Starting A Business

No army can withstand the strength of an idea whose time has come. Victor Hugo

Torroidial Space Colony by NASA
Basic Forms of Business Orgs.

- Sole or individual proprietorship
  - sole owner controls all decisions and receives all profit, but runs entire risk

- Partnership
  - two or more owners jointly share decisions and profits as well as risk; some limited liability available through LLP or LLC forms

- Corporation
  - One of more owners with limited liability
Specialized Forms of Org.

- **Unincorporated Assoc.**
  - Often used for condo or residential developments (i.e., HOAs) or towns/villages

- **Cooperatives (incorporated or not)**
  - Individuals join together to obtain advantages of volume purchases or negotiating power (i.e., agricultural coops)

- **Business Trusts**
  - Unincorporated assoc. run by trustees for investors (beneficiaries)
  - Not common
Joint Venture (JV)

- Two or more persons or entities (e.g., corporations) combine capital and labor for business purpose, sharing profits and losses equally.
- Essentially a partnership for a limited purpose (e.g., film and recording partnerships).
Other Methods of Doing Business

- Franchise
  - Method for technology transfer from franchisor to franchisee with royalties paid to franchisor
    - E.g., McDonald’s, Dunkin’ Donuts, KFC...
  - Large body of law exists because of numerous infractions and disputes
Which Form Should You Choose? Basic Factors Influence Decision

- Ease of creation
- Liability of owners
- Need for capital
- Tax considerations
- Mode of operation
- Strategic plan

Solar Thin Film Technology by Nanosolar
SOLE PROPRIETORSHIP

- Simplest form -- owner is the business
  - *Personally* liable for all aspects of business
- Could also be a corporation
  - Subchapter S tax status under the IRS code
  - Limited liability for owner
Sole Proprietorship

- **Major advantage**
  - All profits belong to proprietor
  - Business income reported as personal income
  - Proprietor makes all decisions

- **Major disadvantage**
  - Proprietor bears all risk of loss
  - Proprietor bears all liability
CORPORATIONS

- One of the oldest forms
- Provides “corporate shield” to owners (shareholders)
  - Owners have limited liability, so not *personally* liable
Corporations

- State law regulates formation, operation, and dissolution of corporation
- Primary advantages:
  - Limited liability for owners; perpetual existence
- Primary disadvantages:
  - Double taxation; operating expense
Corporations

- Typical form for making ownership available to a multitude of owners
  - Especially for public trading of stock
- Sub S tax status available to corporations with \( \leq 75 \) owners
  - Tax status of partnership
  - Limited liability

Welding on Ridley Motorcycle
In general, partnership is an agreement between two or more persons (entities) to carry on as co-owners of a business for profit, but it may be for a non-profit purpose. The "partnership" is a legal entity as well as the individual partners.
Partnerships

- The (Revised) Uniform Partnership Act generally is applicable
- Profit/loss “passed through” to individual partners on their tax returns

Small businesses often are partnerships
Each partner has a *fiduciary relationship* with each other partner

*Fiduciary relationship* requires special trust and loyalty and requires each partner to act in utmost good faith for the benefit of the partnership.

Partners must not compete with the partnership, take a business opportunity from the partnership, use partnership property for personal benefit, or engage in activities that conflict with the interests of the partnership.
A well-drafted Partnership Agreement (though not required) is the key device for preventative law.

- Should clearly define rights and obligations of partners.
Warning: partnership may be created even if (a) parties don’t label the arrangement a partnership or (b) the agreement is oral.

Ex.: if one party claims partnership existed and the other party argues no partnership, a court may examine the facts and conclude that a partnership by estoppel exists.
Participants share in profits and property

Participants share in business management

Participants agreed to share in losses

Participants refer to one another as partners

Third parties recognize the participants as partners
Southex Exhibitions v. Rhode Island Builders Assoc.

