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# Legal tips for SMEs

Our [Corporate and Commercial](#) team have set out some of their top legal tips for small and medium-sized enterprises

## Different business structures and how to ensure you have the right one

For the majority of SMEs, a private limited company or limited liability partnership (LLP) will be most appropriate. Some very small enterprises might prefer the simplicity of being a sole trader, however, there is limited room for expansion and there is no limitation on liability as regards debts and legal actions for the owner.

Reasons to choose a private limited company include:

- The shareholders have their liability for the company's debts limited to the amount of share capital they invest (subject to certain exceptions) while their personal assets are not exposed to company creditors.
- The company has a potentially larger pool of investors than a LLP from which it can gain equity finance.
- A private limited company allows for employee share incentive schemes which can be a useful way to incentivise management to grow the business.

Reasons to choose a LLP include:

- The partners have their liability for the LLP's debts limited to the amount of capital they invest.
- The restrictions applicable to companies and capital maintenance do not apply to LLPs.

An LLP must have at least two members and if they have unequal capital and/or profit shares a members' agreement is vital to prevent the default rules from applying.

It is essential that the business owners take tax advice as to how they wish to structure their business as different structures will have different tax consequences for both the owners and the business entity involved.

## Commercial contracts

SMEs should ensure that they have robust legal protection under their commercial contracts such as a bespoke set of terms and conditions if they are selling goods or supplying services. Having comprehensive commercial contracts in place that provide adequate legal protection will protect the SME from potential warranty claims or breaches of contract by a contract counterparty. Significant warranty claims or claims for breach of contract can have serious financial consequences for SMEs.

## Share buybacks

There are a number of reasons why an incorporated SME may wish to effect a buyback of some of its shares, for example: to return surplus cash to shareholders, to increase earnings and net assets per share or to provide an exit route for shareholders. Under the Companies Act 2006 (CA 2006) there are two different types of buyback: market purchases and off-market purchases. We tend to predominantly deal with off-market purchases by private companies who are funding the buyback out of distributable profits (rather than out of capital).

There are very specific legal requirements under CA 2006 with regard to share buybacks and it is essential that the SME gets proper legal advice if this is something that it is looking to achieve. If a share buyback is not carried out strictly in accordance with the requirements under CA 2006 then the transaction is likely to be unlawful and void. Worst case scenario, the transaction may need to be unwound and the repurchased shares may still be treated as being in issue and held by the selling shareholder. Defective share buybacks are increasingly coming to light through due diligence in sale and purchase transactions; a defective share buyback transaction can de-rail the sale transaction and, at the very least, result in expense and delay.

## Directors' duties under the Companies Act 2006

Another area where we see SMEs encounter legal difficulties is if the SME has not followed the legal requirements and best practice with regard to its corporate governance.

The CA 2006 has specific rules around directors' duties (e.g. the duty to promote the success of a company for the benefit of its members as a whole) which, if not followed, may result in a fine or the director being disqualified. The directors of an incorporated SME should be aware of these duties and should be actively considering them as they conduct the SME's business.

## Statutory books

There are specific rules around what statutory books an incorporated SME should maintain (e.g. a register of members) and we often come across situations where a company's statutory books are either incomplete, incorrect or non-existent. A company's statutory registers of allotments, members and transfers are, effectively, its documents of title. If an allotment or transfer of shares is not registered in the company's statutory books the allotment or transfer is not effective. Planning ahead is essential as it is often very costly to rectify incorrect statutory books or create non-existent statutory books.

It should be noted that since 30 June 2016 a private company can elect to keep certain of its registers at Companies House, such as the register of members, register of directors, register of directors' residential addresses, register of secretaries and "Persons with Significant Control" (PSC) register. There is a specific process under CA 2006 for making this type of election and also specific filing requirements so we would advise that you take legal advice if this is something that you wish to achieve.

## Data protection

Compliance with the General Data Protection Regulation (GDPR) and the Data Protection Act 2018 (DPA) is essential for SMEs. If they have not already, SMEs should be conducting a personal data audit and verifying what personal data they hold and how that personal data is secured. They should identify where they are a "data controller" and where they are a "data processor" and they should also be reviewing their privacy policies and implementing data sharing agreements (if appropriate). A breach of DPA could mean a significant fine for the SME as well as adverse publicity impacting upon a SME's reputation and business.

## Key things for SMEs who employ members of staff to consider

The majority of UK employment law applies to employers regardless of the size of their organisation. This includes (but is in no way limited to) discrimination and whistleblower protection and so it's important to have an understanding of the basic rights and obligations so employers treat employees in the correct way. This can be achieved in part with an employee handbook although employers don't need a policy or procedure for everything!

New employees must be issued with a statement of employment terms within two months of their employment start date which must capture certain specific information, for example, pay, hours, holidays and benefits. This will focus on key areas and employers should check that the terms comply with minimum legal requirements, for example minimum wage, rest breaks, minimum holiday, minimum notice obligations and auto-enrolment pension entitlement.

It's also worth focusing on business protection requirements such as post-termination restrictions and

intellectual property. This is especially the case as employees progress within the business as their original contract may no longer be fit for purpose. As such, contracts should be reviewed and updated ahead of any promotion.

You can find more information on employment and HR requirements for businesses [here](#).

## How can small businesses prepare for Brexit?

Small businesses should conduct an audit of its customer and supplier base and determine the percentage of those that are based outside of the UK but within the EU. This will help to highlight how much of the business will be affected by any changes to import and export costs made by the Brexit deal (or “no deal”) and which of these, particularly suppliers, must be kept or can be changed. Small businesses should also review their employees to determine what percentage of them originate outside of the UK but within the EU. Given the lack of certainty regarding EU workers, SMEs need to be prepared going forwards for a downturn in availability of workers from EU countries.

## In summary, here are our top legal tips for SME owners:

- Ensure that you have legally robust commercial contracts in place: review your terms and conditions, your supply and distribution agreements (if applicable), service agreements and any other commercial contracts that your business may use and, if they are outdated, ensure that you get some good legal advice so that you have a robust set of documents.
- Review your business’ corporate governance procedures: do the directors of the company know what their duties are under CA 2006? Are your statutory books up to date and correct? Are your Companies House filings correct and up to date?
- Review your business’ practices for GDPR and DPA compliance: conduct a personal data audit; determine when your business is a “data controller” and when it is a “data processor”; keep a paper trail of your audit and your processes to monitor compliance (e.g. minutes of a board meeting discussing GDPR/ DPA compliance); and, review your privacy policies and check whether you should have any data sharing agreements in place.

For SMEs, seeking out legal advice and addressing any legal issues well before they are encountered is key. If you would like further advice, please do not hesitate to contact Gerard or any member of our [Corporate and Commercial team](#).