

PROTECTING THE CREATIVE PRODUCT OF YOUR MIND™

Business Law Considerations for Startups

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Housekeeping

- Dumb questions exist
 - They are those that remain burning in your brain but unasked
 - To have at your disposal a lawyer who bills \$275/hour and *not* ask questions is dumb
 - Interrupt with questions, comments, etc.
- Break times
 - This is a two- or three-hour presentation, and it is heavy-duty material; we'll take a 10-minute break after about an hour
 - If required, feel free to leave and come back during the discussion
- I will be here after the class to answer any further questions

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Nancy Baum Delain

- Intellectual Property & Business Law practice
 - JD from Franklin Pierce Law Center, Concord, NH, 2003
 - Registered Patent Attorney
- 20+ years' experience in computer industry as a technical documentation specialist (writer/editor/manager)
 - MS from RPI in Technical Writing, 1981
- 2 years' experience in a virology research lab at Rockefeller University, a think tank in NYC with a faculty containing several Nobel laureates
 - AB from Smith College in Biological Sciences (Zoology and Cell/Molecular Biology), 1978

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Order of Presentation

- Formation and Startup Considerations
- Contracts
- Intellectual Property

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Business Formation in New York

- New York recognizes four separate types of business entities
 - Sole proprietorship
 - Partnership
 - LLC/LLP
 - Corporation

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Sole Proprietorship

- What is it?
 - A single-owner business entity certified by the county to do business in that county
 - Commonly called a DBA because the certificate issued by the county is a license to “Do Business As” an assumed business name (which may, in fact, be the owner’s name)
- How long does it last?
 - Until the owner stops “Doing Business As” in the county of registration, OR
 - Until the owner files a certificate with the County Clerk dissolving the DBA
- How is it taxed?
 - Form 1040, Schedule C

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Sole Proprietorship

- **Advantages**
 - Easiest of all the business forms to set up
 - Register a DBA certificate with the county clerk of the county where the business will operate
 - Pay nominal fee to the county clerk's office
 - Obtain Employer ID number (EIN) from the IRS
 - If you sell goods or services for which you are required to collect sales tax, obtain a sales tax number from the NY Dept. of Taxation and Finance

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Sole Proprietorship

- **Advantages (continued)**
 - Has the fewest formal requirements
 - No seals, no meetings
 - You are the BOSS
 - Very little state oversight leaves you free to operate your business as you see fit
 - Income is reported as personal income and is reported on Schedule C to the IRS

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Sole Proprietorship

- **Disadvantages**
 - No protection of owner's personal assets
 - Total exposure for owner in the event of a catastrophic event such as a lost lawsuit
 - ALL of owner's assets are at risk
 - "Easily made, easily broken" business
 - Lack of credibility
 - More difficult to raise funds
 - More difficult to attract good customers
 - More difficult to get proper insurance for some types of businesses that elect to be sole proprietorships

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Sole Proprietorship

- Disadvantages
 - Registration of the name at only the county level leaves business name up for grabs to anyone who registers a business at the state level
 - DBA is legally valid only in the county in which the DBA is registered
 - This causes confusion in the marketplace
 - Expect a trademark infringement lawsuit
 - Hard to win this suit, since the DBA owner did not act properly to protect the name of the business

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Sole Proprietorship

- Business types for which sole proprietorship can best work
 - Small MLM franchisees
 - Amway, MaryKay, Herbalife, etc.
 - Freelance writers, artists, videographers, musicians, craftspeople
 - Businesses with few, if any, walk-in customers
 - Businesses with no employees other than the owner/owner's family
 - Businesses that are geographically restricted to one county
 - Businesses in which the owner's DBA is the owner's own name

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Sole Proprietorship

- Business types that should stay away from sole proprietorship
 - Professional offices (doctors, lawyers, dentists, architects, real estate brokers, etc.)
 - Businesses with walk-in customers
 - Businesses that transport people and/or goods

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Partnership

- Comes in two flavors:
 - General Partnership
 - Limited Partnership

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General Partnership

- What is it?
 - A multiple-owner business entity that may be certified by the county or by the state
 - Certification is NOT needed to form a valid general partnership
 - All partners in a general partnership participate to some degree in the management of the business of the partnership
- How long does it last?
 - Until the partners stop doing business as partners, OR
 - Until the partners file a certificate dissolving the partnership AND present to the public that they are no longer doing business as partners
- How is it taxed?
 - Partnership tax forms, with each partner reporting gains and losses commensurate with that partner's financial contribution to the partnership

