the law are not "curable," and that they were right to breach the contract first. This, in turn, could result in tremendous unfairness for a small business that was legitimately defrauded and incurred hundreds of thousands in damages from an unscrupulous defendant. As a small business owner, you do not want to be in a position where your meritorious cause of action (or defense) is jeopardized because of a minor violation that can be cured simply by paying a small fee to the city.

It is thus extremely important that you protect your business by complying with all of the requirements to operate legally in a city or county. Typical requirements for businesses in Florida are: (1) a Business Tax Receipt (city and county); (2) tangible personal property taxes; (3) a certificate of occupancy or use; (4) annual reports with the Florida Department of State; (5) Florida income tax reports; (6) payment of payroll taxes; (7) federal tax returns; (8) real estate taxes; (9) paying overtime to employees; and (10) specific permits for your industry.

All of these are simple things that require essentially small payments. Although in the aggregate, they can be burdensome and expensive. As a litigator, I can assure you that it is extremely important that you take care of them, so you can protect bigger assets and rights down the road. You do not want to be in a lawsuit with your landlord, vendor, provider, business partner, or the like, and have his/her skillful lawyer use these non-compliant instances against you, damage your otherwise meritorious case, and ultimately negatively affect your business.

SEPARATION

Out of the many things I tell small business owners, when they ask me how to protect their businesses, separation is high in my list of recommendations. But what do I mean by separation? What I mean is, separate your business from yourself, your family, or your other businesses.

It is quite common that small business owners are the managers of the business or are actively involved in the operations of the business. This carries with it the temptation to mix business activities with personal activities. However, in order to extract the most benefits out of the business' legal structure, you (as the owner) need to be separate and be apart from your business.

For example, there is always the temptation not to pay yourself a salary because the cash flows are low, or to use the company credit card for personal expenses, or to run your business from your home or your other business' office. Mixing such things, while economical and cost-effective, can have an adverse impact if, God forbid, your business gets into legal trouble. A plaintiff might want to go after your business and you, or your other business, and may argue to a court that, since you treat the business as your own personal purse, your business and you are one and the same. This is what we called the "alter ego" or "piercing the corporate veil" (PCV) theory. PCV is, as the name suggests, when one lifts off the corporate mask of the entity and imparts liability on the owners behind it.

Under this legal theory, a litigant will argue that the company structure is just your facade for the purpose of doing improper actions. If you, however, keep a good separation from your business, it will be much harder for people targeting your business to reach your personal assets in the hypothetical situation that your business runs into legal trouble.

Absolute separation is not always viable, however. For example, most small business owners use a single vehicle for business and personal activities. In such a case, paying for gas with the company card is reasonable and will carry little risk. But using the company card to shop at Macy's or to go on a vacation to Disney will likely be a situation where the commingling of accounts is a very bad idea.

1390 BRICKELL AVE #335, MIAMI, FL 33131 | P (305) 570-2208 | F (305) 503-7206 | WWW.LAWAYALA.COM

LAYERING

What do I mean by layering? You can have, for example, a Limited Liability Company (LLC), and you, the human, can be 100% its owner. That type of ownership structure will give you the least protection possible. The law treats these types of entities almost as sole proprietorships rather than a "partnership"—one of the very purposes of an LLC. This structure makes it easier to reach the owner if something happens, as the entity and you are virtually the same.

To avoid this, it is important that you have several layers of ownership protection. The first one is to always have a partner, even if that partner owns 1% of the LLC or entity. Having a 1% co-owner will create a legal partnership that will give the LLC device more strength, and, consequently, it will better shield its owners' assets.

Now, the owners/partners don't have to be humans necessarily; it can be another LLC. For instance, you could have LLC-1 owned 99% by LLC-2 and 1% by LLC-3. LLC-2, at the same time, can have its own owners, LLC-4 at 99% and LLC-5 at 1% ownership. LLC-4 could be owned by an irrevocable trust in a foreign country for the benefit of Human-Owner's children.

This sophisticated system of layers adds additional protections to the company and shields its assets from exposure. Should LLC-1 get in trouble, it will be very hard to reach the personal assets of Human-Owner because they are so far removed, deep into the layers of protection.

Of course, like with all things, there are pros and cons. Creating and maintaining layering systems is not cheap. The more layers and entities involved, the more legal and accounting fees involved—if they are to be properly maintained. A business owner must make a cost-benefit analysis and determine if the amount of assets and the type of business activity involved (and how risky it is) merits investing in a sophisticated system of layers.

1390 BRICKELL AVE #335, MIAMI, FL 33131 | P (305) 570-2208 | F (305) 503-7206 | WWW.LAWAYALA.COM

INSURANCE

How can having insurance protect you from lawsuits? It may not, but at least the insurance could pay for the lawsuit—sometimes.

When any of the aforementioned recommendations to protect your business from lawsuits do not work, having insurance is a good option. If an adverse party manages to defeat you and tries to go after your assets, a good general liability policy may help. General Liability policies are policies meant to protect a business from liability (fault) imposed by lawsuits or similar claims.

A general liability policy, depending on the type of business, is generally affordable at around $1,000 per year or less than $84 per month. Lawsuits, in turn, are only viable when there are tens of thousands at stake, especially if financed by the litigant. In other words, the worst-case scenario for a business—the lawsuit—will almost always involve a lot more money than the small price of having a general liability policy. In certain circumstances, your insurance has to pay the cost of defending you as well.

While a general liability policy is the most popular type of insurance protection, there are other types of insurance that your business may need to have, depending on its size. Some of them include: Workers Compensation Policy (to protect employees for accidents in the work place), Property Insurance (to protect the physical premises—the real estate of the business), Vehicle Insurance (for vehicle protection), Errors and Omissions Insurance or E&O (for errors you may make in the exercise of your particular trade), and, for larger entities, Directors and Officers Insurance (to protect directors as the main decisionmakers of companies from liability for their decisions).

For **more information** about how to protect your business from lawsuits email me at eayala@ayalalawpa.com, or call 1-833-33-AYALA.

1390 BRICKELL AVE #335, MIAMI, FL 33131 | P (305) 570-2208 | F (305) 503-7206 | WWW.LAWAYALA.COM