

The Top 10 Mistakes Which Can Lead to (or Worsen) Lawsuits

Many lawsuits are brought about, or worsened, by a common set of mistakes we see business people make over and over. California is experiencing a lawsuit crisis, which appears to be getting worse. We think one component of the statewide crisis which is completely avoidable is the mishandling of lawsuits once filed, and/or the failure to take appropriate steps to reduce the likelihood of being sued in the first place.

The following list was compiled from the regrets expressed by defendants in lawsuits who suffered unnecessary and avoidable exposure and “wished they’d been warned.” While this is not an all-inclusive list, it does represent some of the most common mistakes we’ve seen which lead to, or worsen, lawsuits against small business.

1. **Doing business as an individual or a partnership:** You can be sued at any time, and many defendants who were doing business as individuals or partnerships have been forced to file bankruptcy, needlessly part with personal assets, and endure litigation tactics they would have been completely avoidable if they had properly incorporated or formed a limited liability company (“LLC”) before the lawsuit was filed.

If you are not doing business as a corporation or limited liability company (“LLC”), all of your personal assets may well be at risk for claims relating to your business operations. Doing business as a general partnership is even worse—you can be 100% liable for the acts of your partners. Further, one or more associates or employees can be deemed a partner of your for liability purposes, even if you had not intended them to be. A corporation or LLC eliminates these and many other risks, and may provide important tax advantages as well. Many business owners put off incorporating because they think they can’t afford it, and usually find out too late that they can’t afford not to do it.

2. **Holding real property in your own name, a living trust or a partnership:** Real estate is perhaps one of the riskiest possible assets to hold in your own name, or that of a partnership or living trust. With the availability of LLCs and limited partnerships, many experienced attorneys think that there is no good reason for holding real property in any other manner. Aside from the fact that it is very easy to determine how much equity you have in every property you own from a free internet public records search, the presence of your name on the “chain of title” of a piece of real property can never be removed, and could become significant in the event of an

environmental lawsuit many years from now. Many lawsuits, such as ADA access lawsuits, can make the financial resources of the property owner highly relevant to the proceedings—if you don't put your property in the name of a business entity, all of your personal resources may be deemed available for such purposes.

3. **Noncompliance with any statute or law** (California's Unfair Competition Law ("UCL") Business & Professions Code §17200): Under California's Unfair Competition Law, almost any act or omission can lead to a major lawsuit. Recently, a rash of UCL lawsuits had been filed against firms which failed to file their State registration statements on time. Such lawsuits can force firms to provide financial information, customer lists and other sensitive information. Most businesses are willing to pay substantial sums to avoid this. More significantly, there is no requirement that the plaintiff purchase your products or services, or that any actual harm be proven. Almost any statutory or regulatory violation—no matter how minor—can form the basis for a UCL claim. A group of firms were recently sued by a private party for failing to send in their State license registrations on time.
4. **Engaging in Internet activity without the proper legal safeguards**: If you have a website or engage in Internet communication in your business, there may be legal factors applicable to your operations which are not apparent. When you make a statement or representation on the Internet, you are making it, in effect, to the entire world, and can be sued in any number of jurisdictions in which you may not realistically interested in doing business. A lawsuit that proceeds to judgment in many of these jurisdictions may well be enforceable in the United States, and therefore cannot be ignored. If you do not wish to offer your product or service to (and risk being sued anywhere in) the entire world, it makes considerable sense to limit the terms of your website to reduce the risk of lawsuits from your Internet activity. There are other ways to do this as well, including requiring visitors to your website to agree to certain terms as a condition of accessing the information, products or services you provide.

The law relating to the Internet and technology is developing almost as fast as the technology itself. The purpose of this article is not to detail every possible source of liability in Internet activity, but instead to emphasize the significant risk, and the need to proceed with considerable care. Particular attention should be paid to privacy rights of visitors to your site, statements made about others, the use of information you derive over the Internet, and the use of intellectual property of others.

5. **Advertising/statements about others (truth is not a defense)**: Advertising claims, and statements about others (or which could have bearing on the business of others) should be reviewed in advance by a qualified attorney. ***Truth is not a defense*** to a number of powerful business tort claims like Intentional Interference with Contractual Relations and Intentional Interference with Prospective Economic Advantage.

6. **If your business is open to the public, failing to comply with access laws:** Perhaps the largest single group of lawsuits being filed in California is the ADA Access Lawsuit. One plaintiff alone is known to have filed 850; law firms have filed thousands. The biggest problem in these cases is the misunderstanding of the law by lawyers and clients alike. If your business is open to the public, you should get a **written legal opinion** from a qualified expert if you think you are not subject to this 10 year old law.

