Innovation Law Handbook:

A Legal Guide for Early-Stage Ventures and Entrepreneurs

v. 1.1

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Prologue.

Congratulations! If you are reading this, chances are you are either in or contemplating being in a small technology based business. Being in one of these businesses is an exciting, fast-paced experience; however, there are also many issues and pitfalls that must be identified and navigated in the process of making a fledgling business into a successful enterprise.

This "Innovation Law Handbook" is written to help assist you with a few of the more common legal issues that many entrepreneurs face. After reading this, you should have a basic understanding of areas of law such as: intellectual property, contracts, business organizations, employment, and immigration. Your newly acquired basic understanding of these issues will be a great asset as you work toward the success of your business.

It is important to note that the "Innovation Law Handbook" is NOT meant to replace the advice of legal counsel. You should work with a qualified attorney when the legal issues described herein arise. However, the knowledge you will gain from reading this should help you identify when contacting an attorney is appropriate or necessary.

This handbook is divided into five major categories: Intellectual Property, Contracts, Business Organizations, Employment Law, and Immigration Law. Each section will provide an overview of the area of law and will also include a glossary of terms you may encounter while building your business. Finally, this handbook includes an Appendix that contains links to related online resources.

Once again, congratulations on your exciting new undertaking. Please feel free to contact ASU Technopolis with future questions or issues. Many resources are available to you. Please use them!

Introduction.

Attorneys as Deal-makers not Deal-breakers

Entrepreneurs often look on the law as an inconvenience—an issue to be left for later when time and budget permit. Many reasons may explain this attitude. Early-stage ventures are often more concerned with payroll than paying attorneys for issues that do not seem to matter *today*. Lawyers contribute to this entrepreneurial malaise. They are trained to provide conservative advice—designing solutions around "worst-case" rather than "likely" scenarios.

Entrepreneurs are, by definition, risk-takers and out-of-the-box thinkers and are justifiably frustrated when legal counsel seems more of an impediment to ideas or opportunities rather than a facilitator. The widespread view that lawyers "always say no" is a major reason why entrepreneurs avoid legal advice—lawyers also often cost a lot.

These reasons and, we suspect, many others often lead entrepreneurs to ignore legal issues at the earliest stages of their ventures. Yet this is often the precise moment at which legal opinion and protection are most valuable. Unfortunately, as many find out too late, entrepreneurs ignore legal issues at their peril. The field of new business ventures is littered with companies that fail for no other reason than that their legal house was not in order. Some fail to defend their investments with appropriate intellectual property protections. Others sign contracts that included unknown onerous terms. Some fail to separate their knowledge from that of prior employers. Many entrepreneurs lose personal savings by failing to properly incorporate. Finally, in a post 9/11 environment, technology ventures that fail to account for changes in immigration laws and enforcement jeopardize, not just the business, but the visa-status of their employees and founders.

This Handbook seeks to encourage legal compliance and ordering by simply and accessibly introducing entrepreneurs to the most common areas of law that affect early-stage companies. From contracts to intellectual property, corporations to immigration, this Handbook serves as a primer on these important areas of law. Recognizing and identifying the legal issues that impact your ventures is the first step in ensuring that they do not endanger the health of the company.

That said, this Handbook cannot take the place of retaining appropriate legal counsel. Choosing an attorney is an essential component for a successful business venture. Demonstrating legal compliance and protection is not only integral to the development of early-stage capital—but is essential for protecting hard-fought advantages and innovations as your venture matures. The importance of counsel, however, must be coupled with an understanding of the kind of lawyer that will best serve your enterprise.

A common complaint from early-stage ventures is that their legal counsel does not understand their business needs. As a result, counsel is often viewed as a mere cost—a drain on the energy and resources of the firm that could more effectively be put toward the immediate business needs of the venture. Key to overcoming this problem is the selection of counsel as a partner to the firm, rather than a drain on its time and resources. Although experience and expertise in the fields most affecting the firm are helpful, it is more important that you choose a lawyer that understands your business, your needs, and your future plans.

One general rule is that one attorney will not be enough. This Handbook covers five major areas of law: Corporations, Contracts, Intellectual Property, Employment, and Immigration. Although it is possible for one lawyer to know something about all of these areas, it is unlikely you will get the best advice by choosing a single attorney claiming expertise in all. Finally, this Handbook is by no means exhaustive in the areas of law that impact early-stage ventures. Among the areas not

even discussed in this primer are: finance, securities, and taxation. Finding attorneys skilled in these highly technical areas can make the difference between success and failure for your venture.

Many have noted that choosing an attorney is like choosing a doctor—there are no easy answers and no checklists that guarantee success. Rather, you should insist that potential counsel meet with you (and waive his or her fee!) to discuss potential representation. At that meeting, be prepared with questions that will guide you in determining: (1) whether she possesses the skill(s) you need; (2) if you are comfortable with her as a person (do you feel comfortable discussing your business); (3) whether she understands your business and your goals (including your willingness to bear some risks to succeed); and (4) if she is willing to share former and current clients as references.

In the end, the choice is yours. We hope that this Handbook alerts you to the importance of law to the success of your venture. We have not tried to take the place of counsel—but hope that the Handbook does provide information to help you succeed. *Good luck.*

Chapter 1.

Business Organizations

Overview

An important and early legal decision that confronts any entrepreneur is whether to transform his or her venture into a formal business enterprise. Formalizing a small business into a legal entity has important business and legal effects. Chief among these is the ability to separate personal assets from business liabilities. Formal organization or incorporation of one's business has other advantages and, often, obligations depending on the form chosen. In this section, we set out some of the forms that may be chosen and provide some advantages and disadvantages to each. The final choice of form is up to the founders and will depend on a number of business and legal decisions.

One such decision is the question of where to organize or incorporate. State laws govern business entities and, as a result, the legal protections and obligations vary significantly from state to state. The advantages of incorporating in one state or another are often overlooked by early-stage ventures—with the vast majority merely organizing or incorporating in the state in which the business entity is physically located. The variations in state regulation may have dramatic advantages or drawbacks for your particular venture—and a discussion on the merits of each is beyond the scope of this Handbook. As always, we urge you to retain counsel when deciding where to organize or incorporate. Other factors may come into play—including the requirement that all ventures must register in each state where they do business. The legal contours of "doing business" is, again, a very complicated question and requires formal legal counsel. Nevertheless, registering in the various states is usually not difficult and may be a good first step in avoiding potential problems down the road.

Finally, although the type of business entity that one chooses is an important decision, it is not irrevocable. Companies can change the nature of their formal organization or incorporation if the need arises. For example, an LLC can transfer all of its assets to a newly formed S-Corporation, effectively switching the form of business entity. But the costs and inconvenience are not insubstantial and, as a result, careful consideration should be given before deciding on the appropriate formal structure. As a result, it is best to choose correctly from the start and give early consideration to the issues associated with choosing one form over another (including early consultation with legal counsel). This process can be a crucial component of the business entity's success.

In the end, there are four basic types of business organizations: Sole Proprietorships, Partnerships, Corporations, and Limited Liability Companies. Each form has its pros and cons, but which form is best for a specific business depends on many different considerations, including:

- number of owners
- nature of the business (i.e. products vs. services, etc.)
- tax implications
- desire to attract venture capital

As noted above, the desire to avoid personal liability for business activities is the main contemplation when considering which type of business entity to form. The importance that the remaining factors are given is up to the person(s) forming the business. The rest of this chapter sets out in greater detail the specific business entities and also offers some strategic considerations that impact choosing one over another.

Types of Business Entities

Sole Proprietorships

The Sole Proprietorship ("SP") is the most basic form of business entity and applies to businesses with a single founder or owner. The owner does not have to take any steps to organize her company into an SP, it is implied by law. In other words, when an individual begins doing business without first forming a separate business entity, the law views the business as an SP although the owner may be required to obtain local licenses or business identification numbers.

The major advantage for companies operating as SPs is simplicity. Another advantage is that, on the death of the founder, the property of the business will pass to the heirs just like personal property. Therefore, loved ones will end up having to (or getting to) handle the business' affairs after the owner's death. This is often an advantage, but can, obviously, be a drawback depending on the nature of your familial relationships! Some other advantages include: less paperwork, minimal legal restrictions, owner retention of all profits, and ease in discontinuing the business. In most cases, a sole proprietorship is not required to obtain an Employer Identification Number (EIN) from the Internal Revenue Services unless it has employees. There is no need to file a separate income tax return for the proprietorship because the activity is reported on the owner's federal and individual income tax returns. Since a self-employed person is not considered an employee, there is no provision to withhold payroll taxes to cover federal, state, and Social Security tax obligations. If you are a self- employed sole proprietor, you must make quarterly estimated payments to provide for these tax liabilities.

This form of company organization does have serious drawbacks. The major negative is that this business entity does not shield the founder's personal assets from the company's liabilities. Business liabilities (i.e. loans, accounts payable, judgments, etc.) are the personal liabilities of the owner and if the business cannot fulfill its responsibilities, the owner will be expected to do so. In addition, the company's profits are taxed as personal income—increasing the owner's tax burden as the company's profits grow. Finally, when the founder dies, the assets of the company will be taxed as personal income on the family members inheriting the business ("pass through taxation"). The entity itself pays no taxes on income.

In most situations, this form of business entity is not desirable. An SP offers no tangible advantages, legally or strategically, that make it an attractive option when starting a business. That said, should the entrepreneur begin doing business but take no steps to formalize his or her operations, the law will imply that the entrepreneur is engaged in an SP—with all of its shortcomings.

Partnerships

A Partnership is an option for companies with multiple owners or founders. The law recognizes two very different forms of partnerships: an informal entity knows as a General Partnership ("GP"); and a more sophisticated structure called a Limited Partnership ("LP"); or, as complexity increases, a Limited Liability Partnership ("LLP"). Each of these forms has advantages and disadvantages.

a. General Partnerships

GPs are the equivalent of SPs except that they involve two or more owners. Like SPs, the law requires no formal action for an entity to be considered a GP. When two or more persons commence doing business together without first forming a business entity, the law views the business as a GP (although the partners may be required to register the entity and obtain state and local business registrations and licenses). That said, most GPs are formalized through a partnership agreement that sets out the ownership interests and obligations of each party.

GPs carry the same disadvantages as SPs in that they do not protect the owners' personal assets, do not adequately account for post-death contingencies, and do not allow for structuring to best take advantage of tax liabilities. The IRS taxes the partners for the profits of the company. Thus, in most situations, this form of business entity is not desirable. A GP offers no tangible advantages, legally or strategically, that make it an attractive option when starting a business other than its ease of establishment and simplicity.

b. Limited Partnerships

Unlike SPs and GPs, LPs are formal legal entities that are separate from the personal identities of the partners themselves. LPs may hold property, sue and be sued, and are considered a taxable entity. Business operations are governed, unless otherwise specified in a written agreement, by majority vote of determined partners. As a result of their complexity, LPs will require legal advice to properly form and necessitate the filing of formal partnership agreements with the appropriate state

LPs are formed by having one general partner and one or more limited partners who invest capital into the partnership, but do not take part in the daily operation or management of the business. The limited partners limit their amount of liability to the amount of capital invested in the partnership. The general partner shoulders the personal liability for the debts and obligations of the partnership. The general partner may be a person or another entity.

One chief difference between LPs and other less formal forms of company organization is that when a partnership is formed, the death of a partner (assuming at least two remain) does not automatically dissolve the business entity. It is possible for the business to continue operating after meeting its obligations to the deceased partner's estate. The obligations of the partnership in this situation and many others are usually detailed in the partnership agreement.

The major advantage is that LPs protect the limited partners' personal assets—but they do not shield the general partner from such liability. In addition, dividends distributed to all partners are reported on the partners' personal income tax return. LPs are treated as pass-through entities for federal and state taxation. The major disadvantage to an LP is the increased costs of its formation compared to a GP.

Overall, partnerships are very flexible because they are mostly governed by agreements between the parties without set obligations and restrictions imposed by law; however, they do not always offer the strongest shield from personal liability for, at least, the general partners. The pros and cons must be carefully weighed before deciding to form an LP.

c. Limited Liability Partnerships

LLPs offer similar pros and cons to the more basic LP except that, under this business form, the general partners receive more asset protection than the simple LP. Like LPs, LLPs: require creation and the filing of a formal partnership agreement; are treated as pass-through entities; may hold property, sue, and be sued in the entity's name; and may survive the loss of one or more of the partners.

