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Forming a Small Music Business: The Who Meets the Whys and Wherefores

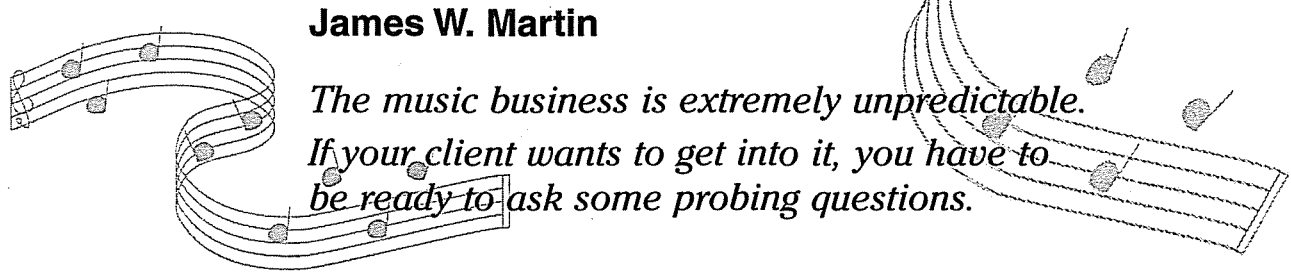
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Forming a Small Music Business:

The Who Meets the Whys and Wherefores

James W. Martin



The music business is extremely unpredictable. If your client wants to get into it, you have to be ready to ask some probing questions.

REMEMBER THE WHO? Remember when they were young? Well, I do. That's when I had my first music client. It was a local band that could cover the Who, the Beatles, the Stones, and myriad other rock bands so well you'd think they were from England. They were good, they were young, they were energetic, and they thought they would be the hottest new band by the time the sun came up tomorrow. But they

never made it. Less than a month after I met with them, they split up, never to be seen or heard from again. And they didn't pay my bill.

That's a lesson a first-year lawyer never forgets. Music is a volatile business; choose your clients carefully. Just because they sound like they're on the radio doesn't mean they are or ever will be. So I spent the next 25 years of my law practice developing a more analytical ap-

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proach to advising clients about the legal side of forming a small business, whether it's an art museum, a jewelry store, a contractor, an artist, or a record company. This article discusses what it boils down to.

THE WHO • These are questions you need to answer in your first meeting.

1. Who's Your Client?

- Avoid multiple clients;
- Is it an entity or an individual?
- Is it the one paying you?
- Do a conflicts check; and
- Prepare an engagement letter (see http://www.jamesmartinpa.com/ltr_eng.htm).

2. Who's Not Your Client?

- Tell them; and
- Put it in writing.

3. Who's Putting in Money?

- Will they be directors, officers, managers, or employees active in the business?
- Will they be passive?

4. Who's Putting in Services?

- Will they be paid compensation as employees or be paid stock for services?
- Have they considered the tax effect of this?

5. Who's Putting in Intellectual Property?

- What exactly is it?
- Do they own it?
- Is it registered or registrable?

6. Who's the Lender?

- Is it a bank?
- Is it really an investor disguised as a lender (see securities laws)?
- What is the loan collateral?

7. Who's the Customer?

- Is it a business (wholesale) or consumer (retail)?
- Where is it located?
- How many are there?

8. Who's the Employee(s)?

- Are they the same as the owners?
- Are they the same as the managers?
- Do they have jobs now?
- Do their present employers know (trade secret, noncompete, breach of loyalty issues)?

THE WHYS • These are further questions you need to answer before you get too far into the work.

1. Why Has Your Client Come to You?

- What exactly does your client see as your role?
- What does your client not see as your role?
- Do you agree?

2. Why Will the Owners Invest?

- What's in it for them? Income? Growth? Fame? Celebrity? Glamour? Family? Enjoyment?

3. Why Will the Lenders Lend?

- Is there income to pay the loan payments?
- Are there assets to use as collateral?
- Is the business plan sound?

4. Why Will the Customers Buy?

- Is there competition?
- Is your client's price lower?
- Is your client's product better?
- Is what your client's doing differently *legal*?

5. Why Can They Make a Profit?

- Will their income exceed their expenses?
- When and for how long?

- How much working capital do they have?
- How long will it take to break even?

6. Why All This Now and Not Before or Later?

- Have they done this before?
- If so, what happened?
- If not, why not?
- Can this be done better later?

THE WHEREFORES • These encompass what you do with the answers to the above questions (these are summarized in the New Entity Checklist which appears as the Appendix to this article).

1. Diagram

Draw a diagram and fill in what you know:

- Create a business entity diagram for the client that covers the basics for the type of entity anticipated (e.g., assets and liabilities, income and expenses, management structure, employees, and so on);
- Do this in the first meeting with the client;
- Use it as a graphical outline of points to discuss;
- Your client can point to it and tell you who's doing what and why.

