

# **MORELLA & ASSOCIATES**

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## **BUSINESS REPRESENTATION OVERVIEW**

### **I. Goals of Corporate and Business Representation**

If you are planning on starting a business, or already have a business, experienced legal representation is a necessity to ensure the financial stability of your business and the protection of your business and personal assets. An experienced law firm like Morella & Associates can develop a plan that will ensure these goals are met and that ensures an enterprise it can conduct business free from the worry of violating any of the numerous statutory requirements for businesses.

### **II. Areas of Representation**

**A. Selecting an Entity** - Selecting the correct business organizational form is a key to success for any enterprise. A number of factors, including tax considerations, contribute to the correct choice of a business form, and each organizational form has its own pros and cons. We can examine your individual circumstances and help choose the right form for your business.

- 1. Sole Proprietorship** - Defined as the ownership of a business by an individual, proprietorships are the easiest and least expensive business entity to set up but lead to unlimited liability of the owner and limitations on the availability of capital.
- 2. Partnership** - Defined as an association of two or more persons for the conduct, as co-owners, of a business enterprise, partnerships provide for profit sharing and joint control. For tax purposes, partners share directly in the partnership's profit and its losses. This concept is known as "flow-through" taxation. "Flow-through" taxation means that the partnership's income is taxed only once even if it flows through and is distributed directly to the partners. Derivatives of the traditional partnership form are becoming more common.

- a. **General Partnership** - A general partnership is one in which all the partners carry on their trade or business for the joint benefit of all the parties concerned, with all partners sharing in the management of the partnership. General partners share in the profits and losses, though their capital contributions may vary. All general partners also have unlimited liability for all acts and losses of the partnership.
  - b. **Limited Partnership** - A limited partnership consists of at least one general partner and at least one limited partner. General partners manage the affairs of the partnership and also have unlimited liability for the acts and losses of the partnership. While the limited partnership does limit the liability of the limited partners, any participation in the management of the partnership's affairs could end this limited liability and, in the eyes of the law, turn a limited partner into a general partner.
  - c. **Limited Liability Partnership (LLP)** - In a general partnership, each partner is liable for the negligent or wrongful acts of other partners. By registering with the Department of State as an LLP, the partners can limit their liability in this area. After proper registration by the general partnership to become an LLP, partners in an LLP are no longer vicariously liable for the acts of other partners, but they remain liable for their own negligent actions, the actions of those they supervise, and other debts of the partnership.
3. **Corporation** - Traditionally, corporations are owned by shareholders and run by directors. A corporation is a separate legal entity from its shareholders. Therefore shareholders of a traditional corporation are not taxed directly on the profits of a corporation and also enjoy limited liability. While the traditional corporate form is beneficial to larger enterprises, its benefits are sometimes lost on smaller corporations. This has led to several new variations on the corporate form to compliment the more traditional forms.
- a. **"C" Corporation** – "C" corporations are the traditional corporate entity. The corporation itself is subject to taxation on its taxable income and there is a complete separation of the shareholder and the corporation. Any income which is distributed by a corporation to its shareholders in the form of a dividend is taxed again as income to the shareholders. Thus, a "C" corporation and its shareholders are said to be subject to "double taxation."

- b. **“S” Corporation** – “S” corporations are corporations that are treated like partnerships for income tax purposes, but retain limited liability for their shareholders. The income or losses of the corporation “flow-through” to the shareholders in proportion to their stock ownership. Shareholders pay tax on the corporations profits and share in the gains and losses. The disadvantages of “S” corporations include stringent requirements to maintain “S” corporation status, the possibility of inadvertent termination, and the inability to vary the allocation of income, gain, loss, and deductions among shareholders in a manner different from their proportionate stock holdings.
- c. **Professional Corporations** - Certain professions will not allow their members to practice in the corporate form unless the corporation’s shareholders consist entirely of members of that profession. While these requirements are not as stringent as they once were, certain professionals, such as attorneys and physicians, need to be aware of the need to incorporate in the form of a professional corporation.

4. **Limited Liability Company (LLC)** – LLC’s can be created by filing a “Certificate of Organization” with the Department of State in conjunction with the preparation of an “operating agreement.” An LLC is taxed like a partnership for income tax purposes, but its owners and officers enjoy corporation-like limited liability. The main difference between an LLC and an “S” corporation is that the latter must meet fairly complex requirements to receive partnership tax treatment while the former must meet only relatively simple organizational requirements. LLC’s can elect to be taxed as a corporation and in-turn elect to be treated as an S-Corporation for income tax purposes.

B. **Agreements and Documents** - Formal agreements and documentation constitute the framework and operational structure of a business. Every step in the formation and governance of a business enterprise needs the proper documentation to accompany it. The following is a list of some of the key business documents we have experience drafting.

1. **Buy/Sell and Shareholder Agreements** - These agreements are used mainly in small corporations and generally include restrictions on the transfer of shares as well as possibly providing for a plan for the continuation of the business if a key shareholder or employee dies, retires, or becomes disabled (see Section II (E) of this outline). Buy/Sell agreements can prevent a shareholder from alienating their shares in a manner that is inconsistent with the desires of those who formed the corporation.