Corporations

There are two basic types of corporations: a regular corporation ("C Corp") and a Subchapter "S" or closely held corporation ("S Corp"). Ownership in a corporation is represented by shares, which are freely transferable unless restricted by statute or by agreement of the shareholders. Many different types of shares can be utilized to serve many different purposes. For example, venture capital firms usually take preferred shares in exchange for their investment. The rights of the preferred shares differ from those of the common shares, which usually comprise the majority of shares issued by a corporation. Corporations are legal persons, separate from their owners.

Therefore, they operate with many of the rights of a living person and can continue doing business after the death of a shareholder (even a majority shareholder).

Persons starting up a new business should give a lot of thought to whether a corporate entity best fits the needs of their future business. A corporation offers strong liability protections for its owners and many ownership options; however, corporations are required to take many different actions to remain in compliance with state corporate laws. Numerous filing, complicated founding documents, and record keeping are onerous burdens for many small companies. Failure to take all actions required by state incorporation laws may result in dissolution of the corporation or the loss of shareholder liability protection.

a. C Corporations

C Corps offer protection from personal liability for the owners (i.e. shareholders) of the corporation. It is usually very difficult for the C Corp's creditors to "pierce the corporate veil" and impose personal liability on the shareholders. Therefore, the corporation's debts and obligations are its alone and the shareholders have no duties to fulfill the corporation's responsibilities. The only risk incurred by the shareholder is the money that they have invested in the corporation (i.e. the cost of their shares).

A C Corp can have any number of owners and will pay taxes on the income it earns at a set corporate tax rate. Recent changes to the federal tax structure have largely removed the so-called double taxation of dividends—making C Corps more advantageous for many companies.

b. S. Corporations

The main difference between a C Corp and an S Corp is that an S Corp has limitations on the number of possible shareholders, while offering the option for its shareholders to elect pass-through taxation. Most S Corp structures employ pass through taxation, meaning, the corporation does not pay income taxes on earnings. Rather, the shareholders pay income tax on dividends on their personal income tax return.

Limited Liability Companies

A Limited Liability Company ("LLC") is very flexible and can be an attractive alternative to S Corps while securing pass-through tax treatment for its owners (called "members"). There are generally no limits on the number of owners, the types of owners (including entities such as partnerships, corporations, or other LLCs) or the residences of the owners. The attributes of ownership, such as the right to a share of profits and losses, can be allocated to owners on bases other than their percentages of ownership. So, LLCs can overcome several of the limitations applicable to S Corps.

However, LLCs are not always an appropriate choice of organization. First, venture capital firms will generally not invest in an LLC. Besides not wanting pass-through tax treatment, the nature of the investment vehicle is considered inappropriate. While it is legally possible to create for LLC members many of the same attributes of preferred stock in a corporation, the legal certainties inherent in corporate statutes and decades of corporate case law are not available for LLCs, which are relatively recent legal creations.

While, on the one hand LLCs are very easy and inexpensive to form, they are governed largely by contract. Therefore, by the time the owners have worked through the many choices available to them regarding governance, management, transferability of membership interest, and sharing of profits and losses, and memorialized those decisions in an operating agreement, the cost can exceed the costs of incorporation. If the company will have many employees and the owners want to incentivize them with the LLC equivalent to stock options, the creation of those options is usually more expensive, and the explanation to the employees more complicated, than would apply to stock options in a corporation, which most employees understand.

Having said all that, LLCs are wonderfully flexible and appropriate structures for many companies. If the number and identity of the owners are relatively fixed, if the company will not be seeking venture capital, if the owners wish to reward each other on a different basis than how they wish to govern themselves or in any number of other scenarios, an LLC is a good solution. Again, the nature and structure of your business and ownership will govern the appropriate choice of organization.

Glossary of Business Organization Terms

Articles of Incorporation

The governing document or charter that must be filed with the state corporation commission to form a corporation (Delaware calls it a "Certificate of Incorporation"). The articles must contain the specific information required by the state corporation act. They are public documents. Thus, every purchaser of a company's stock is on "constructive notice" of the structure of the company as set forth in the articles, such as the number of authorized shares and the classes of stock. This enables any investor to understand the potential for share dilution, the rights of shareholders upon liquidation, and the rights of preferred shareholders.

Articles of Organization

The document which identifies and forms a limited liability company. It is filed with the state corporation commission or equivalent office.

Authorized Shares

The number of shares that a corporation has the power to issue as stated in the articles of incorporation. This is the number of shares the corporation can issue without amending the articles (shareholders must agree to a change in the articles to increase the number of authorized shares).

Issued Shares

The actual number of shares issued to shareholders--they represent the actual ownership of the company. By way of example, if a company has 1,000,000 shares authorized, but has only issued 1,000 shares to its founder, that founder owns 100% of the company. Thus, the issued shares determine ownership. Whether 1 share, 100 shares, or 1,000,000 shares are issued, they all represent 100% of the company.

Member

Term used for a person who owns an interest in an LLC, the functional equivalent of a shareholder in a corporation or a partner in a partnership.

Operating Agreement

The contract made by members of an LLC that governs the relationship between the members and the LLC, and the relationship by and among the members. This is the central governing document for an LLC and establishes how the company will be organized and the business conducted. It serves the same general purpose as a partnership agreement or, for corporations, combines elements of the articles and a shareholders' agreement.

Partnership

At its simplest level, a partnership is the conduct by two or more persons of a business for profit. Since partnerships are consensual relationships and do not require the filing of a charter to be created, they can be implied by law or be deemed to exist by the conduct of the parties, which is often not understood or appreciated. A highly flexible form of business organization, it enables the partners to arrange the financial, management, and governance affairs of the entity as they choose (within certain limits). GPs have unlimited liability while various forms of limited liability partnerships now offer the benefit of limited liability.

Pass-Through Tax Status

The entity still reports income, losses, deductions, and credits, but it does not pay federal tax on those items, which are allocated or "passed through" to the owners (i.e., shareholders or members), whether or not any cash or property is actually distributed to them by the entity.

Piercing the Corporate Veil

The means by which the limited liability of shareholders is disregarded, permitting creditors of or claimants against the corporation to satisfy an obligation from the assets of the shareholders.

In general, the shareholders must be found (1) to be operating the corporation solely for their personal benefit and not for a corporate purpose (usually indicated by a disregard of corporate formalities) and (2) to be using the protections afforded by limited liability for fraudulent purposes, criminal activity or some other improper or unjust purpose.

S Election

If the eligibility requirements are met, an election can be made by filing the proper forms with the IRS. Each shareholder must manifest consent to such election and the form must be filed by the 15th day of the third month of the tax year for which the corporation seeks S corporation status. The S status can be voluntarily revoked by action of a majority of shareholders and will automatically terminate if the corporation violates one of the qualifications.

Shares

The indication of ownership in a corporation. Shares can be divided into classes with different rights and obligations. In general, a share entitles the holder to a share of the profits of the corporation (if and as distributed), a right to elect directors to the company, and a claim on the value of the assets of the company. Shares can be certificated (represented by a share certificate) or un-certificated. Shares are generally transferable unless restricted by agreement of the shareholders (and subject to compliance with federal and state securities laws).

Statutory Close Corporation

A special type of corporation that can be operated and managed directly by the shareholders without a board of directors or officers and without corporate formalities (i.e., like a partnership), although (1) the number of shareholders is limited to 35, (2) the transfer of all classes of shares is restricted, and (3) the shares can never be offered to the public.

Chapter 2.

Intellectual Property

Overview

The term "intellectual property" ("IP") generally refers to four types of intangible property: trademarks, copyrights, patents, and trade secrets. The term "property" is used with these terms because each involves a basic characteristic of property – the right to exclude others. For example, your car is your property and you can exclude others from driving it or even riding in it. Similarly, your IP is yours and you can exclude others from using, copying, importing, performing, or making money from your IP. How you turn your inventions, creations, and ideas into IP is, of course, the real question.

Small businesses and entrepreneurs, especially those working in technology-based areas, should pay close attention to their IP and the IP of their competitors. The ability to secure and enforce IP is often the critical difference between operating a successful business or ending up as a failed endeavor. Furthermore, your ability to attract investment capital and the overall value of your company may depend heavily on your IP protections.

While reading this section, keep in mind that companies can and do use all four methods for protecting IP at the same time – sometimes using multiple forms on one item or product! When contemplating what types of IP protections will best serve the needs of your company, it will be of great benefit to consult an IP attorney. Some forms of IP protections require you to act before making your product or idea public, so securing the protections early in the process is almost always advised.

Types of Intellectual Property Protections

As stated above, there are four basic types of IP protections: trademarks, copyrights, patents, and trade secrets. Each will be described in greater detail below. Additionally, a glossary of terms appears at the end to help you understand words or phrases you may encounter in the marketplace.

Trademarks

A trademark is a word, name, symbol, design, logo, or sound adopted and used to identify goods or services and to distinguish them from goods or services offered by others. Trademarks are important for a number of reasons, including establishing customer loyalty and increasing brand value.

A common mistake that many laypersons make about IP is assuming that they if they don't see a specific mark, like ® or © that there is no legal protection and they are free to use that logo, information, etc. Another error is to assume that you have no protection for your concepts or inventions without taking specific legal steps to "file" or "approve" them. In fact, the legal regulation of IP differs greatly depending on that which you seek to protect.

For trademarks, there is no legal requirement that a mark be registered in order to receive legal protection. Once you use a mark in commerce (sell a product or offer a service that incorporates the mark), it will have legal protection. However, registering the mark can bring many advantages, including:

- ♦ evidence of the registrant's exclusive right to use the mark
- ♦ constructive notice of claim of ownership
- ♦ incontestability after five years of registration
- ♦ allowing the owner to take advantage of certain domain name dispute resolution procedures
- ♦ allowing the owner to use the symbol in connection with their use of the mark
- ♦ reflection of a serious commitment to IP rights

Another tricky area of trademark law is that not all trademarks receive the same level of protection. Marks that merely describe a feature or function of the product or service they identify only receive protection after they have developed a "secondary meaning." For example, imagine a situation in which a baker sells low-calorie muffins and wants to receive trademark protection for the name, "Diet Muffins." The phrase, "Diet Muffins," simply describes the product. This does not mean the baker has no protection—but he will be required to show that the general public has come to associate the phrase "Diet Muffins" with his particular product. As you can imagine, it will be very difficult for this to occur and, as a result, the baker will most likely be unable to get protection for the phrase "Diet Muffins."

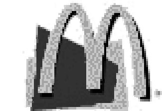
On the other end of the spectrum of protection are so-called "arbitrary or fanciful marks." These marks have no relationship to the product in question other than to identify the brand or manufacturer. For example, "Xerox" has no meaning other than it identifies products from a certain company. Arbitrary marks receive strong protections from the inception of their use and generally do not require a showing that the general public associates the word with a particular product.

When contemplating the use of a trademark, it is very important to perform a trademark search to see of others may be using the same mark. Basic searches may be conducted online using Google, or the United States Patent and Trademark Office website: http://www.uspto.gov. Additionally, consultation with an attorney practicing in this area will help with the choice of a proper trademark and the registration process.

Some famous examples of trademarks include words, such as:

- ♦ Apple
- ♦ IBM
- ♦ Exxon

Logos are another obvious example of a trademark, some famous examples include:

- ♦  McDonald's double arches, or
- ♦ NBC's peacock style design.

Trademarks can also include combinations of letters, designs, colors, and appearance. Some examples include:

- ♦

, or
- ♦

Color can also function as a trademark—think of the color pink and its use by Owens-Corning's fiberglass products. Of course, it was necessary for the general public to come to associate the color pink with Owens-Corning's product—a further example of secondary meaning. Shapes may function as trademarks—the famous Coca-Cola design for its bottles is one such example. Sounds are also open for trademark status—the NBC chime is the most obvious example. Finally, even smells may function as trademarks!