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General Partnership

- Advantages
 - Very easy to form
 - Present to the public as a partnership
 - No EIN needed for a partnership to be formed
 - If the partnership plans to do business with the public as a partnership, an EIN is needed
 - No formalities required to maintain partnership status
 - Just keep presenting to the public as a partnership
 - Easy access to partners' expertise within the partnership

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General Partnership

- Disadvantage
 - Every partner in a general partnership is *personally liable for the debts of every other partner* in the general partnership, regardless of whether those debts are related to the business of the partnership
 - An example of the workings of partnership law:
 - If your partner in a general partnership files for personal bankruptcy protection, his creditors can come after all of his partners for satisfaction of the debts.

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Limited Partnership

- What is it?
 - A multiple-owner business entity that may be certified by the county or by the state
 - No limited partner in a partnership may participate at all in any of the management of the business of the partnership
- How long does it last?
 - Until the partners stop doing business as partners, OR
 - Until the partners file a certificate dissolving the partnership
- How is it taxed?
 - Partnership tax forms, with each partner reporting gains and losses commensurate with that partner's financial contribution to the partnership

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Limited Partnership

- Advantages
 - Those of partnership
 - No personal liability of the limited partners for the liabilities of other partners

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Limited Partnership

- Disadvantages
 - No control by the limited partner over the management or operation of the business of the partnership, regardless of financial or other contribution to the partnership
 - “Silent partner” status
 - General partnership is presumed for all partners until limited partnership is proved
 - Partnership requires at least one general partner to conduct business

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Partnership

- What businesses can use partnership as an effective business form?
 - Formerly, partnerships were often formed between professional people such as doctors, lawyers, architects, dentists, etc.
 - Now, partnership is generally used when corporations wish to form strategic alliances
 - Draconian partnership provisions do not generally have as much impact on a large corporation as they do on individuals
 - Insurance can help cover partnership liability between companies, but it generally will not do so between individuals

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Partnership

- Businesses that should avoid general partnership
 - Sole proprietors
 - Any business wishing to avoid liability for partners' financial decisions

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Limited Liability Entities

- Come in two varieties:
 - Limited Liability Company (LLC)
 - Can have only one member or many members
 - Limited Liability Partnership (LLP)
 - Must have more than one member
 - Only available to certain professions
 - Doctor, Lawyer, Dentist, Chiropractor, Engineer, etc., as listed in the Education Law of New York State

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Limited Liability Company (LLC)

- What is it?
 - An unincorporated business entity that provides the members with the protection of the “corporate veil”
 - Has its own legal existence, separate from that of its members
- How long does it last?
 - Until it is dissolved, either by the members, by the State, or by the courts
- How is it taxed?
 - Single member LLC may be taxed either as a pass-through entity or as a business entity by the federal government
 - Multiple member LLC is taxed as a business entity (generally as a partnership) by the federal government

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Limited Liability Company (LLC)

- Formation formalities
 - File Articles of Organization+filing fee
 - Publish in two newspapers designated by the County Clerk of the county in which the LLC plans to have its main offices once per week for six consecutive weeks
 - File Affidavits of Publication+filing fee
 - Optional but HIGHLY recommended:
 - All members should sign Operating Agreement - within 90 days of formation
- Maintenance formalities
 - Franchise tax payable to NYS within 30 days of the end of the LLC’s fiscal year
 - Annual meeting of members

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Limited Liability Company (LLC)

- Advantages
 - Less structured than is a corporation
 - Provides the “corporate veil” to protect owners’ personal assets
 - None of the partnership responsibilities toward creditors of members

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Limited Liability Company (LLC)

- Disadvantages
 - Very new business form
 - NYS LLC law was enacted in 1994
 - VS.
 - NYS corporation law was enacted when NYS became a state
 - No one quite knows for sure how it will behave in court
 - It currently behaves like a corporation, but it has enough elements of partnership in it that it could turn on the whim of a judge....
 - Treatment across state lines can vary wildly

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Limited Liability Partnership (LLP)

- What is it?
 - Similar to an LLC, an LLP is an unincorporated business entity that provides protection via the “corporate veil” to the partners
 - Has its own existence separate from that of its owner
 - Only available to certain professions
- How long does it last?
 - Until it is dissolved by the members, or by the State or by the courts
- How is it taxed?
 - Generally taxed as a partnership

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Limited Liability Partnership (LLP)