2. Entity

Choose the simplest entity that works:

- Corporations are still the simplest entity that limit liability;
- Florida has 646,000 active corporations and just 42,000 active limited liability companies. Half of those LLCs were formed in the last two years. So LLCs are hot right now, but they are not treated the same in all 50 states and have little guidance in the way of case law. Much commentary has been written about them, including whether the concept of piercing the corpo-

rate veil should apply to LLCs. (The consensus is that it should);

- General partnerships and limited partnerships can also limit liability now.

3. CPA

Bring in a CPA and defer tax, business planning, and accounting matters to the CPA:

- Choosing an entity other than a corporation should be based on tax factors per CPA advice;
- The CPA should apply for tax ID number and elect S (if corporation is to be S corp);
- The CPA should review business plan;
- The CPA should set up accounting system customized to that business; and
- The CPA should prepare or review state and federal income tax returns, employment tax returns, sales tax returns, ad valorem tangible personal property tax returns, and intangible personal property tax returns.

4. Securities

Bring in a securities lawyer if there is an investment:

- An investment is a security, whether it's called stock, share, partnership interest, membership, or nothing at all;
- Even a note (loan) can be a security if sold as an investment;
- Securities must be registered under state and federal laws before being offered or sold;
- Registration is very expensive;
- Most small businesses can fall within an exemption from registration *if* detailed documentation and other requirements are followed;
- Securities lawyers know the details that must be followed. (Few lawyers who are not securities specialists know them); and
- Securities laws have both civil and criminal penalties.

5. Owners' Agreement

Discuss provisions for shareholder agreements, partnership agreements, and LLC operating agreements:

- Partnerships need partnership agreements, and limited liability companies need operating agreements;
- Corporations do not need shareholder agreements, but they are a good way for shareholders to set forth basic agreements such as the right to be elected a director, receive equal compensation, and the like;
- The drafting that goes into an agreement is what makes partnerships and LLCs more expensive than corporations; and
- A well-drawn agreement will reflect the actual understanding of the parties, so it needs to be discussed and reviewed with them.

6. Employment Agreement

- Discuss and prepare employment agreements for key employees; and
- Discuss and prepare confidentiality and non-compete agreements.

7. Intellectual Property

Consider trademark registrability when choosing a name and logo:

- Explain trademark laws in general and use of TM for unregistered common law marks and use of ® for federally registered marks;
- Explain copyright law in general and use of ©, whether or not registered;
- Discuss signs, letterhead, and business cards;
- Discuss Web site domain name, copyright and trademark issues; and
- Explain need for work for hire and assignment of copyright agreements with independent contractors.

8. Fictitious Name

Discuss registration in applicable jurisdictions. If the fictitious name is not to be registered, use exact name including "Inc.," "LLC," "LLP," or "LLLP":

- Florida requires registration of fictitious name with Secretary of State if vary from actual name in any way;
- Some states refer to this as assumed names;
- Registrants in some states need to publish fictitious names in the newspaper.

9. Jurisdictions

Qualify the entity in other states and countries where business will be done:

- What amounts to "doing business" is a question of state law and varies from state to state;
- Generally having an office or agent in that state triggers a requirement to qualify with that state's Secretary of State; and
- For information on qualifying in all 50 states, including forms, see www.secst.com.

10. Real Estate

Review leases and real estate purchases.

11. Equipment

Review major equipment purchases and leases.

12. Insurance

Bring in an insurance agent and discuss coverage limits and exclusions. Coverages to discuss include:

- Business owners' package;
- Property (fire and all risks, flood, plate glass, valuable records, electronic data processing, property of others, transit, foreign);
- Liability (general, products, overseas, foreign, worldwide, environmental, professional [errors and omissions], owned and non-owned vehicle, umbrella [excess]);

- Employees (workers' comp, employee group medical, employee group disability, employee dishonesty, key person life, key person disability); and
- Special (performance and payment bonds, events).

13. Licenses

Discuss city, county, state, and federal licenses required or desired. Consider local occupational licenses and zoning, including noise ordinances and home occupations.

14. Suppliers

Discuss and review or prepare contracts and relationships with major suppliers.

15. Banks

Discuss bank accounts, FDIC coverage, sweep accounts, safe deposit boxes, authorized signers, and the like.

16. Goods and Services Contracts

Discuss, prepare, and review contracts for the specific goods and services the entity will produce. This is the primary work that you will do after the entity is formed. Your work will include:

- Drafting form contracts;

- Negotiating deals, and
- Preparing deal contracts.

17. Signing Contracts

Discuss the proper way to sign contracts to avoid personal liability. To avoid liability, be sure to use the words "by" and "as":

ABC, Inc., a Florida corporation

By: _____

John Doe, as its President

18. Uniform Business Report ("UBR")

Discuss filing UBRs (annual reports) in applicable jurisdictions. Failure to file may result in personal liability.