In the end, it should be clear that trademarks matter. Once your product or service is ready for sale in the marketplace, you should be thinking about how to brand that product. Although legal protection is automatic, a smart entrepreneur will first do the legwork to ensure that his or her intended mark, by name, color, design, or other manner, does not come too close to another's preexisting trademark. Once you are confident that your mark is original to you, taking steps to register your trademark increases your rights to enforce that mark against others.

Copyrights

Copyright, like trademark, is another often misunderstood area of law. Understanding what is copyrightable, what you need to do to protect a copyrighted work, and the rights that copyright protection gives, are important steps for securing your company's assets.

A copyright is a form of intellectual property protection granted by federal law to "original works" of authorship. Copyright protection is limited to particular expressions of ideas and does not cover the underlying ideas themselves (i.e., it covers a painting of a flower, but does not cover the idea of painting that flower). Copyrightable works include:

- ♦ literary works – books, computer software, documentation, stories, etc.
- ♦ audio-visual works – videotapes, movies, etc.
- ♦ graphic or pictorial works – photographs, paintings, etc.
- ♦ sound recordings – recordings of music, sounds, voices, etc.

Copyright protection offers a "bundle of rights" to the owner. Others can be excluded from making unauthorized copies, displaying, performing, distributing, or even creating a work based upon the protected work.

Trademarks, you may remember, obtain legal protection once they are used in commerce. Copyright protections vest even earlier—at the very moment a work is "fixed" in a tangible medium of expression, such as when a poem is written down, computer software is saved on a hard drive, or a song is recorded to a CD, it has copyright protection. In other words, once the idea (whether a poem, a song, dance routine, or software code) is out of your head and onto the paper, located in the hard-drive, or captured in an audio recording, it is copyrighted.

So, registration is not required to receive copyright protection, but like trademarks, copyright law provides substantial benefits to those that do register. For example, registration is a requirement before a copyright infringement suit can be filed. Additionally, registration serves to create evidence of the copyright that can be used in an infringement action. Finally, attorney's fees and statutory damages are only available to registered works. In short, if you want to enforce your copyrights against someone you think has stolen your idea—you need to register. You can register at the time of suit, but you won't be able to recover damages for any period prior to that registration.

Software companies should pay special attention to copyright protections because it is often the main form of legal protection available for software; however, all companies can take advantage of copyright protections. To serve notice to others that a work is protected by copyright, a company should place a copyright notice on the work or the work's packaging if it cannot be placed on the work itself. The correct format of copyright notice has three elements: (1) the symbol © or the word "Copyright" or the abbreviation "Copyr.;" (2) the year of first publication of the work; and

(3) the name of the copyright holder. For example, if John Doe first publishes a short story in 2004, the notice should read "© 2004 John Doe." That said, if you don't have the © on your works, that doesn't mean they aren't copyrighted. Remember, you have a copyright protection as soon as you get your ideas out of your head—you don't have to do a thing to have protections.

Patents

Patents are not like trademarks or copyrights—they require legal action to gain protection and the process for obtaining a Patent is very complicated. A patent is simply a document, issued by the federal government, which grants an inventor the right to exclude others from using, in almost any way, your invention. Once you receive a patent, nobody else is allowed to use, sell, offer for sale, incorporate into their own invention, or export or import your invention. You have an almost total monopoly over the use of that invention – but there are a few catches.

First, you have to obtain the patent – which as has been noted, is not easy. Second, you only get patent protection for a relatively short period of time—basically 20 years from the date you file your patent application with the federal government. Finally, you must disclose all of your ideas in your patent application, which becomes a publicly available document 18 months after you file. In other words, all of your secrets will be known by your competitors if you file a patent application—this is why some inventions are more properly protected by trade secrets (see below).

To be eligible for a patent, an invention must meet all of the following criteria:

1) fall within one of the several classes of subject matter defined in the patent statute;
2) be new or novel;
3) be useful; and
4) be non-obvious.

With regard to requirement 1), types of inventions that can be patented include machines, processes, articles of manufacture, compositions of matter, plants, and ornamental designs for articles of manufacture.

Patents are the most expensive and difficult form of IP protection to secure. A detailed description of the invention and legal claims that describe the invention must be filed with the United States Patent and Trademark Office, where a Patent Examiner will review the application against the requirements mentioned above. Usually, the patent examiner initially requires more information and/or refuses to issue a patent based upon the primary application. Once this happens, applicants do have various options, but the process can be very confusing and expensive. Use of a patent attorney knowledgeable in the subject area of your invention is *strongly* suggested. The patent-granting process is very detailed, time consuming (usually lasting years), and expensive. Additionally, drafting of a patent's claims is a critical step that can have huge positive or negative impacts on a company's IP protections and should be undertaken by someone skilled in drafting legal claims. As noted above, patent protection is very powerful—but it only extends to the exact invention described in your original invention. So, taking the time (and money) to ensure that you get everything you want in your original application is a very important step in gaining patent protection.

Of course, the patent disclosure process is a double-edged sword. Just as you want to get everything you can from your patent, others are using their patents to make sure you don't get what they have already claimed. So, if you claim too much in your original application, you run a much greater risk of claiming something that somebody else has already claimed in their patent—if that happens, your patent will be considered either "not novel" or "obvious" and you will get no protection. Consequently, you need to be careful to draft your invention description so that it is not too broad—but also not too narrow because you want the patent to cover as much as legally possible. Drafting the description can be a very difficult line to walk and it is best to err on the side of being too narrow.

A final issue that all entrepreneurs must understand about patent protections is that they are very easy to lose. The most common way that inventions fail to obtain patents is because the inventors have either already tried to sell or have talked about their invention before seeking patent protection. Trademarks and copyrights both obtain legal protections by being used or expressed. Patents are not like trademarks or copyrights. Inventions can only gain patent protection by having a patent issued by the federal government and one *important* restriction on such issuance is that patents do not get issued to inventions that have been "out in the public" for any period of time. Indeed, for a long time, merely talking about your invention, writing about it, or trying to sell or license it, resulted in an absolute bar on being able to obtain a patent. Fortunately, at least here in the United States, the rule has been relaxed somewhat—but inventors still delay patent applications at their peril. The rule in the United States is that you have one year from initial disclosure or offer for sale to file your patent application. If you wait more than a year, you will not be able to get a patent. A best practice then, for any inventor, is to seek the advice of counsel before disclosing your invention to anyone. Filing a patent application before a disclosure is always the best way.

Despite their difficulty to obtain, patents can offer a great competitive advantage over your competitors. By securing a patent on an invention, you may be able to preclude your competitors from entering an area of the market or at least require that they pay you for their ability to enter the area (i.e., by forming a licensing agreement with your company). Additionally, patents can ease in the process of securing investment capital and are also important when assessing a company's value.

Trade Secrets

Trade secrets are the opposite of patents. As just mentioned, patents are public disclosures—everyone can read your patent and see just what you have invented. Trade secrets, as their name implies, are those inventions, processes, ideas, or formulas that companies choose not to show the rest of the world. Given their secrecy, the law does not provide strong protections for trade secrets—imposing most burdens on the inventor to *keep* the invention secret and only punishing those who go too far to breach your secrecy.

With this is mind, the law does protect as a trade secret any formula, process, pattern, device, or compilation of information provided these are: (1) used by a business; and (2) confer a competitive advantage over competitors. There are three general categories of trade secrets: (1) an invention (patentable or not) reduced to practice and associated "know how" (e.g. business processing patterns); (2) abstract or general commercial or industrial ideas (e.g. business plans); and (3) non-novel information of value to its owner (e.g. customer lists).

Trade secrets are generally protected by state laws, and can vary in some ways in different jurisdictions, but the important point here is that trade secrets must actually be used by the company and, important, it must be shown that that they have a commercial application. It is not sufficient to hoard ideas in the hope of restraining the ability of others to use those ideas.

It is also important to recognize that trade secrets are not automatically protected by the law. Rather, the law requires that the company take actual and reasonable steps to keep the information secret. Only if the company has taken these steps will the law protect trade secrets against third party misappropriation. These steps can encompass many different actions, which may include:

- identification of what company information should be protected as trade secrets
- evaluation of the company's applicable procedures to determine if they adequately protect the information
- amendments to third party agreements to ensure that trade secrets are kept confidential indefinitely
- requiring future third party vendors and consultants to execute non-disclosure agreements
- creation of an internal trade secret policy that addresses building access, photocopier use and placement, security of electronic information, record retention, locked desks and file

cabinets, shredding bins, clean desk and lab space, and access of independent contractors and temporary workers to sensitive materials.

In other words, if a company wants to claim something as a trade secret, it better take steps to keep that information secret. Provided it does so, the company may rely on trade secret laws to punish third parties that illegally obtain the information the company sought to keep secret. However, laws do not protect against innocent discovery by your competitors. Whereas patents prevent any other party from using your idea, even if they independently thought of it, trade secrets are no protection against a competitor's discovery of the same information provided they did not obtain and use your trade secrets.

Trade secrets offer a good strategic option because they do not expire as long as the information remains a secret; however, the "patent vs. trade secret" decision is a very important one and can greatly affect the future profitability of a company. The main factor to consider is how easy it will be to keep the information secret. Once again, consultation with an attorney will help identify the pros and cons of each option, which will help you make a well-informed business decision.

Glossary of Intellectual Property Terms

Due Diligence

The process of researching the ownership history of intellectual property. For example, if your company is looking into acquiring a new technology, you should evaluate both the technology itself and the party from which the IP is being acquired. This evaluation should include research into whether the party actually has all of the rights to the IP that you are attempting to acquire.

When potentially licensing rights to IP, you should investigate the buyer's financial strength, reputation, and future prospects. This is especially important in situations in which the licensee has agreed to pay future royalties. In short, proper due diligence will reduce your risk in any IP transaction.

Exclusive License

Entitles the licensee, and only the licensee, to exercise the rights licensed. For example, if you license all of your rights in a piece of IP within the U.S. and Canada to another party, only that party can exercise the licensed rights within those two countries. However, you should also keep in mind that by granting another party an exclusive license, you are agreeing not to license those same rights to additional parties. In fact, unless explicitly indicated in a license agreement, even the licensor must refrain from exercising the exclusively licensed rights.

Field of Use License

Confers rights to a licensee within a specified area – geographic, market segment, or other – while holding back those rights in non-licensed fields for the licensor to potentially use or license to a different licensee. For example, you might license the right to make and sell a piece of IP to a third party for the airplane manufacturing industry only. The licensee would have the right to make and sell the licensed technology to sell to airplane manufacturers and suppliers; however, but you have retained the right to sell the product make and sell the technology to the automotive industry (or to license to a different licensee to do so).

Infringement

Occurs when a non-owner exercises the owner's rights in IP. For example, you own a patent on a certain piece of machinery. You then find out that another party is importing the machinery from a company in South America. Because your patent rights include the exclusive right to import the machines, the third party is infringing your patent rights and you have the option to file a lawsuit asking the court to require the other party to cease and desist the activity and for damages. In many instances, infringement suits such as these settle when the alleged infringer agrees to a licensing agreement with the rights holder.

License

Intellectual property rights can be bought, sold, or otherwise transferred by granting a license. By negotiating a license to a piece of IP, a non-owner obtains the right to do something that he or she would otherwise not be permitted to do. Licensing agreements can be used to grant the entire "bundle of rights" associated with the IP or limited, specified rights in the IP.

Misappropriation

When a party wrongfully obtains the trade secrets of another party. Industrial espionage is the flashiest example of misappropriation. Many times, trade secrets are misappropriated when your company hires away your competitor's employees and they employ the competitor's trade secrets while working for your company. Additionally, not following the terms of a non-disclosure agreement can cause misappropriation of the other party's trade secrets. In these situations, the trade secret's owner can sue the other party for the damages caused by the misappropriation. Unfortunately, receiving an award of damages does not put your trade secrets "back in the safe."

Provisional Patent Application

A shorter and less expensive version of a full patent application. It is used only to establish a filing date for a future full patent application for the technology described. In reality, a provisional patent application is not an application for rights but simply a depositing of documents in order to establish a filing date. A full application must then be filed within twelve months if the filing party wants to utilize the application date established by the provisional filing.

Companies may choose to use provisional filings to utilize the following twelve months perform additional testing and sales efforts to determine whether the costs of a full patent application are justified from a business perspective.

