BUSINESS LAW BASICS

The Most Common Legal Mistakes Small Businesses Make

By Ari Tuchman | Tuchman Law, APC | Los Angeles, CA

Most versions of this article assume the mistake is not knowing something — get a contract, form an entity, buy insurance. In practice, small business owners usually do know the basic move. The actual pattern is different and more interesting: the right instinct gets executed just well enough to feel handled, and the gap between “handled” and “actually protected” doesn't show up until something specific goes wrong. Every mistake below looks fine on paper right up until it's tested.

Forming the Entity Without Actually Using It

Almost every small business owner forms an LLC or corporation for liability protection. Far fewer maintain the separateness that protection actually depends on — a dedicated business bank account, no commingled personal and business funds, actual documented decisions rather than informal agreement. None of this matters day to day, which is exactly why it gets skipped. It matters enormously the moment someone sues the business and their attorney argues the entity is just a shell — alter ego, in legal terms — and that the owner should be personally liable anyway. The entity existed on paper the whole time. Whether it actually protected anyone gets decided only when it's tested in court, which is the worst possible time to discover the answer is no.

A Signed Contract That Doesn't Say What Both Sides Think It Says

Having a signed contract feels like a completed task. Whether that contract actually protects you depends on details that don't matter until a disagreement forces you to read it closely: is the scope of work defined precisely enough that “we didn't agree to that” has a real answer, does it say what happens if either side wants out early, does it specify who owns the work product. A contract that's vague in these places isn't obviously broken — it reads like every other contract right up until a dispute reveals that both sides had a different understanding of what it said, and there's no clear answer in the document itself.

Policies That Don't Match What Actually Happens

An employee handbook or written policy looks like protection — it demonstrates the business has rules. But a policy that isn't consistently followed in practice can create worse exposure than having no written policy at all, because it becomes evidence: a termination that doesn't follow the progressive discipline policy on paper, or a benefit promised in the handbook that managers don't actually apply, hands the other side a clean argument that the business didn't follow its own stated standards. The mistake isn't skipping the handbook. It's writing one that doesn't reflect what the business actually does.

Assuming a Name Is Clear Because It Was Available

Registering a business name with the Secretary of State or buying a domain confirms almost nothing about whether you're legally entitled to use that name. Trademark rights come from actual use in commerce, not registration availability, and a name can be operated under for years — building real brand value the whole time — before a cease-and-desist letter arrives from someone with a senior claim. The mistake isn't picking a bad name. It's treating “I was able to register it” as the same question as “am I allowed to use it,” when they're not connected at all.

Handshake Agreements Between People Who Trust Each Other

Co-founders and early partners frequently agree on roles, equity, and expectations verbally, with the shared understanding that they'll “paper it later” once things are more established. The trust is usually genuine, which is exactly why nobody insists on getting it in writing early. What gets discovered later — during a disagreement about who owns what, or when one person wants to leave — is that everyone remembered the verbal agreement differently, and there's nothing to point to that resolves it. The mistake isn't the trust. It's mistaking a shared understanding for something legally enforceable.

Classifying Workers Based on What Feels Right

Calling someone an independent contractor because the relationship feels informal, or because that's how a similar role was classified elsewhere, isn't the same as satisfying California's actual multi-factor legal test for that classification. The classification can go unquestioned for years, right up until an EDD audit or a worker's unemployment claim applies the real test retroactively — at which point the business owes back payroll taxes, penalties, and potentially damages for benefits the worker should have received the entire time.

Insurance That Doesn't Cover the Thing That Actually Happens

Having a general liability policy feels like the risk is handled. Whether it's actually handled depends on exclusions that don't matter until a claim tests them — professional services carve-outs, cyber incident exclusions, coverage gaps for exactly the kind of dispute that occurs. The policy existed the entire time. Whether it covered anything relevant gets discovered only when a claim is filed.

Final Thoughts

The thread connecting all of this is that these aren't failures of ignorance — they're failures of execution that stay invisible under normal conditions and only surface under stress: a lawsuit, an audit, a falling-out, a claim. The businesses that avoid this pattern aren't the ones that know more. They're the ones that have someone periodically checking whether the things that look handled actually would hold up if tested, before something forces the question.

About the Author

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