7. **Failing to take proactive steps to reduce the risk of lawsuits from employees:** Employment-related lawsuits can be among the most costly for the average employer to litigate. Despite this, many employers customarily fail to take reasonable precautions which can reduce the likelihood, if not prevent, these problematic suits. The following is not a comprehensive list, but identifies just a few practices which seem to virtually invite claims:
 - a. **Failure to run checks on prospective employees:** Some of the worst people make the best first impressions. Given the cost of an employment-related lawsuit, a thorough background review (with the employee's written consent) and lawsuit search may be the single best investment an employer can make.

 - b. **Failure to use a written employment agreement; confirm policies and reprimands in writing:** Some lawyers have been reluctant to advise employers to have written employment agreements for fear they could create unintended expectations for employees. We'd politely suggest that a well-drafted employment agreement should do exactly the opposite—it should eliminate any doubt about the requirements and expectations of the employer. For example, a prospective employee's agreement to, or acknowledgment of, permissible sick days, working hours, personal Internet usage and other important policies and procedures might stave off a future lawsuit better than the same terms in an employee handbook.

 - c. **Failure to adequately document terminations:** Companies exist in perpetuity, but even the best employees come and go. Because terminations are inevitable, the failure to plan for them is inexcusable. Few employers have appropriate documentation when a termination is required and even fewer handle the termination process in a manner to minimize the risk of claims.

8. **Failing to strictly comply with laws about "OPM" (Other People's Money):** Sarbanes-Oxley and the recent scandals in public companies are increasing evidence of the duty you undertake when you use the funds of others (whether partners, investors or lenders) in business. Although most of the laws and publicity, to date, have involved public companies, private investors, lenders and partners have a growing expectation of similar standards, and many think it is only a matter of time before judges and legislators begin to apply them to non-public firms. Think carefully about the true cost (including lawsuits) of using the money of others in your business—it should be factored into any financial decision you make.

9. **Failing to take out all appropriate insurance and an umbrella policy**: If you fail to take out reasonable amounts of insurance for an activity for which insurance is generally purchased and available, you may not be entitled to corporate liability protection if sued. Additionally, insurance can be surprisingly useful in defending meritless lawsuits, and coverage often comes from unexpected sources. Defending a lawsuit through trial can cost \$100,000 to \$500,000—if those are not small numbers to you, you will probably be forced to pay money to settle a meritless claim.

10. **Failing to protect your personal assets**: Even if you are doing business as a corporation or LLC, you can always be sued personally. While the protection that a corporation or LLC provides is an absolutely essential first step, too often, the need to protect personal assets is ignored. You can always be sued personally for any matter in which you are, or should be, involved. If you are, any assets held in your own name are vulnerable to the claims of those suing you.
 - a. **Common Misconceptions**. Many people incorrectly think that each of the following can protect their assets:
 - i. **Living Trusts**: There is generally no asset protection from a living trust, unless it is *irrevocable* (i.e., can't be changed); almost all living trusts are revocable and offer no asset protection whatsoever.
 - ii. **Fictitious Name Statements (i.e., DBAs)**: provide no asset protection.
 - iii. **Transfers to Spouse/Family Members**: In many cases, such transfers can be ineffective; in all cases, they subject the asset to claims against the recipient. Transfers to spouses may still be subject to community property claims without a valid, binding and effective transmutation agreement.
 - iv. **Individual Retirement Arrangements (IRAs)**: Unlike an ERISA-qualified pension plan (which has strong asset protection), the asset-protection of most IRAs is limited, and may not be available when you need it.
 - b. **Possible Solutions**: The scope of this report cannot include a comprehensive discussion of all available means to protect personal assets, or even the selected few summarized below.
 - i. **ERISA-Qualified Pension Plans (not IRAs)**: These are available through most brokerage houses for very little and offer some of the strongest asset protection available.
 - ii. **Family Limited Partnerships (FLPs) and Family Limited Liability Companies (FLLCs)**: In addition to substantial tax and estate planning

advantages, FLPs and FLLCs have offered strong asset protection to families for decades.

- iii. **Offshore trusts**: Certainly not for everyone, these arrangements are becoming less expensive and more common, and provide a level of protection and anonymity which can't be matched in the U.S.

Finally, an "eleventh commandment" relating to the risk of lawsuits

11. **Avoid the appearance of profit or wealth**: If you or your firm appear to be profitable or successful, it may well be a question of "when" and not "if" you will have to deal with an opportunistic lawsuit. Some can be avoided entirely through proper planning; the severity of those which can't can be reduced.

It has been said that it is essential to learn from the mistakes of others, because you won't live long enough to make them all yourself.

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