Work for Hire Doctrine

Employers own works created by an employee within the scope of employment along with certain works specified in the statute. Generally the employer owns those items which are the result of the kind of work the employee is paid to perform, prepared substantially within work hours at the workplace, and prepared, at least in part, to serve the employer.

"Start ups" tend to utilize many consultants, contractors, and part-time employees. The works created by these categories of workers may or may not fall under the Work for Hire Doctrine. Requiring these workers to execute an IP Assignment agreement that transfers ownership of any IP created as part of their work for the employer is suggested. Consult an attorney to determine the specific types of non-employee work product that are covered by the Work for Hire Doctrine.

Chapter 3.

Contracts

Overview

A contract is a legally enforceable agreement between parties to do something…anything really. Contracts can be written or oral, although written contracts are much more easily enforced. For this reason, new companies are urged to make sure that all agreements pertaining to their business arrangements are in writing. Putting an agreement in writing has many benefits, including: reducing the risk of an expensive misunderstanding between the parties; increasing the amount of scrutiny performed by each party by requiring the signing of a written document; and providing documentation for any disputes that may arise. In short, as any good lawyer will tell you and any business person with real experience will agree, if it is important to your business, make sure it is in writing.

Formal legal doctrine requires a valid contract to incorporate three basic elements: offer, acceptance, and consideration. What do these elements mean? Go to law school if you want to know their deeper meanings—but the basic point is that mere promises to do something are not contracts. Someone needs to pay (if not in money, then in exchanged services or other tangible item) for something for it to be a contract. In addition, in cases where one party has an entirely different understanding about the nature of the deal than you, there may not be a contract (even if you signed something). For this reason alone it is important that any contract clearly and unequivocally convey the terms of the deal struck—so that neither party can come back later and claim something different.

Parties can, obviously, write their own contracts and have them enforced. However, lawyers (despite televised portrayals and an unfortunate professional reputation) are trained to write clearly and succinctly. There are times where lawyers may be paid to engage in some obfuscation (there's one example!) but any lawyer worth her salt has the ability and the inclination to write contracts so that any reasonably intelligent person can understand the terms of the deal they have just struck.

State law determines the validity and interpretation of contracts. As a result, subtle differences between state laws may result in different interpretations and enforcements of contractual terms. One real advantage for many businesses is that they can choose which state's laws will apply to a given contract and, in many cases, in the exact court where any disputes will be litigated. Here again, lawyers can be invaluable resources for navigating you through the many differences that exist between different state's contract laws and which, so-called, "governing" law should apply to your contracts.

As you work hard to build up your business, it is important that you pay close attention to any contracts you use or are asked to sign. Contractual relationships play a large part in attracting investment capital and in the overall value of a company. For example, if critical contracts to a company's success can be easily cancelled on short notice and with no penalty, outside investors or evaluators will lower their estimate of your company's value. The opposite is also true. If the company is tightly locked into its strategic relationships, the value of the company rises.

You may not just lower the value of your company if you don't take care with your contracts, you might lower your personal fortunes. For example, consider the situation in which John Doe has yet to form the corporation, WidgeCo, under which he plans to sell his widgets. In order to make

the widgets, John signs an agreement on behalf of WidgeCo with SupplyCo to purchase the materials necessary to make 1000 widgets over the next six months. Later, John files the documentation to form WidgeCo and commences the process of making widgets under the newly formed corporation. Soon after, WidgeCo is unable to buy the remaining materials agreed to in the contract with SupplyCo. If SupplyCo chooses to file a lawsuit based upon the breach of contract, John Doe may be personally liable for the remaining money owed to SupplyCo because he entered into the agreement before he actually formed the corporation!

So, if we could sum up this overview in two simple rules they would be:

- Get it in writing!
- Know what you are agreeing to before you sign!

It is harder to imagine two more common-sense legal maxims yet, these are two of the more common and costly mistakes made by new entrepreneurs. The remainder of this chapter sets out some other rules, strategies, and principles that you should keep in mind as you negotiate and sign contracts. It also provides descriptions of the most common forms of contracts you may be asked to sign or create. As always, an attorney may be an invaluable resource not just in carrying out these strategies, but in their formation.

Contract Creation Strategies

Choose Your Battles Carefully During Negotiations

A company should have clearly defined "mission critical" items they know are keys to their success going into any negotiation. These items are of the utmost importance to the company's strategic success. In addition to identifying these items, you should also perform market research to understand current market trends and how other players in the market have handled similar issues. Finally, research the other party's business situations to anticipate their key items and then brainstorm ideas for how to bridge any differences that may exist.

Define the Scope of Performance

In other words, make sure to clearly state what each party has agreed to do or not to do. Carefully defining the scope of performance can help to avoid expensive misunderstandings and disputes. Make sure to fully explain what consideration each party will be contributing to the agreement. For example, if you are licensing the right to sell a piece of software to third parties, make sure to detail the amount and frequency of royalty payments, which party will provide the software to the end user, and other important details. Keep in mind that "agreeing to agree later" invites future disputes and misunderstandings. If possible, come to a consensus on all aspects of the agreement at the time the agreement is initially executed.

Allocate Risks

An important aspect of any relationship is the allocation of business and legal risks between the parties. Each party should consider the "worst case" scenario if the other party does not live up to their end of the bargain. Actions to alleviate these potential issues can then be included in the agreement, including a requirement to buy product liability insurance, the deposit of funds in an escrow account, an agreement that the breaching party will pay all attorneys' fees, or other appropriate actions.

Popular Document/Contract Types

Non-Disclosure Agreements

Perhaps the most common contract you will be asked to sign or may ask another to sign is a Non-Disclosure Agreement ("NDA") or Confidentiality Agreement. This is a document that, not surprisingly, requires the parties to keep certain information confidential. NDAs may be one-way agreements, where only one party has confidentiality obligations. In other cases, they may be mutual or “two-way” agreements where each party discloses confidential information to the other.

In these documents, the party providing the information is often termed the “discloser” or “disclosing party” while the party receiving the information is often called the “recipient” or “receiving party” (see…not all legalisms are dense or vague!). Typically, the interests of the discloser and recipient are diametrically opposed on a number of issues including the scope, duration and terms of the NDA. For example, the discloser would prefer to have the scope of the materials covered by the NDA be as broad as possible to protect all of the information it discloses. The recipient would prefer to narrow the scope of the NDA by: (1) creating a so-called "marking" requirement so that only materials marked "confidential" by the discloser would be protected; (2) creating certain exceptions that would fall outside of the NDA; or (3) making the agreement’s term shorter.

A marking requirement places the burden on the discloser because there will be no protection under the NDA if the discloser fails to mark a document confidential. Another issue is whether you, as recipient, may disclose the information to your advisors (e.g., your counsel or accountants) or potential financing sources. The discloser may require that you be liable for any violations of the NDA by such parties. As an alternative, the discloser could require that your advisors sign an NDA in their own capacity or that they must acknowledge awareness of the NDA signed by you and agree to be bound by its terms.

Additional concerns arise when you are competitors or potential competitors. The discloser may want to include a non-solicitation provision that would prevent the recipient from hiring specific employees or management. The recipient may want to include a provision that the discloser accepts the recipient as a competitor as long as it does not use the confidential information in its business activity. As you can imagine, in the earliest stages of your business, you will be asked to talk about your idea or invention with numerous individuals (e.g., potential investors, employees, contractors, manufacturers etc.). It is important that those discussions occur only after each side has signed an NDA. Oh, you do not need to have an attorney sign an NDA provided your discussions with that attorney are either after you have hired her or during discussions about retaining her. That said, if you are not comfortable talking to an attorney without having her sign an NDA, she should not object (but may want to make some changes to the contract you present).

Letters of Intent

Another very common legal document is not, necessarily, a contract at all. The Letter of Intent (“LOI”) is simply a document that describes the basic terms of a future, not yet agreed upon, business transaction. There are pros and cons associated with using an LOI. On the one hand, an LOI has the advantage of summarizing the basic terms of the transaction. Some business executives feel that the process of negotiating an LOI before moving to contract stage focuses the parties on the key business terms earlier in the transaction process, and thus may lead to "deal momentum." Furthermore, you typically can save costs when deals "die" at the LOI stage because you have not expended the cost or efforts necessary to draft a full contract. The LOI can also serve a useful evidentiary purpose when, in negotiating the final contract, you feel the other party is engaging in "term creep" (i.e., departing from the terms of the LOI).

On the other hand, some business executives feel that time spent negotiating an LOI would be better used negotiating the definitive agreements. In addition, a poorly drafted LOI can lead to

costly misunderstandings and litigation. Typically, the LOI will be drafted to be "non-binding" since the definitive agreements have not been drafted. However, there are cases where parties have been sued on the basis of an LOI that they thought was non-binding. In the case of a public company, execution of an LOI may sometimes trigger a disclosure obligation under the securities laws. Finally, the other party could use the LOI to "shop" for better terms from third parties. For this reason, LOIs often contain an "exclusivity" or "no-shop" provisions, which can be enforced as contracts.

Although LOIs can be useful documents, we hope you can see how they can cause problems. If the deal is worth it, it may be time to ask an attorney to draft the LOI or review it before signing anything.

Shareholder's Agreements

Basic NDAs and LOIs are agreements that, in some circumstances, can be easily understood and even drafted by you. Shareholder's agreements are completely different animals. If you are at the stage where you worrying about this contract, you need an attorney (and are probably doing quite well anyhow, so congratulations!).

A shareholder's agreement is a contract between a corporation and its stock holders that generally covers a number of very technical matters affecting the structure and governance of your company. Among the issues usually addressed are: (1) voting; (2) restrictions or prohibitions on stock transfers; (3) rights of first refusal and co-sale; (4) restrictions on corporate action; and (5) rules regarding how the company will be run. The interpretation and validity of such agreements will depend on the nature of the applicable provisions, the governing law and the applicable facts and circumstances. For example, there are some significant differences in the corporate law depending on the state of incorporation (e.g., Delaware as opposed to Arizona). Once again, the variations in state law are matters best left to experienced counsel.

Restrictions or prohibitions on transfer are sometimes used to prevent the transfer of capital stock to limit the number of shareholders or to prevent certain third parties (e.g., competitors) from acquiring the stock. As for rights of first-refusal, you should consider whether the right should be held: (1) only by the company; (2) only by the shareholders; or (3) first, by the company, and then, the shareholders to the extent of stock available for purchase. If the company has the right to purchase or redeem stock, state corporate law may prohibit purchases in certain circumstances (e.g., if the redemption would make the company insolvent).

There are many other issues that arise out of the execution of shareholder's agreements. In most cases, once a company sells public shares or even provides shares to later investors, it will never be the same as it was before. Investors and shareholders will often insist on changes in the governance of the company, including creation of a board of directors that represents shareholder interests rather than the manager's (that's probably you!). One basic rule of thumb is not, we repeat *not* to use the same counsel as your investors when creating a shareholder's agreement. In many cases, investors will recommend an attorney for the small company—this attorney will often represent the investor in many deals and, if that is the case, may not be the best representative for your interests. Wherever possible, find your own counsel and ask them to create or review any shareholder agreement.

Commercial Real Estate Leases

The terms of commercial real estate leases will vary based on the nature of the proposed lease transaction (e.g., rent, nature and amount of space and the parties involved). Some of the key terms of a commercial lease include: the duration of the initial term, renewal rights, the amount of space, the rental payment (and any adjustments on renewal), the security deposit, the nature of the lease (i.e., full service or triple-net), subletting, assignment, liability, termination, improvements, and expense allocation (e.g., improvements and repairs). For smaller companies, landlords will

often demand personal guarantees from company founders. Your ability to negotiate favorable terms in the lease will often depend on current vacancy levels in the local real estate market.

If you are considering a sublease, remember that the original lease between the landlord and the original tenant will affect your sublease. First, the sublease will automatically end upon the termination of the original lease between the original tenant and the landlord. Second, if you pay the rent to the original tenant but the original tenant fails to pay the landlord, then you will have no claim against the landlord if the landlord terminates the original lease and evicts you. Finally, if the landlord breaches any covenants that it made in the original commercial lease, generally only the original tenant can sue the landlord for breach of those covenants.

