

# Tips To Help Small Businesses Avoid Lawsuits

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It is not unusual for small businesses to face a major lawsuit some time during its first five years of business. The more successful the business, the greater the likelihood of being sued. The following areas are particularly "litigation sensitive."

## **Relationships with Investors**

One of the worst things that can happen to a company is to have a minority shareholder who is unhappy with how the company is being run and have no way to force him to sell his shares back to the company at a fair price. This situation can foster a devastating lawsuit by an unhappy investor. A shareholder agreement or a partner buy-out agreement can avoid this problem and give the company the right to buy-out an investor. Without an investor buy-out agreement, there is virtually no way to eliminate an unhappy investor at a fair price.

## **Raising Money**

Observe the securities laws scrupulously when raising money. Failure to do so will invariably result in an investor obtaining the upper hand if and when the investor sues the company. The only way to have a good understanding of securities laws that apply to money-raising efforts is to consult a legal adviser prior to soliciting money from everyone -- including friends and relatives.

## **Trade Names**

One of the worst shocks a small business can receive is a lawsuit or the threat of a suit alleging that the company should stop using its name. Do your homework to ensure that you have the right to use the name of your business.

Simply filing a fictitious name statement or incorporating the business does not give you the unquestioned right to use a name. A trademark search is the only way to be sure a particular name is available. These searches and the legal review associated with them generally cost less than \$1,000.

After the search, consult your legal adviser to determine whether or not you should attempt to register the name with the U.S. Patent and Trademark Office. Loss of name identification and costs associated with it can ruin a small business.

## **Employee Relations**

Employee-related litigation is the most prevalent type of litigation faced by small businesses.

Every small business should have a definitive employee handbook that contains all essential employee

issues, such as the employer's right to terminate employees, maternity-leave rights, confidentiality, sick leave, vacation, sexual harassment, etc. The owner and each manager should be intimately familiar with the rights of employees in these areas.

Even when a business has only a few employees, management must understand all employee rights. If you comply with the handbook and the rules regarding employees' rights, employees should be discouraged from suing you, or you should have the upper hand if they do. Consult your legal adviser before terminating any employees.

Adopt policies that require reporting of sexual harassment and discrimination. Doing so may give the business the upper hand if a disgruntled former employee files a complaint with the EEOC. Also, have policies in place outline procedures for overtime and then rigorously adhere to those policies. Doing this will help protect the business in the event that a disgruntled former employee files a complaint with the US Department of Labor.

### **Selling and Buying Products**

Whenever you sell or purchase products, use comprehensive purchase-order forms tailored to your business. These purchase orders should be carefully reviewed and drafted by your legal adviser to ensure that they provide the maximum protection in the event of litigation. Standard purchase and sale contracts should be used only with great caution. The only thing standard about any "standard" document or agreement is that it is probably designed to take advantage of you in a very standard manner.

Each business is unique. Few, if any, "standard" forms or agreements ever provide the same protection as one tailored to fit a particular business.

Purchase orders for buying are as important as those for selling. Many items can be included in the purchase or sale orders that will substantially improve the chances of success if a business must pursue a claim in court to collect for products sold or must defend against such a claim. Simply having a good purchase order can often discourage a lawsuit from being filed. Typical provisions that would be covered are:

- Warranties -- What kind of warranties are you giving? The law implies certain warranties on the sale of all products unless they are disclaimed in a particular manner.
- Attorneys Fees -- Under California law you generally are not entitled to attorneys fees when you collect a debt unless they have been agreed to in writing.
- Risk of Loss -- Who suffers the loss if the goods are destroyed or lost during shipment?
- Payment -- What are terms of payments, late charges, etc.?

### **Be Reasonable About Litigation**

Litigation exists primarily for the purpose of collecting money or protecting a business -- not to prove principles. Small businesses exist solely for the purpose of making a profit, not for the purpose of defending a principle or setting things straight. Never become involved in litigation because of the principle of the matter.

Settle a dispute and go on with your business. In addition to the hard dollar cost of litigation, it's time consuming and likely to have a disruptive effect on your business. The other party could choose to go over your records with a fine-tooth comb or tie up your employees in endless hours of depositions. Although these costs are not tangible, they can have a devastating effect on a small business.

### **Lawsuits Best Avoided**

As a general rule, it is in a business' best interest to avoid litigation or reach a quick settlement if sued. There are always two sides to every story and, if you file a lawsuit, the person you sue will probably file a lawsuit against you. Be cautious of anyone who says your business will be a clear winner in a lawsuit without any risk of loss; have your case evaluated by a second source.

It is very easy to file a lawsuit. The complaint is fairly inexpensive to prepare, and the filing fee is only a couple of hundred dollars. However, once the lawsuit is filed, it's virtually impossible to get rid of without the other side's consent or without exposing yourself to serious liability.

Should you find yourself faced with the prospect of litigation, carefully explore the alternatives of arbitration or mediation; these alternatives are often faster and cheaper and provide less exposure for the business. And, if you do find yourself involved in litigation, whether it be as the plaintiff or the defendants, good luck -- you're in for the experience of a lifetime!

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