- Formation formalities
 - Same as those for LLCs
- Maintenance formalities
 - Same as those for LLCs

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Limited Liability Partnership (LLP)

- Advantages
 - LLP partners can have management control of the partnership without incurring the liabilities of general partnership

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Limited Liability Partnership (LLP)

- Disadvantages
 - Like LLCs, LLPs are fairly new legal entities so no one is quite sure how they work just yet
 - Treatment across state lines can vary wildly

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Corporations

- Come in two types:
 - C-corporations
 - S-corporations

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Corporations

- Formation formalities
 - File Articles of Formation with the Secretary of State and pay the filing fee
 - Hold and document initial meetings
 - Optional but **HIGHLY** recommended:
 - Sign Shareholders' Agreement
- Maintenance formalities
 - Hold and document annual BOD and shareholder meetings
 - Pay taxes

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C-Corporation

- What is it?
 - An incorporated entity
 - The entity is separate from its owner(s), having its own legal existence
- How long does it last?
 - Until it is dissolved by its shareholders, by the State or by the courts
- How is it taxed?
 - As a separate entity, it is responsible for income taxes based on the revenues it receives
 - If the corporation holds property, it is responsible for property taxes in most cases

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C-Corporation

- Advantages
 - Well established legal entity, well recognized by the law and the courts
 - Consistent treatment in different states
 - With proper procedures, you can take a C-corp public
 - Unlimited number of shareholders
 - Unlimited as to what types of entities can hold shares

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C-Corporation

- Disadvantages
 - Double taxation
 - Formal requirements for maintenance can be just stupid with a single-shareholder corporation

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S-Corporation

- What is it?
 - A so-called “closely held” corporation
 - The classic small business form
- How long does it last?
 - Until the shareholders, the state or the courts dissolve it
- How is it taxed?
 - Can elect to be taxed either as a corporation (similar to a C-corp) or as a partnership

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S-Corporation

- Advantages
 - Corporate veil
 - Reasonably uniform treatment across state lines
 - Small management team → quick action

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S-Corporation

- Disadvantages
 - Limitations on number and types of shareholders
 - S corp can have up to 75 shareholders
 - S corp shareholders must be natural persons
 - Your LLC cannot hold stock in your S-corp

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Corporation or LLC?

Corporation	LLC
<ul style="list-style-type: none">• Eliminates personal liability; may have pass-through taxation• May be taxed as a separate legal entity or as a partnership. No individual taxation• Some hoops to jump through to form	<ul style="list-style-type: none">• Eliminates personal liability while keeping pass-through taxation• Taxed as a partnership for multiple members; taxed as an individual for single member• Some hoops to jump through to form

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Issues to Consider After Formation

- In what business is the entity engaged?
 - What special or unusual requirements might the business have?
- How does the entity perform its business?
- How does the entity make money?
 - Contracts
 - Licensing of assets
- Tax considerations

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Issues to Consider After Formation

- Business
 - Your certificate probably says that you're in business for "any lawful purpose" unless you're forming a professional company
 - What IS your business?
 - Where will you get customers or clients?
 - How do you plan to market your business?
 - Can your business change over time?
 - How?
 - How flexible are you in terms of market demands?

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Issues to Consider After Formation

- Performance
 - Do you do it all or do you hire employees?
 - What kind of equipment do you need?
 - What kind of customer do you need?
 - What kind of service does that customer need?
 - Who is your competition?
 - How can you out-perform your competition?

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Issues to Consider After Formation

- Revenue
 - You need money to stay in business
 - How much will you charge for your goods or services?
 - How do you know that the market will bear your price?
 - Can you use price to attract your customer?
 - How can you get a fair price for your goods or services?
 - What IS a fair price for your goods or services?

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Issues to Consider After Formation

- Tax considerations
 - Pay your taxes
 - Or the taxing agency WILL put you out of business and possibly in jail
 - Different taxes for different entities
 - Franchise tax on corporations and LLP/LLCs don't exist on partnerships and sole proprietorships
 - Sales tax
 - To collect sales tax, you need a state-issued sales tax ID number
 - Contact the Dept. of Taxation and Finance to obtain a sales tax ID
 - Payroll taxes:
 - YOU are responsible for payment of employer's portion of your employees' payroll taxes (FICA, state, federal taxes)
 - YOU are responsible for getting payment to the taxing authorities (federal, state, and local) on time
 - Voluntary pre-tax withholdings (usually used for child care or medical costs) can REDUCE your payroll tax bill and cost you essentially nothing
 - Several payroll outsourcing suppliers exist; use one of them unless you are comfortable with payroll taxes and want to spend your time doing them for your employees