If you are a life science company seeking laboratory space, additional issues may arise. You may be subject to numerous environmental or disposal regulations created by federal, state, or even local governments. You should consult a real estate attorney before signing a lease or a sublease because of the potential for liability. You may not only be liable for the lease itself, but also for potential tort (i.e., civil lawsuit) liability for visitors injured on the premises, and the liability for environmental matters.

When negotiating a commercial lease, please keep in mind that if you need to expand or contract in the future, long-term leases can create significant financial risk, especially if your rights to assign or sublease are restricted.

Intellectual Property Assignments

Technology companies depend on IP. To get IP, they rely on their employees to create it or keep it working. As a result, any technology company worth its salt needs to make sure that it not only owns its current IP but any future IP created by the employees it hires. If you remember from the chapter on IP, the ownership of some ideas vests with the employee and not the company (particularly patents). As a result, the company should take steps to make sure that any IP created by employees will be owned and controlled by the company.

The most common way to do this is to require employees to execute an “IP Assignment” as part of their employment agreement or as part of an enforceable employee manual. An IP Assignment agreement should be included in a company’s standard employment contract and should also be part of the employee handbook. Additionally, it should be part of all agreements with contractors and temporary employees.

As you might expect, this area of law also depends on state laws and, as a result, is quite complicated. In some states, employee manuals are much more difficult to enforce against employees than an executed agreement. In other cases, IP assignment may be implied by the law and the employee’s IP will be assigned to the company even in the absence of explicit policies or contracts. Consulting with an attorney is always a good idea when dealing with general employment/IP questions (see also, Chapter 5).

Glossary of Contract Terms

Alternate Dispute Resolution

Litigation is the default method of resolving disputes that the parties cannot resolve among themselves. However, the parties can include provisions in contracts that require alternate methods to be utilized when resolving disputes. Depending on the nature of the dispute, costs may be lower for an alternate method, such as arbitration. Additionally, claims can be usually be resolved in less time through the arbitration process.

Amendment

In order to avoid potential conflicts down the road, parties to a contract should specify how changes to the contract can be made after it is executed. For example, if you have signed an agreement with a supplier of parts you use to make a piece of machinery and later need to change the standard size of an order (i.e., from a dozen to twenty parts), you may have trouble coming to an agreement if the original contract does not specify what needs to happen in order for the changes to take effect.

Assignment

The transfer of all or a part of the rights of a party to a contract to another party. In other words, one party sells or gives all of its rights in a piece or multiple pieces of IP to another party.

In many instances, a company's ability to assign its rights under a contract without the consent of the other party may be valuable. For example, if your company is a supplier of disk drives to a computer manufacturer and is purchased by a larger company, you will want to be able to assign your rights and obligations in the contract to the acquiring company.

Choice of Law

The process of deciding which state's law will govern the validity, interpretation, and enforcement of a contract. The law that will govern disputes under the contract can be important because it may affect the type of legal claims that are available, the nature or amount of the recovery, and the applicable statutes of limitation.

Many courts recognize the validity of a contractual provision where the parties agree to have the law of a specific state govern the contract. However, there are situations where courts will not recognize a choice of law provision. For example, if the court determines that the choice of law was obtained by fraud or the state chosen by the parties does not have a reasonable relationship to the contract or the parties, it may choose to not enforce the clause.

If no choice of law provision is included in a contract, a court will choose to apply the laws of the state it believes is most connected to the disputed activities. For example, if the dispute arises from the delivery of a product and the delivery takes place in Missouri, then the court may choose to apply the laws of Missouri when interpreting the contract. If your dispute's outcome can vary widely depending on which state's law is applied, you should consult an attorney to determine which state is most likely to be chosen.

Indemnification

Creates an obligation for one party to the contract to reimburse another party for certain types of damages or injuries. For example, if you agree to indemnify your landlord against any damages or liability arising out of personal injuries that occur on the property, then you are, in effect, agreeing to act as an "insurer" regarding that type of damage or liability.

When potentially agreeing to provide indemnification, it is important to consider whether there will be a maximum cap on the amount being reimbursed. If you have negotiated an indemnification clause in which the other party agrees to reimburse you for certain types of damages and liabilities, you will want to also require that party to obtain an insurance policy so that he/it can actually pay.

Statute of Frauds

The statutory requirement that certain types of agreements are in writing, or they are unenforceable. Some examples of business contracts that generally must be in writing to be enforced under the statute of frauds and applicable state laws include:

- the sale of goods priced at $500 or more;
- the sale of personal property priced at $5,000 or more;
- promises to act as a surety (i.e., to pay the obligations of another);
- promises that cannot be fully performed within a period of one year from the date of the agreement;
- the lease of real property for period of more than one year; and
- the purchase of real property.

There are some exceptions to these situations. Consult an attorney to determine if your situation is excluded from these general rules.

Statute of Limitations

The maximum amount of time a party can initiate litigation after a disputed activity takes place. For example, if the applicable statute of limitations for fraud in your state is four years, you must file a complaint within four years of the alleged fraudulent activity having taken place. If more than four years go by, you will not be allowed to assert your claim. For this reason, companies seeking to litigate disputes relating to contracts should make sure they file their cases before the expiration of the applicable statute of limitations.

Additionally, many states' laws provide different periods of time for litigation of contract disputes depending on the nature of the underlying contract. If considerable time has passed since the activity you believe deserves to be litigated, consult an attorney to determine if the statute of limitations for the claim has elapsed.

Chapter 4.

Employment Law

Overview

The two most basic assets of any business are its people and ideas. Both are of critical importance to success. This means that you should spend as much time considering how your company will attract and retain talented people as how you will protect your company's ideas.

Growing companies can be bogged down by troublesome employment issues if proper plans and procedures are not put in place from the very start. These plans and procedures need to address how to avoid serious issues such as discrimination, harassment, and retaliation. Companies also need to plan for how to properly handle these topics should they arise, despite the company's best efforts. Clearly articulated policies and procedures can avoid costly employment disputes down the road.

As a technology-based start-up, the policies and procedures you put in place should also address the protection of your IP. In this day and age, employees are very mobile and you will want to protect yourself from unfair activities by departing employees. This is usually accomplished through appropriately structured agreements, such as non-disclosure, non-solicitation, and non-competition agreements. Each of these devices can help limit your company's exposure when an employee leaves for the competition. It will almost certainly happen, so you better be prepared!

Furthermore, as discussed previously, your company should require employees, contractors, consultants, and temporary employees to execute agreements in which they agree to assign any IP they generate as part of their job to the company. This policy should also be placed in the company's employment handbook or manual. It is also important to ensure that when you start your company, you are free to take the ideas or inventions that you may have had from your previous employer. One of the most difficult employees to handle is you! Many companies have been sunk because the founder's prior employer has made claims to the ideas or inventions that form the basis of the new company.

Hiring Issues and Strategies

Background Research and Interviewing Practices

Start-ups need not invest in large Human Resources departments to engage in good hiring practices. By focusing on a few fundamentals, you may attain a relatively high degree of certainty that you are making good hiring decisions. Follow these policies when looking to hire qualified individuals:

- all candidates should be required to submit resumes in writing… achievements and education claims should be checked;
- all candidates should be required to fill out job application forms with key questions such as "reason for leaving" prior jobs;
- all candidates should be required to provide several references from prior employers which should be carefully checked;
- all candidates for sensitive positions, such as jobs which require handling money, should be the subject of background searches into prior criminal convictions and other issues

bearing on trustworthiness, which will require certain disclosures and consents if the background check is to be conducted by a third party;

- hiring-managers should be trained about what types of questions are permissible and what types are not… questions about age, national origin, religion, marriage status, disability, and many other areas are illegal and could result in litigation if asked—avoid them;
- where possible, ensure that all candidates meet with senior personnel rather than delegating hiring decisions to the newest employees.

Another potentially dangerous area of employment law is the offer letter. Most employers, even if they do not use formal employment agreements, provide offer letters to potential hires. These letters, if not carefully worded, may form the basis of an employment contract. Most states are "at-will" employment states (see glossary below) but this general state of legal affairs can be undone by a poorly-worded offer letter that makes promises or provides terms on which a potential employee may rely. One easy way to avoid most of the downsides is to ensure that any offer letter explicitly declares that it is not to be taken as an employment contract. It is usually a good idea to make clear that the terms of employment in the offer letter override any prior oral agreements.

Consultants vs. Employees

Many emerging businesses cannot predict workflow with much certainty and retain consultants to provide services on short-term bases. However, you need to be very careful to ensure that persons who were initially (and correctly) classified as "consultants" do not become "employees" by operation of law. Under many statutes intended to protect employees, it is possible for agencies such as the Internal Revenue Service or the U.S. Department of Labor to take the position that "consultants" have been misclassified and should properly be deemed "employees." The two have many different rights and your company's obligations are different. You should regularly review your "consultant" population to ensure that such individuals are appropriately classified and should ensure that a consultant agreement specifying the nature of the relationship, including IP rights, is in place with each individual.

Affirmative Action

Government contractors or sub-contractors may be required by law to implement affirmative action plans and to report regularly on their compliance with those plans. Employers who are not subject to such laws are not required to engage in affirmative action; however, they are required to prohibit discrimination in compliance with federal and state non-discrimination laws. The categories of prohibited discrimination may vary from state to state, country to country, and even by municipality. You need to be aware of these local variations in laws prohibiting discrimination. Consult an attorney with expertise in the geographical location in which you want to learn more about its discrimination laws.

Intellectual Property Agreements

Many companies ask employees to sign agreements in which employees promise not to use or disclose their company's confidential information and to assign any inventions created during the course of their employment to their companies. As discussed in previous chapters, the names of these agreements vary. Remember, it's a good idea to have employees promise to assign to your company any inventions that are created using your company's time, equipment, or ideas. The assignment of inventions provision is crucial to avoid disputes in which employees might claim ownership over inventions derived from your company's business, especially patents.

Restrictive Covenants

Restrictive covenants generally fall into three categories, all aimed at protecting your company's proprietary information and related business interests: (1) non-disclosure agreements; (2) non-solicitation agreements; and (3) non-competition agreements. Once again, NDAs typically state that employees will not use or disclosure a company's confidential information after termination of their employment. Non-solicitation agreements typically provide that employees will not later solicit your company's customers or employees for a reasonable period of time after termination of their employment. Non-competition agreements typically provide that employees will not work in a particular industry for a reasonable period of time after termination of their employment.

Because non-competition agreements restrict the ability of individuals to earn their livelihoods, courts may be unwilling to enforce them unless such agreements are carefully drafted as to: (1) geographic scope; (2) time period; and (3) scope of restricted activities.

The enforceability of restrictive covenants varies widely from state to state, and if you have employees in more than one state you may need to use different agreements to fully protect yourself.

Foreign Labor

Alien (both permanent and temporary) workers in the U.S. may have immigration circumstances that limit their ability to work in this country. Immigration law is a highly specialized field. If you have any questions about a foreign worker's ability to work in the U.S., you should seek specific advice from a qualified specialist (also consult Chapter 6 of this handbook).

When an alien worker is hired, you must complete an I-9 form verifying the identity and work authorization of each employee, regardless of citizenship. Although the form appears straightforward, you should seek training to be sure you understand how to complete all parts of the form accurately and within the required time limits. Mistakes on the I-9 form can produce a lengthy and costly process to fix the problems.

When hiring workers to function outside of the U.S., know that employment laws outside of this country (e.g. Canada, South America, Europe, Asia) may be far more protective of employees. Also, just as the law may vary from state to state within the U.S., employment law may vary from province to province within other countries. In some European countries, it is not permissible to hire employees unless your specific business entity is established in those countries, which may raise tax and accounting issues. Thus, obtaining specific employment, corporate, and tax advice may be essential when hiring in a foreign country.

Hiring from Competitors

An emerging company can be slowed down by litigation brought by a competitor who alleges that the company (your company) has hired the competitor's former employees who are bound by restrictive covenants (i.e. non-competition, non-solicitation, or non-disclosure agreements). You should take care to understand whether job candidates are subject to restrictive covenants, and you should not assume that restrictive covenants are unenforceable. Even when candidates are not subject to restrictive covenants, former employers may threaten lawsuits when they perceive unfair "raiding" of customers, employees, or trade secrets.

At the onset, *you* should inform job candidates not to take any proprietary materials from prior employers. When appropriate, you should avoid placing new hires in positions in which they will immediately be calling on their former employers' customers, and you should counsel the newbies not to immediately solicit other employees still working at their prior place of business.