19. Meetings

Discuss formalities to be followed such as minutes and meetings.

20. "CYA"

Confirm all of the above in written letters to client, CPA, insurance agent and others; copy your client on all correspondence.

CONCLUSION • That's it. Ask eight "Whos" and six "Whys," and then do 20 "Wherefores." The music gods will surely bless you and your client, even if the music stores don't.

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APPENDIX

New Entity Checklist

Subject	Issues
Ethics	<input type="checkbox"/> Who is the client? Investor? Talent? Intellectual property owner? <input type="checkbox"/> Multiple clients <input type="checkbox"/> Conflicts check <input type="checkbox"/> Engagement letter www.jamesmartinpa.com/pubs.htm
Entity	<input type="checkbox"/> Discuss types <input type="checkbox"/> Discuss jurisdiction
Names and logos	<input type="checkbox"/> Fictitious name <input type="checkbox"/> Trademark: Common law™ (no registration required) Federal® (registration required) <input type="checkbox"/> Copyright: © 2001 John Doe Enterprises, Inc. All rights reserved. (no registration required) <input type="checkbox"/> Letterhead & business cards—correct spelling; trademark symbol <input type="checkbox"/> Signs—correct spelling; trademark symbol
Licenses	<input type="checkbox"/> City, occupational <input type="checkbox"/> Business or professional
Taxes and accounting	<input type="checkbox"/> CPA <input type="checkbox"/> Business plan <input type="checkbox"/> Accounting system <input type="checkbox"/> IRS tax ID number <input type="checkbox"/> IRS S election <input type="checkbox"/> Federal & Fla. employment taxes <input type="checkbox"/> Federal & Fla. income taxes <input type="checkbox"/> Fla. intangible tax <input type="checkbox"/> Fla. sales tax <input type="checkbox"/> County ad valorem tangible tax
Insurance	<input type="checkbox"/> Business owners' package <input type="checkbox"/> Fire and all risks <input type="checkbox"/> Flood <input type="checkbox"/> Plate glass <input type="checkbox"/> Valuable records <input type="checkbox"/> Electronic data processing <input type="checkbox"/> Property of others <input type="checkbox"/> Liability <input type="checkbox"/> Products liability <input type="checkbox"/> Professional liability <input type="checkbox"/> Umbrella liability

- ☐ Owned and non-owned vehicle
- ☐ Workers' compensation
- ☐ Employee group medical
- ☐ Employee group disability
- ☐ Employee dishonesty
- ☐ Transit
- ☐ Foreign
- ☐ Performance and payment bonds
- ☐ Events
- ☐ Key person life
- ☐ Key person disability

- Banks and cash management
 - ☐ Authorized check signers
 - ☐ Loan authority
 - ☐ Checking account
 - ☐ Money market account
 - ☐ Repurchase agreements
 - ☐ Sweep account
 - ☐ Foreign currency exchange
 - ☐ Foreign currency forward contracts

- Office and other space
 - Lease
 - ☐ Location
 - ☐ Term
 - ☐ Rent
 - ☐ Personal guaranty
 - ☐ Option to renew
 - ☐ Environmental site assessment Phase 1
 - ☐ Utilities
 - Purchase
 - ☐ Legal description
 - ☐ Price
 - ☐ Financing
 - ☐ Closing
 - ☐ Title insurance
 - ☐ Survey
 - ☐ Inspection period
 - ☐ Environmental site assessment Phase 1
 - ☐ Zoning (city)
 - ☐ Improvements (state construction lien law if applicable)
 - ☐ Water use (water supply authority)
 - ☐ Water discharge (regional water management district)
 - ☐ Environmental (sound ordinances)
 - ☐ Real estate lawyer

Owners and
investors

- ☐ Securities lawyer
- ☐ Promoters
 - Investors ☐ Passive
 - ☐ Active
 - Securities laws ☐ State
 - ☐ Federal
- ☐ Shareholders buy-sell agreement
- ☐ Shareholders voting agreement
- ☐ Proxies

Lenders

- ☐ Terms: principal, interest, term
- ☐ Collateral: fixed assets; inventory; accounts receivable; trademark & other intellectual property; shares of stock; real estate
- ☐ Personal guaranty
- ☐ Equity participation
- ☐ Secured creditor perfection: security agreement, UCC-1, mortgage, intellectual property collateral assignment

Officers

Directors

Incorporators

Registered agent

- ☐ Client, attorney, CT Corporation System

Employees

- ☐ Noncompetes; confid agreements; policy manuals; trade secret policy

Uniform business
report (UBR)

- ☐ Accuracy

Qualifying to do
business in
other states

- ☐ www.secst.com ; registered agent (CT Corporation System)

Merger with
other entities

- ☐ Applicable state statute

Business
relationships

- ☐ Contracts; work-for-hire agreements