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Doing Business Across State Lines

- May need to register as a "foreign entity" in the state
- Qualifying to do business in another state
 - Certificate of Authority + filing fees
 - Publish
 - Annual reporting fees (can be expensive)
 - Pay tax on revenue generated by business within the state
 - Appointing a Registered Agent
- Lawsuit possibilities in the state
 - Being sued
 - Personal jurisdiction
 - Website --> personal jurisdiction?
 - Suing others

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BREAK
10 minutes

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Business Agreements

- What IS a contract?
 - Promise
 - Secured by consideration
 - Legally binding (usually)

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Business Agreements

- Every business has at least one contract
- Four ways to form a contract
 - Bilateral agreement
 - The contract you think of, often memorialized in a signed writing
 - Detrimental reliance
 - One party acts to its own detriment in reliance on the word of another
 - Unilateral offer accepted by performance
 - Reward offer is a good example
 - Formal
 - Sealed writing
 - Not used much

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Business Agreements

- Fourteen ways out of a contract:
 - **Infancy:** A person under age 18 (in NY: 21 in some states) can enter a contract, but that contract is voidable at the infant's option
 - **Mental incapacity:** A person who is mentally incapacitated and is recognized as such by a court can enter into a contract, but that contract is voidable at the mentally incapacitated person's option
 - **Impossibility:** If the purpose for which the contract was formed becomes impossible to achieve, the contract is voidable
 - **Impracticability:** If the performance of the contract becomes impractical (that doesn't mean inconvenient, it means really impractical), the contract is voidable
 - **Duress:** If the contract was entered into under duress by one party, the contract is voidable at the option of the duressed party
 - **Unconscionability:** If performance of the contract, or the contract itself, is or becomes unconscionable (legal but morally repulsive to a Reasonable Person), the contract is voidable
 - **Bilateral mistake:** If both parties are mistaken in their understanding of each other's positions and promises, the contract is voidable at the option of either party

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Business Agreements

- Fourteen ways out of a contract:
 - **Unilateral mistake:** If one party is mistaken in its understanding of the other's positions and promises, the contract is voidable at the option of the party
 - **Changed circumstances:** If circumstances surrounding the performance of the contract materially change during the course of performance, the contract may be voidable at the option of the affected party
 - **Frustration of purpose:** If the purpose for which the contract was formed is no longer viable, the contract is voidable
 - **Public policy violation:** If a contract is repugnant to public policy, the contract is voidable
 - **Misrepresentation:** If one party misrepresents a material fact to another, the contract is voidable at the option of the party to whom the misrepresentation was made
 - **Nondisclosure:** If one party fails to disclose a material fact to another, the contract is voidable at the option of the party who was the victim of the nondisclosure
 - **Undue influence:** If a person exerts undue influence on a party at the time of contract formation in order to achieve formation of the contract, the contract is voidable at the option of the victim of the undue influence

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Business Agreements

- Discuss the ramifications of any contemplated business agreement, including the "fine print," with your attorney *before* you sign
- When you do sign a contract, follow through on your end of the bargain
 - Remedies exist at law and in equity for not fulfilling a contract obligations
 - Money damages and judgments
 - Specific performance can be enforced

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Business Property

- **Tangible property**
 - Desks, lamps, chairs, office supplies, business equipment, real property, inventory, accounts receivable, cash on hand, etc.
 - Protected with insurance
 - You need adequate insurance to cover replacement cost
- **Intangible property**
 - Intellectual property
 - Contracts, company know-how, inventions, trade secrets, trademarks and service marks, copyright, trade dress, goodwill
 - Replacement-cost insurance is unavailable
 - Intangible property forms 80-97% of the value of most businesses

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Protecting Tangible Property

- Put it under lock and key
- Have inventory control systems in place
- Monitor employees and visitors to prevent theft
- Have adequate replacement-cost insurance

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Protecting Intangible Property

- What you can't see, smell, touch, hear or feel makes up the main value of your business
- Insure your life
 - Protect your family
 - Protect your business
- Insure your income

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Protecting Intangible Property

- **Company know-how**
 - The collective knowledge within the company of how the company does business
 - Processes & procedures
 - Data
 - Often reside only in the brain of the owner or key management personnel
 - Protect them
 - Write them down
 - Keep them secure, protected from unauthorized disclosure
 - Have non-disclosure agreements in place with all employees who have access to company know-how