Current Employee Issues and Strategies

Compensation Practices, Including Stock Options

Employees of start-ups, including founders, officers and executives, often forego substantial salaries in favor of equity in the company. If this decision is made as part of the original employment agreement, then its enforceability is usually simple. A more difficult question arises when you ask an employee to forego his salary because the company is strapped for cash. In this case, the enforceability of the decision to accept equity in lieu of salary becomes more complicated.

Ensuring that the decision to take equity in lieu of monetary compensation is valid, it should be memorialized (read, be in writing). However, even such written agreements may not always be sufficient. The better practice is to pay at least the federal minimum wage, including overtime, to all employees. Any equity taken in lieu of further salary should include a written acknowledgment that the company's obligations have been fully satisfied.

Emerging companies often engage in compensation practices designed to incentivize employees. For example, it is not uncommon for the base salaries at emerging companies to be set at lower levels than more established companies. However, such relatively lower salaries may be offset by potentially larger year-end bonuses that may be paid upon achievement of individual and company goals. To avoid misunderstandings, give care to draft appropriate language regarding your company's discretion to award bonuses in offer letters, employment agreements, or bonus plans. In addition, you should be aware that in some circumstances, even if bonuses are described as discretionary, the law may require payment of bonuses to employees who have given substantial effort to achieving the milestone but have left the company before the bonus is paid.

Stock, or the option to purchase stock, is another tool sometimes used as incentive for employees. Any offer of stock, or options to purchase stock, needs to be carefully thought through in consultation with your legal, tax, and accounting advisers. Also, you should give serious consideration to the forms of equity offered (e.g., an outright grant of unrestricted stock, a grant of restricted stock, or a grant of option(s) to purchase stock). In most instances, it is advisable for you to adopt stock (or stock option) plans, which require execution of written stock (or stock option) agreements in order to document the terms of the grants. Because the issuance of stock or stock options to employees involves the offer of a security, seeking advice regarding securities law is recommended.

Stock options can take the form of Incentive Stock Options ("ISOs"), intended to qualify for favorable tax treatment under the Internal Revenue Code, or options which do not so qualify and which are commonly referred to as Nonqualified Options or Non-Statutory Options ("NSOs"). ISOs and NSOs can result in markedly different tax treatment for both the optionee and the granting company. You should seek expert advice on the types of stock options appropriate for your company. Most stock options vest in specific increments over time pursuant to a vesting schedule. The method of vesting options may also affect the accounting treatment for those options. You should clearly articulate that you do not assume responsibility for providing financial or tax advice to employees, but you should also alert employees to the complexities involved in deciding when to exercise stock options and to seek appropriate financial and tax advice to avoid "phantom income" and related issues.

Health and similar benefits often are important elements of compensation. You should be aware that certain rules must be followed to achieve the tax advantages of providing benefits, and you should consult with your insurance brokers, legal, and tax advisers to ensure that your benefits plans are properly administered.

State Employment Law Variations

Employment laws vary widely from state to state. Employees generally will be subject to the employment laws of the state in which they are employed, even if their employer is headquartered elsewhere. Some states have special employee protections that do not exist in other states. As a result, it is difficult to tailor one set of policies to cover all jurisdictions.
Many companies have a basic set of policies applicable to all employees and also have some separate supplemental policies applicable only to employees in specific states. For example, the law regarding restrictive covenants such as non-competition, non-solicitation, and non-disclosure agreements varies between states and may change from time to time. As a result, some companies use different non-competition, non-solicitation, and non-disclosure agreements in different states and update them to address changes in the law. Be aware that employment laws vary between jurisdictions and seek guidance when appropriate.

Computers in the Workplace

Computers and other technologies, including voicemail and e-mail, can have a tremendous impact upon the workforce. Just as technology can be used for good purposes, technology can also be abused by employees who wish to misappropriate trade secrets, view obscene materials, harass other employees, or engage in other improper activities. You should adapt your employment policies appropriately.

In particular, you should strongly consider implementing "electronic data policies" which state that your company's technology is supplied for business purposes, and that you reserve the right to monitor its usage. Such statements put employees on notice that they have no expectation of privacy when using your company's equipment. You should also carefully watch telecommuting, in order to minimize risks including trade secret theft, uncompensated overtime, and discrimination issues. Finally, you should maintain an inventory of your company's technology.

Privacy

As the flow of personnel information becomes easier, employees are increasingly protective of their privacy at the workplace. Some states have strong public policies in favor of employee privacy which should be considered before implementing drug-testing, employee monitoring, or other practices affecting privacy. In most instances, however, companies may engage in suitable monitoring of computers, emails, voicemails, and other company systems provided for business use… if appropriate notice to employees is given. Seek advice before implementing policies with implications regarding employee privacy.

Termination Issues and Strategies

Discrimination, Harassment, and Retaliation

The policy of protecting individuals who make allegations of discrimination or harassment is very strong. In many instances, employees who raise allegations internally are legally protected to the same extent as employees who go outside of their employer's organization to the EEOC or similar state or local agencies. This protection has been extended to the point that a hiring employer may not decline to hire a candidate based on the candidate's allegations of discrimination, harassment, or retaliation which were made against his prior employer.

There is a broad array of both federal and state law which prohibits discrimination in employment (Title VII, the ADEA, the ADA, the FMLA, and their state counterparts). These statutes also prohibit harassment and retaliation. For example, not only is it impermissible to terminate (or demote, or otherwise adversely affect) someone's employment on the basis of race, but it is also im-

permissible to harass someone on the basis of race. In addition, employees who voice concerns that they are being subjected to discrimination or harassment may not be retaliated against.

Harassment in employment crosses the line from a mere friction (which exists in any workplace), to that which is legally actionable when a "hostile environment" has been created. You can begin to defend yourself, particularly in harassment cases, by implementing policies against discrimination, harassment, and retaliation, and by taking prompt, effective remedial action when an employee complains about these issues. Remember, simply having a policy on the books is a good start, but is not enough.

Retaliation is one of the most frequent claims brought by employees. Employees have the legal right to allege that they were subjected to discrimination or retaliation. Even though such allegations may be found to be without merit by the EEOC or the courts, the law protects the act of making those allegations. Thus, you *may not* take adverse employment action against an employee who loses his discrimination or harassment claim, when such adverse employment action is motivated by retaliation for having made the allegations!

Layoffs

Emerging companies may experience rapid ups and downs which require layoffs. Many employment lawsuits have resulted from layoffs that were not adequately planned. Advance planning of layoffs can avoid expensive and time consuming litigation.

The federal WARN Act may need to be taken into account if/when you have more than 100 employees. If the WARN Act applies to a particular "plant closing" or "mass layoff," then 60 days' advance notice of termination must be given to employees, unions (if applicable), and to the local government. The WARN Act is a complicated statute, and you should seek expert advice about whether it applies to a particular layoff. State laws may impose additional and different requirements.

Hopefully you'll never encounter the situation, but in case it arises, a layoff should be planned in a manner which reduces the risk of claims of discrimination or retaliation. You should think about the process used to select candidates for termination, using objective criteria if possible. The demographics of every proposed layoff should be analyzed carefully to determine whether any particular protected category of employees is disproportionately affected. Age discrimination is one the most frequently asserted claims following layoffs. Accordingly, you should consider offering severance in exchange for the release of all claims, including age discrimination claims. Special release forms must be used in order to obtain valid releases of federal age discrimination claims under the ADEA.

Finally, you should think about logistical issues, such as: (1) what message will be delivered to employees; (2) who should deliver the message; (3) preparation of separation documents including mandatory health coverage information under COBRA; (4) information regarding unemployment benefits; and (5) what message should be communicated to employees who are not laid off. From this partial list, it should be apparent that appropriate planning for layoffs often takes a matter of weeks, not days, and you should consult with your lawyer.

Whistleblowers

Motivated by Enron, Worldcom, and other corporate collapses, Congress passed the Sarbanes-Oxley Act in the summer of 2002. The act includes significant new protections for corporate employees who report alleged financial wrongdoing. Congress determined that employees should be protected for raising concerns about financial improprieties at publicly traded corporations and created a new civil right of action for employees who are retaliated against for raising financial concerns. There are also criminal penalties in some instances. You should be very careful not to

retaliate against employees who may take actions covered by the Sarbanes-Oxley Act or the state and federal protections is supplements.

Final Paychecks

Final paycheck rules can catch multi-state employers by surprise. You need to be aware that different states have different rules specifying when employees' final paycheck must be paid. In some states, the final paycheck must be paid on the company's next regular pay date following the date of termination. However, in California for example, a "live" final paycheck must be delivered to an employee on her last day of work. Similarly, rules vary from state to state regarding whether employers are required to pay for accrued vacation when employment terminates. State laws also regulate the frequency (e.g., every two weeks) with which non-exempt employees must be paid.

Glossary of Employment Law Terms

ADA

The Americans with Disabilities Act ("ADA") forbids discrimination against employees on the basis of physical or mental disabilities, whether such disabilities are actual or perceived. The ADA requires employers to provide reasonable accommodations to disabled employees who request accommodations. Employers may refuse to provide accommodations only when "undue hardship" would result.

ADEA

The Age Discrimination in Employment Act ("ADEA") prohibits discrimination in employment against persons age 40 and above.

COBRA

The Consolidated Omnibus Budget Reconciliation Act ("COBRA") is a federal statute applicable to employers with 20 or more employees. It established rules which allow employees and their covered dependents to obtain, at their own expense, continued health care coverage under their former employer's group heath plan. Employers are required to give written notice to separating employees regarding their rights under COBRA.

Employment At-Will

Generally, employment may be terminated for any reason, or no reason, with or without notice. However, employment "at-will" may be modified by an employment or other agreement for a specific period of time. Also, employment "at-will" may be modified by public legislation.

There are exceptions to employment at-will. For example, many federal, state, and local laws prohibit terminations of employees for reasons such as discrimination, retaliation for exercising legal rights (i.e. filing a worker's compensation claim), and many other reasons. As a result, care should be taken with respect to termination of employment to ensure that some exception to employment at-will is not implicated.

Also, the frequently-used saying that a state is a "right-to-work state" has no relation to employment "at-will," but rather has a narrow meaning that refers to

employees in that state not being forced to join labor unions as a condition of employment.

ERISA

The Employee Retirement Income Security Act of 1974 (“ERISA”) is a federal law that created various rules regarding the establishment and administration of employee benefit plans.

FMLA

The Family and Medical Leave Act (“FMLA”) is a federal law applicable to companies with more than 50 employees. The FMLA gives qualified employees (who have worked for their current employer at least one year and a minimum of 1,250 hours) the right to take an unpaid leave of absence of up to 12 weeks per year to care for the serious medical condition of a family member or themselves, including the birth (or adoption) of a child. The FMLA also prohibits retaliation against employees who exercise the rights created by the statute.

IRCA

The Immigration Reform and Control Act (“IRCA”) is a federal statute requiring employers to verify the identity and employment eligibility of all employees hired after November 6, 1986. IRCA also creates a series of anti-discrimination provisions applicable to employers with 4 or more employees which prohibit discrimination based on national origin or citizenship status. IRCA furthermore imposes specific anti-discrimination provisions based on citizenship status for “protected individuals” – U.S. citizens or nationals – and four types of persons who intend to become U.S. citizens: (1) U.S. permanent residents; (2) U.S. temporary residents; (3) U.S. refugees; and (4) persons seeking asylum in the U.S.

NLRA

The National Labor Relations Act (“NLRA”) is a federal law that recognizes an employee’s right to join a union for the purpose of engaging in collective bargaining. Among other things, the NLRA protects the rights of all employees, whether in a unionized workplace or not, to engage in “protected concerted activity,” which often takes the form of organizational speeches or distributing various communications. For example, even employee e-mails that complain about working conditions may qualify as “protected concerted activity” and therefore, you may use this as the basis for taking adverse employment action against the complaining employee.

