THE
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Keeping Up With
The Corporate Books

Don't Turn Your Business into a Scene From Reality T.V.

If I were a TV producer, I'd suggest there's no better drama-filled, high stakes thrill of a story than that of a business that fails to keep its corporate house in order and, as a result, things blow up. But I'm not a TV producer. I'm a business lawyer. So I'll share with you some of the tales of woe I've experienced through my clients over the course of my career, in the hopes that you avoid these costly mistakes by taking action to get your corporate records up to date:

SCENE 1

Catfight in the Fashion World: No Partnership Agreement and a Whole Lotta Sass

Two lifelong friends, neighbors and business professionals. One with a passion for fashion, a skill for design and a head for business. The other a marketing guru with connections far and wide. The two thought it was a match made in heaven and feverishly went to work on an innovative clothing line that was par to none. They dedicated countless hours and dollars to the goal they'd set. Giving up sleep, free time and other business ventures to pursue their dream.

They were "partners" in crime. Thelma and Louise. Until the business started to take off. Then it got real.

Never having entered into a formal agreement, neither Thelma nor Louise reduced to writing who had equity in the venture. No one determined what the voting rights would be. There was no clarity as to who was entitled to claim ownership to the intellectual property. Thelma suddenly looked at Louise and decided, "you're not my partner, I hired you as an employee." Louise was aghast. But without any written document, this was going to be a she-said she-said fight that wouldn't end well.

Thelma and Louise lawyered up and the mud-slinging commenced. The lifelong friends, practically sisters, started a letter-writing campaign in which they disparaged one another, made allegations of breach of fiduciary duty, infringement of intellectual property, demanded a partnership accounting and made other claims that irrevocably broke the 25-year relationship made of gold. In the end, the business shut down, the women privately resolved the dispute and went their separate ways. Forever.

All of this could have been avoided if the women had sat down with an attorney at the outset of the venture and formed a legitimate business entity with appropriate governing documents.

SCENE 2

Sibling Rivalry on Steroids. Failure to Disclose in Writing = Battle to the 2D Circuit

Once upon a time, a dad had a thriving business that he passed down equally to his four doting children. While each of those children also took a Board seat with the company, only one took an active role as CEO/President of the family operations. Initially, the set up was great. The business was thriving and the siblings were happily relishing in their success and wealth. But when the business took a turn for the worse, one of the brothers turned to his sister and said: "THIS IS ALL YOUR FAULT!"

You see, brother was accustomed to receiving a hefty salary as an officer of the company – which role entailed signing checks once a month – on top of pretty lofty dividends. So when his sister's efforts no longer afforded him the extra income he had grown accustomed to receiving, he wanted her to pay. So he sued. In federal court.

The fight boiled down to an issue of disclosure – reduced to a writing in board minutes. Sister retained the service of her husband to assist with the various transactions the business took on in an effort to salvage a sinking ship. Although it was very clear to the board that the sister's husband was retained and was being paid for his efforts, the brother insisted that he was never made aware of the terms and conditions of the engagement, including the cost of his services. He claimed that his sister and her husband essentially looted the company's assets.

Many years and millions of dollars in legal fees later, after fighting in the district court, then at the appellate level and then in state court on issues that the federal judge threw out of his court, the family legal dispute came to an end.

None of this Thanksgiving dinner drama had to happen – if there was simply adequate disclosure that was reduced to writing in the corporate books and records.

SCENE 3

GOTCHA! Can't Sue Here if You Are Not Up to Date with the Secretary of State

ABC company does business in NY. It had a breach of contract claim against XYZ company for failure to pay for ABC's services. So it sues in state court. XYZ answered and sought to dismiss ABC's claims because ABC was not in good standing in the State and, therefore, was precluded from making use of the court system. Unless ABC corrected the problem quickly, it stood to lose the court battle against XYZ even with a valid cause of action for breach of contract. This did not have to happen!

An LLC that has not met its publication requirements, a corporation that has not filed its biennial statement, and any company that is not otherwise deemed "in good standing" by the New York Secretary of State stands to face the challenge that ABC faced, and lose the privilege of being able to make use of the NY court system.

Beware of making the simple but potentially costly mistake of not properly forming your company or not staying on top of registration requirements.

SCENE 4

You Think your Business is Worth What? Not with This Mess

The owners of a company were desirous of selling their interests to a third party. When the prospective purchaser started to conduct due diligence, they asked for the usual things like financials, material contracts and corporate books and records. The problem is that there were no corporate books and records. There was nothing to show who currently owned the company, who were the company's officers and directors, what, if any, management or other employment contracts existed and what the company rights and obligations were to those people and whether or not the company was in good standing in the jurisdictions where it was doing business. Some "corporate cleanup" could have helped to reduce how bad the company looked to the proposed purchaser, but because the owners didn't bother to seek counsel before shopping the company for sale the consequences were bad.

The proposed purchaser took one look at the company's dearth of books and records and decided the company's value was far less than what the owners wanted.

If you think you've got a dynamo business, don't shoot yourself in the foot by not maintaining your books and records. Being sloppy or negligent in this area of your enterprise can devalue your business tremendously, and can cause you to lose a prospective investor in a heartbeat.

Don't get caught up in the drama. Beware of the pitfalls of not maintaining proper books and records and consider cleaning up your "corporate house" before you become a reality star … for all the wrong reasons!

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