

# Symposium on Legal Problems of Small Business

## FOREWORD

Everyone who has studied small business recognizes its tremendous importance to the economy of this country and the high desirability of strengthening small business enterprises and stimulating their development. As Roy L. Brooks points out in his article in this issue, entitled "Small Business Financing Alternatives Under the Securities Act of 1933," small businesses provide more private employment than any other business sector of the economy and account for over 40 percent of the gross national product and nearly 50 percent of the private sector's output. In an address at the University of Missouri-St. Louis, Milton Stewart, Chief Counsel for Advocacy for the U.S. Small Business Administration, stated that two of every three jobs created in this country are created in companies which employ fewer than 20 people.<sup>1</sup>

Small businesses in infinite variety are constantly springing up. They are the vehicles through which individual business people or small groups of business people test new business ideas, sometimes "long shot" ideas. Small businessmen often initiate ventures on the basis of "faith" or "hope" rather than an objective analysis of the chances of success. To use an oil field term, they do a great deal of "wildcatting."

Small business is free enterprise in its greatest glory. Despite an alarming increase of governmental regulation and red tape, small business still offers great freedom for individual genius, resourcefulness, and risk taking. Each year thousands of business people with widely differing ideas and talents, in widely different business settings, launch a multitude of new business enterprises. Many unexpectedly spectacular successes result. The new businesses exploit promising inventions, develop new products and services, and gain acceptance for those products and ser-

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<sup>1</sup> St. Louis Globe-Democrat, April 28, 1980, at 18A, col. 3.

vices from the public. A surprising number of these small businesses not only survive but grow and prosper. Many eventually "go public" or are absorbed by big business enterprises through mergers or acquisitions.

Yet more than half of the businesses that are started fail within five years. These business failures are attributable to many causes. A principal cause is a lack of experienced and resourceful management. Another cause is under-capitalization: sufficient long-term capital is tremendously difficult for a small business to obtain. A third is the simple fact that many small business people take "high risks." They venture into untried, untested, and uncharted areas of operation.

As I have pointed out elsewhere,<sup>2</sup> disputes often occur among small business owners. Such dissension can bring tremendous losses to an enterprise. Among those losses are impaired efficiency of management, heavy loss of working hours by key personnel, expensive litigation and diminished confidence in the business and its managers by banks, suppliers, customers, and employees. Occasionally strife, litigation, and unfavorable publicity completely destroy a business.

Equally important, a potential source of much-needed risk capital for small business is threatened by the unfortunate fact that those in control of some small businesses mistreat owners of minority interests. Most small businesses depend largely upon individuals in the local community for risk capital. Certainly the frequency of squeeze-outs and other oppression of minority owners has become well-known to many prospective investors. Because of the dangers of oppression in a close corporation or other closely held enterprise, some persons undoubtedly choose to purchase securities in publicly held corporations or even permit their accumulated funds to remain idle rather than risk the purchase of a minority interest in a closely held enterprise.

Most small businesses cannot effectively enter national credit markets. The minimum financing which the securities market will handle at the present time is around two or three million dollars. As the sources of equity capital open to large corporations are not available to small businesses, it is all the more important that investment in small businesses be made attractive to local investors and they be given full assurance that they will

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<sup>2</sup> F. O'NEAL, *OPPRESSION OF MINORITY SHAREHOLDERS* § 4 (1975).

receive just treatment at the hands of their fellow participants.

Congress, some state legislatures, and various governmental agencies have taken measures in recent years to aid small businesses. For example, in 1958 Congress enacted the Small Business Investment Company Act to encourage the establishment of small business investment companies, that is, private corporations which provide equity and long-term funds for small businesses and operate under the supervision of the Small Business Administration. On the state level, a considerable number of states have enacted special close corporation statutes which facilitate the organization and operation of small corporations and specifically sanction shareholders' agreements and other preventive law measures designed to avoid insofar as possible disputes among shareholders, settle quickly those which do occur, and protect minority shareholders against mistreatment. At the administrative level, the Small Business Administration has long provided management aids and financial assistance to small business.

Top-flight legal literature is greatly needed to provide guidance to lawyers in general practice who counsel small business enterprises. This symposium is a significant step toward filling that literature gap.

Professor Harry J. Haynsworth IV of the University of South Carolina School of Law writes in this issue on "Competent Counseling of Small Business Clients." Professor Haynsworth has spent a considerable part of his distinguished legal and teaching career in the study of small business and in writing about and drafting legislation concerning small business enterprises. His article is by far the most comprehensive, authoritative and useful guide thus far for lawyers counseling small business clients. As Professor Haynsworth points out, counseling small business clients cuts across many different fields of law. A small business client may have a legal problem in any of a number of areas of law, including agency, contracts, insurance, anti-trust, the Uniform Commercial Code, bankruptcy, securities regulations, patents, trademarks, copyright, or trade secrets. Many non-legal business considerations must also be taken into account. Not only must a business plan be legal, it must also be workable from a business and economic point of view.

Among other things, Professor Haynsworth notes the dramatic increase in recent years in the number of malpractice law suits and disciplinary claims against lawyers. As he says, "increased

complexity, uncertainty, and exposure to ethic and malpractice sanctions characterize the milieu in which the small business practitioner must operate."<sup>3</sup>

Roy L. Brooks, in his article on "Small Business Financing Alternatives Under the Securities Act of 1933," describes the small business financing alternatives that are available under the securities laws and regulations and charts in detail the procedures to be followed in utilizing the various alternatives. The footnotes of the Brooks article are lengthy and packed with useful information.

Daniel William Fessler, Professor of Law, University of California at Davis, in his article titled "The Fate of Closely Held Business Associations: The Debatable Wisdom of 'Incorporation,'" examines "the wisdom or folly implicit in the basic proposition: that a state should modify its corporate law so as to accommodate the asserted special needs of a closely held entity." He states the essential arguments for a negative position on this proposition as follows:

that corporate status is a privilege conferred upon certain members of society at the demonstrable expense of others; that this privilege is extended upon the assumption that it facilitates combinations of capital and management skills otherwise unattainable to society; that the essence of a business held by few persons with entry closed to outsiders is the exact opposite of the combination fostered by incorporation; that the "advantages of incorporation" (essentially limited liability and tax concessions) are properly tied to the functions of that status; and that the bid for such advantage by entities unable to perform the capital formation and management centralization function should be rejected.

A sub-theme of Professor Fessler's article is that the desire of business people to incorporate "may well spring from profound ignorance of the advantageous possibilities offered by alternatives such as general and limited partnerships and joint ventures."<sup>4</sup>

The student comments in the symposium are impressive in number and in content. They cover a wide range of subjects, including deadlocks in close corporations, the accumulated earnings tax, securities law applicable to small business enterprises,

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<sup>3</sup> Haynsworth, *Competent Counseling of Small Business Clients*, this issue at 399.

<sup>4</sup> Fessler, *The Fate of Closely Held Business Associations: The Debatable Wisdom of "Incorporation,"* this issue at 473.

antitrust problems of small businesses, franchising, partnerships, limited partnerships, joint ventures, independent motion picture financing, age discrimination in small businesses and product liability insurance for the small manufacturer.

I salute the editors of the *University of California Law Review* on the size and high quality of this symposium. It is indeed a valuable contribution to the legal literature on small business.

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1980