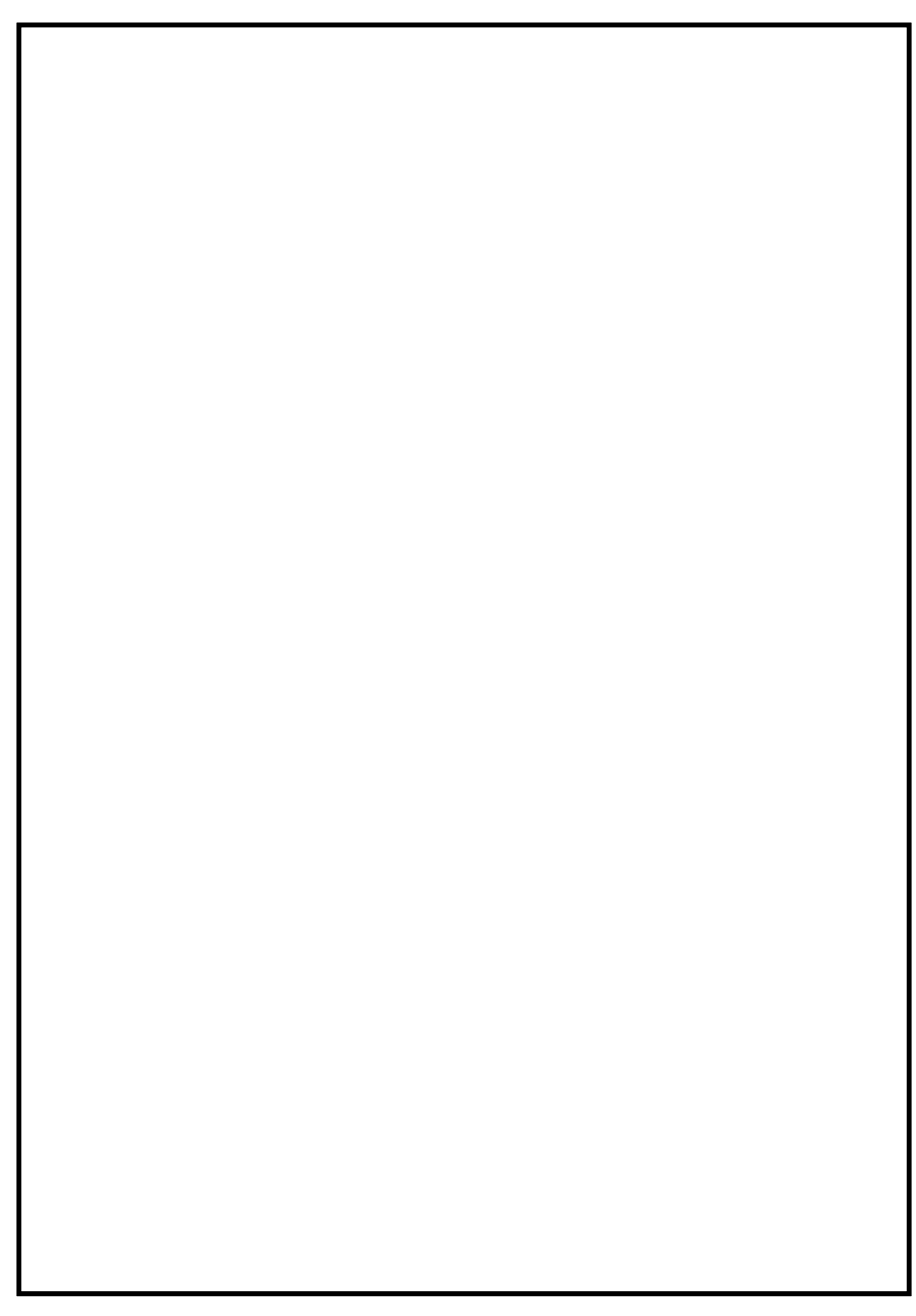
OSHA

The Occupational Safety & Health Act (“OSHA”) is a federal law which requires employers to provide a safe workplace for employees.

Respondeat Superior

Employers are legally responsible for the damages caused by their employees during the course and scope of their employment. For example, when a driver operating a company vehicle causes injuries, the employer will be held responsible.

As a practical matter, employers should seek insurance for acts of their employees and should implement and enforce appropriate policies to reduce the risks of injury to property or persons.



Chapter 5.

Immigration Law

Overview

The hardest area of Innovation Law has been saved for last. The reason that this area, immigration law, is so difficult is that it is changing drastically and at a rapid pace. Perhaps the clearest indication we have of the fundamental changes occurring in U.S. immigration law is that the long-time agency in charge of immigration, the Immigration and Naturalization Service ("INS") exists no longer and has been replaced by the Bureau of Citizenship and Immigration Services ("BCIS"). The motivation behind these changes is, of course, the aftereffects of 9/11. Since that attack, U.S. immigration law has become far stricter and, as a result, the workplace is one area on which immigration authorities are beginning to focus.

Caught in this complex legal system are millions of legal aliens, landed immigrants, and aspiring citizens eager to test their entrepreneurial skills out in the American marketplace but fearful that their actions may void their visas. Indeed, the general view among most is that the BCIS and its immigration policies only toil for those very few with the resources necessary to work the system and avoid the pitfalls of visa disallowance.

The many changes to U.S. immigration law over the last few years have affected many different groups, not just foreign workers. Employers also face the effects. In fact, U.S. companies seeking to employ non-U.S. skilled labor face the dilemma of severe penalties for non-compliance with immigration laws or a stiff legal bill for taking the steps required to comply. Neither is probably a particularly enticing choice for you.

Fear not. Despite the complexity of rules and procedures, opportunities do exist for non-U.S. citizens to undertake entrepreneurial activities in the states without violating their legal status. To repeat a constant refrain in this work—but with as much emphasis as we can muster here—this area of law is too important and complex to navigate without consulting an experienced attorney. The best advice we can give is to see an attorney who specializes in this area BEFORE taking any steps to implement your entrepreneurial ideas.

This advice applies to non-U.S. students studying in the U.S. who may want to start their own business, students or non-U.S. citizens seeking to work for U.S. companies, and foreign citizens seeking employment within the U.S. (or with U.S. companies). Failure to seek appropriate legal counsel in this area not only may damage your company, but may result in deportation, revocation of legal status, and other sanctions. Be careful! That said, you should be aware of the general outline of U.S. immigration law in order to see the areas where you might run afoul of this complex system while starting and building a new business.

Immigrant vs. Non-Immigrant Visas

The most common term used in U.S. immigration law is "visa." A visa is simply a document that demonstrates the U.S. government's permission for a non-U.S. citizen to enter the country. There are two main categories of visas: *immigrant* and *non-immigrant*.

Immigrant Visas

Immigrant visas are semi-permanent in nature. Often known as a "Green Card," an immigrant

visa grants the holder the right to reside in the United States as a Lawful Permanent Resident ("LPR"). To obtain a Green Card, the applicant must demonstrate intent to permanently reside in the U.S. and, often, pre-approved gainful employment or other demonstrated ability for financial independence. Once granted, the Green Card entitles the LPR to remain indefinitely in the US provided there are no significant changes in employment, criminal history, or other events. LPRs are granted full civil rights under U.S. law, but do not have the right to vote or gain other so-called political rights. Of course, LPRs can eventually apply for full U.S. citizenship.

Obtaining a Green Card often requires a significant amount of time. Although difficult, many non-U.S. citizens can arrange a Green Card on their own behalf without immediate employment opportunities in the U.S.—although these avenues are often restricted to foreign citizens who will invest in the U.S. economy by founding businesses and employing a number of U.S. citizens.

For cases in which the Green Card is sought by a U.S. employer on behalf of a potential employee that is a foreign citizen, the employer will need to complete a "labor certification" process. The labor certification process entails, mainly, a demonstration that the position the foreign citizen will fill cannot be economically filled by available U.S. workers. To do this, the employer must show an actual failure to fill the position through demonstrated efforts or, more likely, point to government statistics showing that the field of work in question is considered a "shortage"—meaning, that the U.S. labor supply is insufficient to meet the industry demand (nurses are a great example of this). In many cases, the labor certification may take two years or more and, even when granted, the LPR is only granted a probationary period where removal or other action is easily obtained if employment conditions change. As a result, employers seeking to hire foreign workers to work in the U.S. should be prepared for a time-consuming, confusing, and potentially expensive process.

Chart 1 below sets out the various immigrant visas available for US employers seeking to complete the labor certification process. As you can see, the various types of immigrant visas require substantial showings that: (1) the available US workforce is incapable of filling the position; (2) the foreign citizen possesses unique skills; or (3) the immigrant has substantial individual resources for investing in the American economy.

Immigrant Visas (Green cards)		
Type	*Description*	*Comment*
EB-1	Extraordinary Ability	People who have extraordinary ability in the arts, sciences, business, education, or athletics.
EB-1	Outstanding Professors or Researchers	A professor or researcher internationally recognized as outstanding in his/her field and is coming to the U.S. to accept employment in the same field.
EB-1	Qualified Multinational Executives and Managers	An executive, managerial, or specialized knowledge employee transferred to the U.S. by an international petitioning business that has been in existence for at least one year.
EB-2	Advanced Degreed Professionals or	Workers who are members of professions

	Exceptional Ability Professionals	who hold advanced degrees in the arts, sciences, or business.
National Interest Waiver	Advanced Degreed Professionals of Exceptional Ability Working within Fields deemed in the National Interest	Those who possess exceptional ability in fields of national interest to the U.S.
EB-3	Skilled Workers/Professionals	Through the labor certification process, these individuals are sought for positions that no American can or will fulfill.
EB-5	Investor	Any person establishing a commercial enterprise that creates 10 jobs with significant investment ($1,000,000).

Non-Immigrant Visas

Not surprisingly, non-immigrant visas are the opposite of immigrant visas in that they imply no ability of the holder to stay permanently within the U.S. Non-immigrant visas are, by definition, temporary. When a person comes to the U.S. under a non-immigrant visa status, they affirm to the government that their intent at their time of entry to this country is to return to their own country of citizenship.

Sometimes a person admitted to the U.S. on a non-immigrant visa will have the right to work while she is in the U.S., but her acceptable types of work are strictly regulated. However, there can be advantages to applying for the various non-immigrant work visas. First, the application process tends to move more quickly than with immigrant visa categories. Second, a non-immigrant visa holder can usually request a status change (from non-immigrant to immigrant) while continuing her business endeavors in the U.S. Finally, the onerous labor certification process, depending on the visa, may be reduced to a more manageable and time efficient "labor condition" application. Again, this is a very tricky area of law and the smallest missteps by the visa-holder may result in adverse government action—so be careful and, if at all possible, obtain counsel from the very start.

Table 2 sets forth the various non-immigrant visas that are available. As you can see, the U.S. government issues visas to people with many different intentions – from foreign citizens seeking nothing more than a vacation to those who seem intent on transforming their non-immigrant visa to an LPR for an indefinite stay.

Non-Immigrant Visas		
Type	*Description*	*Comment*
B-1	Business Visitor	Market Assessment entry for 30 to 90 days.
E-1	Treaty Trader	Must be a citizen of a country that has a treaty with the U.S.

E-2	Treaty Investor	Must be a citizen of a country that has a treaty with the U.S.
H-1B	Professional Specialty Occupation	Work authorization for skilled specialty occupation in the professions.
H-2B	Temporary Worker in Shortage Occupation	For jobs that will last less than one year for which no U.S. workers are available.
J-1	Exchange Visitor	Allows specialist, student, trainee, scholar, teacher, research assistant, or leader to work while furthering their studies or skills.
L-1	Intra-Company Transfer	Multinational executive manager or specialty worker.
O-1	Extraordinary Ability Business, Arts, Science, Athletics	For those who have risen to the very top of their fields.
O-2	Essential Support staff of an O-1	Assists O-1.
P-1	Athlete or Recognized Entertainment Group	Internationally recognized as exceptional.
P-2	Internationally Recognized Performers, Artists, or Athletes Coming to Participate in a Reciprocal Exchange Program	Performers, artists, or athletes for exchange programs.
P-3	Performer, Teacher, or Coach in a Culturally Unique Program	Culturally unique program.
R	Religious Worker	Member of recognized religious denomination coming to work as a minister, religious professional or in a traditional religious occupation.
TN-1	NAFTA Professional	Canadian or Mexican professional worker in an occupation recognized by the NAFTA treaty.
F-1	Student Visa	Foreign students seeking to study full-time with a U.S. academic institution.