Facts:

- 1974: RIBA and show producer SEM entered a 5-year contract. RIBA agreed to sponsor and endorse only SEM shows with net show profits shared 55% to SEM and 45% to RIBA.
- During negotiations, SEM and RIBA discussed agreement’s use of the term “partners” and SEM’s president claimed “no ownership.”
- 1994: Southex acquired SEM’s interest in agreement and RIBA contracted with another show producer.
Procedural History and Legal Reasoning:

- Southex sued RIBA to enjoin the 2000 home show claiming the 1974 agreement established a partnership and RIBA breached fiduciary duties by wrongful dissolution.
- Trial court found for RIBA and Southex appealed.
- Appellate court reviewed partnership law basics and noted first that the 1974 agreement simply titled “Agreement” rather than “Partnership Agreement.”
Southex Exhibitions v. Rhode Island Builders Assoc.

- **Legal Reasoning and Holding:**
  - Court noted that agreement was for a limited term and, more interesting, plaintiff Southex entered contracts with third parties “in its own name, rather than in the name of the putative partnership.”
  - Court concluded partnership did not exist and affirmed the judgment for RIBA.
In a *general* partnership, each co-owner is a “general partner”

Each general partner is *personally* liable for the debts and obligations of the partnership whether s/he caused them.

All partners have equal rights in management:
- this may be altered through agreement
- majority rule controls most decisions unless otherwise stated in agreement
Developed in Italy, LPs have been around since the 12th C
- adopted by France & traveled with French settlers to US
- Limited Partnerships differ from general partnerships primarily in degree of liability of partners
Limited Partnerships

- Must comply with statute (RULPA) & certificate must be executed & filed
- Must be ≥ 2 partners
- Two types of partners:
  - General (at least one partner) OR limited
Limited Partnerships

- Limited partner has limited liability; general partner incurs full liability.
- If sued, limited partner liable only to amount of the investment in partnership.
  - Ex.: Gen. Partner A and Ltd, Partner B each invest $10,000; if sued and judgment against them, A is fully (personally) liable and B is liable only for $10,000 of award.
Limited Partnerships

- In general, limited partners have same *rights* as general partners
- But limitation = NO management participation
- Participation (incldg use of ltd partner’s name) subjects limited partner to same liability to creditors as general partner

Tagging tobacco leaves
LTD LIABILITY PARTNERSHIPS

- Typical organization for family businesses and professional services organizations
- Allows ALL partners to avoid personal liability for malpractice of other partners

Commonly used for agricultural business or professional services
Limited Liability Companies (LLC) are a hybrid company formed in accordance with statute – a corporation-partnership.

- Articles of organization must include info similar to articles of incorporation.
- Business name must include “LLC” tag.
- Owners are designated as “members.”
Advantages of LLCs

Limited liability for owners similar to corporations and tax advantages of partnership

Cosi Sandwich Shop
LLC Specifcics

♦ Operating Agreement
  - Members decide how to operate business
  - operating agreement need not be in writing

♦ Management
  - all members participate in member-managed LLC
  - a group of persons (members or not) designated by the members hired to manage the firm in a manager-managed LLC

♦ LLC Owners may also be Managers
Managers are the persons who manage or “run” the company

Compare:

- In a partnership, general partners manage or “run” the company, but limited partners may not participate in management.
- In a corporation, shareholders also may be managers, officers, or directors.
Meyer, Knapp & Cavanna establish a partnership to operate a window washing service. Meyer contributes $10,000; Knapp & Cavanna each contribute $1,000.

Partnership agreement is silent on how profits and losses will be shared.

One month after operations begin, Knapp & Cavanna vote, over Meyer’s objection, to buy another truck for the firm.
Meyer believes that since he contributed more money, no major commitments to purchase materials can be made over his objection.

In addition, Meyer claims that in the absence of an agreement, profits must be divided in the same ratio as capital investment.

What are the issues?