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Protecting Intangible Property

- **Inventions**
 - Protect by patent or by maintaining the invention as a trade secret
 - Patent = exercise in disclosure
 - Must disclose best mode of practicing the invention as of the date of filing the patent application
 - Can keep improvements from that day forward as trade secret company know-how
 - Patent gives the holder the right to prevent others from making, using, selling, offering for sale, or importing the invention for a limited time
 - Patent cannot be renewed
 - Trade secret dies with disclosure

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Protecting Intangible Property

- **Trade secrets**
 - Best kept trade secret of all time?
 - Formula for Coca-Cola®
 - Trade secret is just that: a secret
 - Only protection is through secret
 - If another legitimately invents your trade secret and patents it, you can lose the rights to the secret
 - If secret is disclosed, purposefully or not, the cat's out of the bag and your trade secret is gone forever

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Protecting Intangible Property

- Trademarks and service marks
 - Identify a good or service as coming from your company
 - Valuable goodwill in the marketplace
 - Trademarks/service marks exist to prevent consumer confusion
 - Can be registered federally if you are engaged in interstate commerce, i.e., if you have the mark on a website
 - If you do not engage in interstate commerce, the mark can be registered in the state in which you do business
 - Trademarks are first come, first served
 - Unlike a patent, to keep a trademark, you must continually use it in commerce

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Protecting Intangible Property

- Examples of registered marks




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Protecting Intangible Property

- Examples of unregistered marks



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Protecting Intangible Property

- Trademarks and service marks
- Use it or lose it
- How to obtain a mark
 - Decide on a mark to associate with your company
 - Have a trademark search done
 - If the search comes back clean, begin using the mark on everything you put into the stream of commerce (goods, services, stationery, website, advertising, all of it) **with the ™ designation**
 - Register the mark when you begin doing business across state lines
 - For this purpose, Canada is NOT a state
 - Massachusetts IS a state, as is Ohio, Pennsylvania, Vermont, New Jersey, etc.

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Protecting Intangible Property

- A trademark has a grammatical part of speech associated with its usage. Is that part of speech a:
 - Noun?
 - Verb?
 - Adjective?
 - Preposition?

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Protecting Intangible Property

- A trademark has a grammatical part of speech associated with its usage. Is that part of speech a:
 - Noun?
 - Verb?
 - **Adjective?**
 - Preposition?

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Protecting Intangible Property

- Examples of Lost Marks
 - Plastic clingy wrap
 - CELLOPHANE
 - Moving staircase
 - ESCALATOR
 - Pain reliever (and blood thinner, as it turns out)
 - ASPIRIN
- All lost to improper usage

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PROTECTING THE CREATIVE PRODUCT OF YOUR MIND™

Protecting Intangible Property

- Marks In Danger
 - Facial tissue
 - KLEENEX®
 - We do not get a kleenex; we get a KLEENEX facial tissue
 - Photocopier, the act of photocopying
 - XEROX®
 - It is not a xerox, and we do not xerox anything; it is a XEROX copy and we make a photocopy
 - Internet search engine
 - GOOGLE®
 - It's not possible to google anything. We use the GOOGLE search engine
- All may be lost to improper usage

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PROTECTING THE CREATIVE PRODUCT OF YOUR MIND™

Protecting Intangible Property

- Trade dress
 - The protectable appearance of goods, services, décor, etc. that is associated with business goodwill
 - Protectable under trade dress law
 - Federal
 - State

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PROTECTING THE CREATIVE PRODUCT OF YOUR MIND™

Protecting Intangible Property

- Copyright
 - Of all the registrations for intellectual property, copyright is probably the easiest to obtain
 - Protects works of authorship (books, music, architecture, artwork)
 - Does NOT protect taglines
 - Cheap to get really good protection: \$35 registration fee for online registration
 - In return for registration, statutory damages are available for infringement (\$750-\$30,000 per infringing act), trebled if you can show willful infringement

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PROTECTING THE CREATIVE PRODUCT OF YOUR MIND™

Planning

- What happens if you get into a car crash on your way home tonight?
 - Suppose you die (we all will, one day)
 - Suppose you don't die but can't work
 - Suppose you will be able to work again in a while
 - Suppose you won't

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PROTECTING THE CREATIVE PRODUCT OF YOUR MIND™

Questions?

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Business Law Considerations for Startups

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