Foreign Students

Because of our affiliation with ASU, we recognize that many of those who will read this Handbook will either be students seeking to start their own businesses, employers seeking to hire students, or students seeking employment with U.S. companies. In high-technology fields, it is not unusual for the majority of students to be non-U.S. citizens. A typical scenario for many of our student readers is as follows:

> An international student has come to the U.S. to further his studies at an American institution of higher education on a valid F-1 visa. While in school, the student is either offered a job at a local company or has an idea that she believes has economic potential. Unfortunately, the student does not know or understand the steps necessary to be able to begin her career in the U.S.

This simple, everyday scenario raises a host of legal and regulatory pitfalls that could, conceivably, result in the revocation of the student's F-1 visa, the end of her studies, and as one might imagine, an unwanted and unexpected deportation. With that in mind, we set forth some of the ways that students can get themselves in trouble with U.S. immigration law.

F-1 Visas and OPT Programs

Most students enter the U.S. on what is called an F-1 visa. This visa carries significant restrictions on the students' ability to work for anyone other than the academic institution they attend (and, even there, many restrictions apply). In addition, once the student graduates, they are expected to return to their home country.

That said, U.S. immigration policy has long understood that many graduates wish to remain in the U.S. Recognizing this desire and the many benefits the U.S. receives from an educated workforce, immigration law has provided an exception to the general rule that the F-1 visa holder must return to his or her home country upon graduation. According to BCIS regulations, students with F-1 visas are eligible to work for up to twelve months outside of school in an Optional Practical Training ("OPT") program. The OPT program must be directly related to a student's academic major and can be used prior to or after graduation. There is a small catch… the BCIS requires that international students apply for OPT authorization BEFORE graduation, whether or not the student has a firm job offer at that time.

Assuming that a U.S. company wishes to retain the services of the international student at the end of an OPT term, the employer – not the student – can pursue immigrant and/or non-immigrant visa options on the student's behalf. The employer will need to pursue a labor certification process by seeking EB or H visas (further described below). In almost every other case, the F-1 visa holder *should not* undertake paid employment or accept grants, stipends, scholarships or other economic benefits without checking with her academic institution or an attorney.

EB Visas

You, as a U.S. employer, may file a visa petition on behalf of a non-U.S. student seeking employment either before or after graduation. The student visa holder will need to have their visa status altered to an EB-2 or EB-3. Obtaining EB-2 or EB-3 visas will require a labor certification process that, when successful, generally results in the Department of Labor determining that there is a shortage of U.S. workers for the position in question. Despite the many difficulties in obtaining this determination and the transformation of a student into an EB-2 or EB-3 visa holder, the real benefit is that these visas transform the student or other potential employee into an LPR, with all of the permanence and rights this status grants.

An alternate path for the employer is to seek an EB-1 visa. However, this may be an unrealistic option for current students because EB-1 visas are generally reserved for executives and managers

that often work for multinational companies with close ties to U.S. companies or industries. Though nearly impossible for the average worker to acquire, persons that are considered to be of extraordinary ability may fit the strict requirements. This category is generally reserved for persons who have reached the top of their field in business or the sciences. A third category of EB-1 exists for outstanding researchers and professors.

H-1B Visa

The H-1B non-immigrant visa is available to a person that qualifies as a "specialty occupation" worker. Specialty occupations refer to professional fields and the H-1B is most often used for technology related positions (e.g., - architecture, engineering, physical sciences, medicine, or law). Normally, the job in question requires at least a Bachelor's degree. H-1B visas permit foreign employees to work from one to six years in the U.S. One interesting feature of the H-1B visa is that during the length of the visa, the holder can apply for LPR status without violating his H-1B role. For obvious reasons, many students choose to seek an H-1B visa before applying for an immigrant visa.

The H-1B visa process places the burden on the employer and the visa cannot be obtained by the employee without the employer's aid. As with EB visas, the H-1B visa process requires the employer to file a petition with the BCIS. Rather than a labor certification, however, an H-1B petition will be accompanied by an approved labor condition application from the Department of Labor, indicating that the wages offered to the foreign worker will not be less than the wages paid to similarly situated workers at the job site or in the local area. The application process for an H-1B visa can take anywhere from two weeks to five months to complete. Consequently, the employer of our hypothetical student should submit the application approximately six months before the student's OPT expires.

The H-1B visa holder can only work for the sponsoring employer in the job specified by the employer's petition. If the visa holder wants to change jobs (either within the company or by changing companies), she must obtain a new H-1B visa. However, a person may hold H-1B visas from two or more employers concurrently, as long as each was obtained separately. While it is possible to arrange an H-1B visa for self employment, BCIS carefully scrutinizes these applications. It is possible for an H-1B visa holder to maintain employment with one company while creating his own business on the side.

The H-1B visa program is subject to quotas. Currently the level is set at sixty-five thousand grants per year (including some reserved placements for specialty areas). Quotas are calculated in October of each year. Therefore, applications should be placed in BCIS hands as early as April for the following fiscal year. The 2004 cap for H-1B visas (beginning in October of 2003) was quickly met. It is expected that the cap for 2005 may be reached as early as March. Almost always, the cap for any given year is reached well before the end of that year and persons and employers seeking to obtain H-1B status are urged to pursue their applications early and vigorously.

Finally, spouses of H-1B visa holders and their children under twenty-one years of age may remain in the U.S. with the visa-holder for the duration of the authorized stay. Spouses and children are issued H-4 visas that provide legal status to attend school and obtain other civil benefits during this period. However, H-4 visa holders are not permitted to work and will be required to seek their own certification process to become work-eligible.

Hobby vs. Self-Employment

One way that many student immigrants trip themselves up is by pursuing hobbies or other endeavors that may have economic benefits. It is important to note that employment is not the same thing as a hobby. Creating a new technology in the basement of your house can be considered just a leisure pursuit. Anyone can construct and tinker with his or her ideas in their spare time. Winning prize money for a competition for that technology may be just that… prize money. An alien can-

not, however, begin to advertise and sustain her livelihood by those actions. There is a fine line to be drawn. Using personal funds to bankroll advanced operations that provide sources of revenue that sustain the visa holder transforms the hobby into paid employment and may void the entrepreneur's visa. Entering competitions and winning prizes are not, necessarily, a violation of a visa—but they could be, so be careful. Put simply, you must stay vigilant that your hobbies do not become sources of real income.

Non-Students

The preceding section discussed the most common visa and immigration pitfalls for students. The remainder of this chapter discusses, in short order, some other visa and immigration law issues that are less directed at students and may affect a broader array of potential employees or entrepreneurs.

In particular, we are interested in those cases where individuals may wish to start their own business—either to transform their non-immigrant visas into immigrant visas or else to apply for LPR status from their home country. Again, the actual process for obtaining these visas is quite complicated and the consequences of missteps very dear—so an attorney is an essential component of these endeavors.

New Business Formation

a. B-1 Visa

The non-immigrant B-1 visa is designed for people seeking to enter the U.S. for the purpose of assessing the market. This visa is available for individuals whose residence is outside the U.S. and who will enter on behalf of their foreign employer. Activities allowed while present in the U.S. on a B-1 visa are limited. The visa is for the purposes of conducting business meetings with prospective customers or research, etc. A B-1 visa holder may not "run a business." Furthermore, individuals in the U.S. with a B-1 visa may not receive any compensation from a U.S. source, although the reimbursement of expenses that are incidental to the trip may be undertaken. B-1 Business Visitors may be admitted to the U.S. for an initial period of up to ninety days, but extensions are available.

b. E-2 Treaty Visa

E Treaty non-immigrant visas (both the E-1 and E-2) are available to citizens of certain countries that have entered into special arrangements with the U.S. Most European countries have such treaties. Other participating countries include Canada, Mexico, Japan, Australia and New Zealand. India has no such agreement.

The E-2 visa is available to treaty investors. E-2 investments must be "substantial," normally meaning over the $100,000 mark. The beneficiary of an E-2 visa must own at least 50% of the investment's business. E Treaty visas are valid for varying amounts of time and can usually be extended without an ultimate limit.

c. EB-5 Visa

The EB-5 immigrant visa is also called the entrepreneur visa. To obtain an EB-5 visa, an alien must invest at least $1million in a U.S. business (by creation or expansion) and create full-time employment for at least ten U.S. workers. There is a two year probationary period before he will qualify for LPR status, but then the investor may turn his efforts to other endeavors.

Foreign Business Transfer

a. E-1 Treaty Visa

The E-1 visa is available to treaty traders (working in a business that has substantial trade with the U.S.). For E-1 applications, it must first be shown that majority ownership of the business that wishes to employ the visa applicant is held by nationals of a treaty country. In situations where the ultimate parent company is publicly owned, the entity is presumed to be a citizen of the country where its shares are principally traded. Then, it must be demonstrated that the future employee is also a citizen of the company's same treaty nation. Afterward, it is necessary to confirm that the employing entity in the U.S. is engaging in substantial trade between the U.S. and the treaty country or is a substantial investment of a treaty entity.

For E-1 qualification, there is no college degree requirement; however, applicants should possess unique and specialized skills that are necessary to the company.

b. L-1 Intra-company Transferee Visa

The L-1 intra-company transferee non-immigrant visa is available to executives, managers and specialized knowledge personnel, who are transferred to a U.S. parent, branch, subsidiary or affiliate entity. The foreign national being transferred to the U.S. must have worked for the overseas entity for at least one full year in the previous three years prior to the transfer.

Authorization for an L-1 visa is a two step process. First, the BCIS requires a petition by the employer which includes documentation confirming the nature of the relationship between the transferor and transferee companies, as well as details about the responsibilities of the person entering the U.S. The petition itself can remain open for a period of up to three years. However, in new office situations (where the U.S. office has been in existence for less than one year), the maximum period of the initial petition is one year. For such start up situations, the BCIS will also need to review the relevant documentation pertaining to the entity's formation. Second, with an approved petition, the requesting company submits its application for the individual's L-1 visa.

International businesses that have U.S. sales over $10 million or who have more than one thousand employees may petition the BCIS for an L blanket designation. This allows the entity to issue their own approval notices to qualified executives, managers and specialized knowledge professionals.

There is no nationality restriction or quota imposed on L-1 intra-company transferees. The maximum period of stay for executives and managers (L-1A) is seven years. Specialized knowledge personnel (L-1B) are limited to a maximum of five years. The spouses and children of L-1 visa holders are entitled to L-2 status. Dependents may be students in the U.S. while holding L-2 status; however, they may not be employed.

For more information about immigration and visa details, visit: http://uscis.gov.

Appendix.

Additional On-line Resources

Intellectual Property

Resource	URL
U.S. Patent and Trademark Office	www.uspto.gov
U.S. Copyright Office	www.copyright.gov
World Intellectual Property Organization	www.wipo.int
Intellectual Property Law Server	www.intelproplaw.com
American Intellectual Property Law Association	www.aipla.org
FindLaw Intellectual Property Resources	http://www.findlaw.com/01topics/23intellectprop/

Contracts

Resource	URL
Legal Information Institute Overview of Contract Law	http://www.law.cornell.edu/topics/contracts.html
Contract-Law.com	www.contract-law.com
UN Convention on the International Sale of Goods (Pace Law School)	http://www.cisg.law.pace.edu/cisg/text/cisg-toc.html
FindLaw Contracts Resources	http://findlaw.com/01topics/07contracts/index.html

Business Organizations

Resource	URL
Introduction to U.S. Business Organizations	http://www.managementhelp.org/org_thry/org_thry.htm
Arizona Corporation Commission	http://www.cc.state.az.us/
StudyFinance.com Business Organization Overview	http://www.studyfinance.com/lessons/busorg.html
FindLaw Business Organizations Resources	http://findlaw.com/01topics/08corp/index.html

Employment Law

Resource	URL
Equal Opportunity Employment Office	http://www.eeoc.gov/
Legal Information Institute Employment Law Overview	http://www.law.cornell.edu/topics/employment.html
HR Business and Legal Reports Online	http://hr.blr.com/index.cfm?source=MKD&effort=713
Legal Database.com	http://www.legal-database.com/laborlaw.htm
FindLaw Employment Law Resources	http://findlaw.com/01topics/27labor/index.html