How should the judge rule if a dispute arises?
<table>
<thead>
<tr>
<th></th>
<th>Sole Proprietorship</th>
<th>Partnership</th>
<th>Limited Liability Partnership</th>
<th>Limited Partnership</th>
<th>Limited Liability Limited Partnership</th>
<th>Corporation</th>
<th>S Corporation</th>
<th>Limited Liability Company</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formation</strong></td>
<td>When one person owns a business without forming a corporation or LLC</td>
<td>By agreement of owners or by default when two or more owners conduct business together without creating another business form</td>
<td>By agreement of owners; must comply with limited liability partnership statute</td>
<td>By agreement of owners; must comply with limited liability partnership statute</td>
<td>By agreement of owners; must comply with corporation statute</td>
<td>By agreement of owners; must comply with corporation statute</td>
<td>By agreement of owners; must comply with limited liability company statute</td>
<td></td>
</tr>
<tr>
<td><strong>Duration</strong></td>
<td>Terminates on death or withdrawal of sole proprietor</td>
<td>Usually unaffected by death or withdrawal of partner</td>
<td>Usually unaffected by death or withdrawal of partner</td>
<td>Unaffected by death or withdrawal of partner, unless sole general partner dissociates</td>
<td>Unaffected by death or withdrawal of partner</td>
<td>Unaffected by death or withdrawal of shareholder</td>
<td>Usually unaffected by death or withdrawal of member</td>
<td></td>
</tr>
<tr>
<td><strong>Management</strong></td>
<td>By sole proprietor</td>
<td>By partners</td>
<td>By partners</td>
<td>By general partners</td>
<td>By general partners</td>
<td>By board of directors</td>
<td>By board of directors</td>
<td>By members, unless choose to be manager-managed</td>
</tr>
<tr>
<td><strong>Owner Liability</strong></td>
<td>Unlimited</td>
<td>Unlimited</td>
<td>Limited to capital contribution, except for owner’s individual torts</td>
<td>Unlimited for general partners; limited to capital contribution for limited partners</td>
<td>Limited to capital contribution, except for owner’s individual torts</td>
<td>Limited to capital contribution, except for owner’s individual torts</td>
<td>Limited to capital contribution, except for owner’s individual torts</td>
<td></td>
</tr>
<tr>
<td><strong>Transferability of Owners’ Interest</strong></td>
<td>None</td>
<td>Limited</td>
<td>Limited</td>
<td>Limited, unless agreed otherwise</td>
<td>Limited, unless agreed otherwise</td>
<td>Freely transferable, although shareholders may agree otherwise</td>
<td>Freely transferable, although shareholders usually agree otherwise</td>
<td>Limited, unless agreed otherwise</td>
</tr>
<tr>
<td><strong>Federal Income Taxation</strong></td>
<td>Only sole proprietor taxed</td>
<td>Only partners taxed</td>
<td>Usually only partners taxed; may elect to be taxed like a corporation</td>
<td>Usually only partners taxed; may elect to be taxed like a corporation</td>
<td>Usually only partners taxed; may elect to be taxed like a corporation</td>
<td>Corporation taxed; shareholders taxed on dividends (double tax)</td>
<td>Only shareholders taxed</td>
<td>Usually only members taxed; may elect to be taxed like a corporation</td>
</tr>
</tbody>
</table>
Test Your Knowledge

- True=A, False = B
- The Revised Uniform Partnership Act (RUPA) is a model partnership statute.
- Partnership is an “association of two or more persons to carry on as co-owners a business for profit.”
- Partnership capital belongs to the individual partners in equal shares.
Test Your Knowledge

**Multiple Choice**

- The partnership interest includes a partner’s:
  - (a) Management and other rights participation
  - (b) Share of profits and losses and right to receive partnership distributions
  - (c) Ownership interest in partnership capital
  - (d) both A and B
  - (e) none of the above
Thought Questions

- Do you want to start a business? If you wanted to start a business (snowboards, for example), would you choose partnership as the form of business?
NEXT: CORPORATIONS

QUICK!
FORM A COMMITTEE!!

THE BIRTH OF CORPORATE LEADERSHIP