



Starting Your Own Practice

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The goal of many consultants and engineers is having their own practice. For these people, the more planning they do before leaving their current positions, the better their chances for success.

This article addresses common questions engineers ask when starting their own practice. However, laws governing design professionals and their businesses differ significantly from state to state, so engineers thinking about starting a business should seek counsel familiar with locally applicable laws.

Can I solicit business from my employer's clients before I leave?

Employees owe a duty to employers to act in the employer's best interests. Therefore, design professionals normally should wait until they cease employment before approaching clients of their former employers. An employment agreement may restrict solicitation of the employer's clients for an additional period.

Can an employment agreement keep me from competing with my employer or soliciting its clients after I leave?

Employment agreements restricting competition are not enforceable if drafted too broadly. For instance, an employment agreement restricting an engineer from practicing anywhere in the world for 20 years after ceasing employment would not be enforceable because the time and geographic scope are unreasonable. However, an employment agreement with reasonable time and geographic scope can be enforced.

Employment agreements that restrict soliciting business from an employer's clients can be enforced, even after the employee leaves. Employees with signed employment agreements should seek counsel's advice in determining rights and obligations under the agreement.

How should I give notice of resignation notice?

If an employment agreement is signed, it may specify timing and the manner in which notice should be given. If no agreement is signed, then notice is not legally required. However, it is usually wise to give enough notice so that the hope of having a future relationship with the employer is not ruined. If there is no employment agreement and plans call for soliciting the employer's clients, notice should be given in writing, noting the last day of employment.

Can I take drawings and designs with me if I leave my employer?

Written designs and drawings are owned by employers, and employees cannot take them without permission even if they created them. This does not mean ideas and concepts learned on your job cannot be used.

In what legal form should I run my new business?

A number of factors that cannot be thoroughly explored in this article enter into the decision. Design firms operate as sole proprietorships, partnerships or corporations.

Sole proprietorship is the simplest legal form. A sole proprietor need comply with very few legal requirements other than those pertaining to state licensing and business permits. Sole proprietors are personally liable for business debts.

Partnership is the simplest form in which two or more design professionals conduct business. As with a sole proprietorship, few legal requirements, other than professional licensing and business permits, apply. Partnerships are less flexible than sole proprietorships because more than one person is involved in management decisions, and partners must account to each other for partnership activities. A significant drawback is that partners are jointly and severally liable for all partnership debts. In addition, personal creditors can reach partnership assets.

Operation and management of a partnership is controlled by oral or written agreement. State law decides issues left unaddressed. Many design professionals erroneously perceive partnerships as less expensive to form than corporations, but this is because they do not spend the time or money to prepare a partnership agreement. A well-drafted partnership agreement can be expensive but can save money in the long run by anticipating unexpected problems.

For example, assume A and B form a partnership and share profits equally. A invests \$100,000 and B, who has a lot of talent but no money, promises to do a majority of the work instead of making a monetary investment. Both A and B are anxious to start the practice, deciding "to worry about everything else later" and never prepare a partnership agreement.

B works day and night to turn a profit. After a few months, however, the partnership loses the \$100,000 A contributed. A, who did very little work, decides not

to invest more money, and the partnership is dissolved.

One might believe A and B parted company owing each other nothing. However, logic does not always coincide with law. All states, with the exception of Louisiana, have adopted some form of uniform partnership act. Under the act, B owes A \$50,000—half the financial loss incurred—even though B performed most of the work. In addition, B would not be entitled to any compensation. Had these issues been addressed at the outset in a written partnership agreement, B could have been paid and avoided this liability.

Corporation is the most complex form of business and is less flexible than a sole proprietorship or a partnership with respect to control and operation. State law and the corporation's own internal rules, known as the articles of incorporation and bylaws, define the operation's structure and control.

Contrary to popular belief, corporations are not more burdensome to run than partnerships. They must follow certain procedures that do not apply to partnerships or sole proprietorships, such as filing annual reports with their state of incorporation and in the states they do business, giving formal notice of meetings, and documenting certain corporate actions. However, these forms usually take only a few minutes to fill out.

In many states, design professionals can choose from a general business corporation, close corporation or professional corporation. In most states, any business can incorporate as a general business corporation. For the most part, these corporations have no statutory restrictions on stock ownership or who can be a director.

Close corporations and professional corporations, however, do have statutory provisions affecting stock ownership and directors. A close Design firms operate as either sole proprietors, partnerships or corporations corporation generally has a limited number of owners and simplified formalities to ease administrative burdens otherwise placed on closely held businesses by general business corporation statutes. Close corporation laws allow substantial restriction on the transferability of closely held business stock, discouraging stock transfer without the other owners' approval.

Professional corporations restrict ownership and directorship to licensed professionals of design firms.

The greatest advantage of doing business in a corporate form is that liability is more limited than in a sole proprietorship or partnership. However, protecting corporate limited liability is, by no means, absolute. Design professionals are liable for performed and supervised work. Bankers, landlords and other creditors often ask for personal guarantees from some, if not all, shareholders before extending credit. Shareholders also may be liable for other federal and state corporate taxes not properly disclosed and paid by the corporation.

What kind of insurance will my business need?

The unfortunate reality of professional life is that a practice stands a strong chance of being named in a lawsuit. Therefore, most engineers purchase malpractice insurance. In addition, death and disability insurance should be considered for all key professionals.

How much business do I need before leaving?

Talent alone does not make a practice successful — it needs clients. As a legal matter, no clients are needed to start a business. However, as a practical matter, a fairly clear idea of revenue sources is needed before the business is formed. Current employers or other friends in the practice may help garner business.

How much money will I need to open my own practice?

A realistic operating budget is needed, covering start-up operating costs and other amounts necessary to survive until the first receivables are paid. Clients often do not pay bills on time, which a budget should reflect. When preparing a budget, take into consideration hidden expenses, such as library costs, office supplies, furniture, interest payments on borrowed money, secretarial expenses and utility costs.

Will I need a banker, lawyer and accountant?

A banker helps finance the business, establishes necessary bank accounts and gives general business advice. A lawyer may be needed to draft a partnership agreement or help incorporate. A lawyer also helps prepare or review contractual agreements. An accountant helps organize business records, especially accounts receivable and payable. An accountant also will be needed to help file the many state and local income tax and withholding tax forms.

Anything else?

Once finances are straightened out, determine the ability to provide services and the capacity to do so. Keep abreast of the licensing requirements of the company's jurisdiction and the jurisdictions in which it conducts business. As with most service businesses, cash flow is a key to survival. Therefore, keep a close eye on accounts receivable and do not be afraid to bill for services performed.

About the Author

Mark C. Friedlander is a partner in the Construction Law Group at the law firm of Schiff Hardin LLP. He obtained his B.A. from the University of Michigan in 1978 and his J.D. from Harvard Law School in 1981. He is currently an adjunct professor at the University of Illinois at Chicago School of Architecture and a lecturer at Northwestern University's Engineering School, and had lectured at the Illinois Institute of Technology School of Civil Engineering from 1987-89, at the Engineering School of the University of Wisconsin in 1988 and 1990, and the Architecture School of the Georgia Institute of Technology in 1997-98. Mr. Friedlander concentrates his practice in construction law and litigation with particular emphasis on design-build methods of project delivery.

Former Schiff Hardin associate Kerry T. Smith also contributed to this article.

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