2. **Partnership Agreements** - Partnership agreements form the framework and set the limits of a partnership. Properly structured agreements can limit the boundaries of one partner's duty to other partners, and control the distribution of a partnership's income.
  3. **Operating Agreements** - Operating agreements are similar to partnership agreements but are used to form the framework of an LLC as opposed to a partnership. Operating agreements generally allow an LLC to be run with quite a bit of flexibility but still provide guidance to members and managers for the management and operation of the LLC.
- C. **Business Development and Change** - Forming a business and running a business are very distinct operations. Morella & Associates has experience providing counsel during all aspects of a business's life, from initial formation to dissolution. As a business grows its needs change. Experienced legal counsel will provide room for a business to evolve, while insuring that, no matter how circumstances change, the goals of a business's owners are achieved. The following is a list of some of the situations where legal counsel will benefit a business.
1. **Business/Corporate Governance** - The structure of a business's governance is vitally important to the success of the enterprise. Experienced legal counsel can assist a business in the process of determining what division of responsibilities best serves the interests of the business's owners. Legal counsel can also insure that a business's governance is running in compliance with applicable statutory regulations.
  2. **Financing** - Financing is important for a business in several circumstances, including: initial formation, growth or expansion, acquisition, and financial difficulty. Financing can come from many sources, including: family, employees, banks, and governmental programs. An experienced law firm can determine when additional financing is necessary and what financing source would be most beneficial for a business.
  3. **Mergers and Acquisitions** - Businesses often merge or acquire other enterprises. Such transactions must follow strict statutory guidelines such as notifying shareholders, adopting a plan of merger or acquisition, and filing articles of merger or acquisition with the Department of State. Morella & Associates has experience drafting the necessary documents and can ensure that all statutory guidelines are met.
  4. **Recapitalization** - Recapitalization involves modifying the capital structure of a company primarily to allow for some significant change in ownership or to allow flexibility for key successions. Knowing when to pursue a recapitalization and the proper legal method for pursuing a recapitalization

are areas where our financial and legal experience can be very beneficial for a business.

5. **Private Placement Offerings** - Private placement offerings are sales of securities to raise start-up capital or significant expansion capital. Morella & Associates has experience with a variety of businesses in many stages of development so we can help develop a strategy that will best effectuate this capital raising tool.

**D. Idea and Employee Protection** - Employees and intellectual property are often the most valuable assets of a business. Legal representation can help ensure that ideas are protected and that valuable employees remain with the business. An experienced law firm will also prepare in advance for the possibility that employees may leave by preparing protective documents. The following are documents and processes that can protect a business's employees and ideas.

1. **Employment Agreements** - Written employment agreements are useful in retaining key employees and in preventing employees from engaging in unfair competition during and after their employment. Employment agreements can include protective provisions dealing with confidentiality of information obtained in the course of employment as well as non-competition provisions.
2. **Restrictive Covenants** - Restrictive covenants provide that an employee may not solicit former employees or customers of the employer after termination of employment, as well as not compete with the employer during or after the term of employment. Restrictive covenants are often contained in employment agreements, however, if structured properly they can be entered into separately. Employers must be careful that these covenants are not too restrictive. Experienced legal representation can ensure that these covenants are truly enforceable and are not violative of judicial standards.
3. **Confidentiality Agreements** - Confidentiality agreements are often used when one business is contemplating the acquisition of another, or when individuals are interested in possibly investing in a business. A confidentiality agreement ensures that any documents or information exchanged in contemplation of such a transaction remains private. Legal representation can protect a business by reviewing confidentiality agreements to determine that they are fair and that they provide sufficient privacy guarantees.
4. **Employee Benefits** - Benefit programs can attract quality employees and bring about a sense of loyalty to a business enterprise. Many regulations, both federal and state, govern employee benefit plans. We can help a

business navigate the maze of legal requirements and provide an effective benefit program for its unique situation.

5. **Trademark and Copyright Registration** - Trademark and Copyright Registration are two key methods of protecting intellectual property. Registering ideas and innovations can guarantee that this property is not stolen or co-opted by a competitor. Having access to a law firm with experience in this area is vital to any innovative business.

## **E. General Small Business Issues and Considerations**

1. **Employee Disputes** - Disputes may arise between a business and a terminated employee over the reasons for termination. Employees who feel they were unfairly discriminated against may file complaints with several government agencies such as the Pennsylvania Human Relations Commissions (PHRC) and the United States Equal Employment Opportunity Commission (EEOC). Complaints and the ensuing investigations can be disruptive and time consuming for a business. Experienced legal representation for the business can make this process run smoother and more efficiently, allowing the business to remain focused on its goals.
2. **Commercial Leases** - Every business needs a suitable location that fits its line of business. Negotiating a workable lease for a company is vital to its success given that lease payments are typically one of a business's larger monthly expenditures. Morella & Associates has extensive experience with real estate and lease matters. This experience allows us to protect the interests of a business in this vitally important area.
3. **Succession Planning** - Small businesses are often owned by families or a small number of employees. Due to their closeness, if one owner dies or becomes disabled these groups often desire to maintain control over the business and to protect the business's assets from creditors. At the same time, these groups wish to minimize death and transfer taxes. Succession planning is the mechanism that allows this to happen, and experienced legal counsel is necessary to handle the complications that will arise.
  - a. **Buy/Sell Agreement** - Buy/Sell or Shareholders Agreements (as discussed in Section II(B) of this outline) are likely the most important documents a small business can create for succession purposes. These agreements can provide that the company or an individual will repurchase the interest of an owner who dies. This type of buy/sell agreement allows ownership of a small business to stay in a closely allied group. All buy/sell agreements are unique to the business and the ownership situation.

- b. **Family Limited Partnership (FLP)** - Family owned businesses can create FLP's, a business entity that allows the main interest holders of a business to maintain control, while at the same time protecting family wealth and keeping the business's assets in the family. The main interest holder of a business usually creates an FLP and transfers the assets of the business to it. An entity, usually an LLC, is created to assume the role of general partner of the FLP. The main interest holders in the family business (usually the parents) receive limited partner interests and limited liability. The limited partners then proceed to slowly and systematically gift the limited partner interests to children or other family members. This reduces the value of the parents' estate and leaves control of the family business in the hands of the desired family members who would be managers of the LLC or general partner.