The Top Five Considerations for Startups

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Starting a new business can be both exciting and challenging. Protecting your business from day one can set you up for success and help you avoid costly litigation down the road. To help set you on the path to success, here are the top five items that every startup should consider:

1. Forming The Legal Entity That Best Fits Your Business Needs.

Becoming a legal entity rather than operating as a sole proprietorship will afford you limited liability legal protections. Barring any egregious behavior (e.g. comingling business funds with your personal accounts), forming a legal entity means you will be protected from personal liability if your business is sued. From there, you need to decide in which state to incorporate your business. Typically, most businesses register in Delaware because of its established corporate case law and separate Court of Chancery that hears cases specific to corporate law. Deciding on the type of entity for your business (e.g. LLC, S-Corp, C-Corp) is equally as important, as it can have different tax implications. For example, LLCs and S-Corps are taxed as pass-through entities, meaning the business owners report business income and losses on their personal tax returns. It is important to keep each of these items in mind when incorporating your business. *For further insight on choice of entity, see my colleague Chip Wry's article, Tax Considerations in Choosing the Form of Organization for a New Business.*

2. Sufficiently Protecting Your Intellectual Property.

Although all founders and employees get along now and have long term plans to stay with the company, it is important to always be prepared in the event that something goes sour, an employee leaves, or another company decides to acquire the business. For example, if your lead intellectual property ("IP") developer never signed an IP agreement, there could be ambiguity as to the ownership of the IP, which could put a hard stop to any acquisition or investment negotiations. To avoid this scenario, make sure you have all of your employees complete Assignment of IP Agreements whereby they agree that the business will own all rights to any IP that may be developed or discovered. In addition, although some states like California do not enforce non-compete agreements, Massachusetts typically will as long as they are reasonable in scope. Non-compete agreements can protect your company from having one of the founders or key employees leave the company and prevent that individual (for a finite, reasonable period of time, within a reasonable geographic scope) from directly competing against your business. Finally, registering trademarks, patents and copyrights as soon as possible will protect the intellectual property, logos and inventions of your business, and will allow you to file an infringement lawsuit if it becomes necessary.

3. Establishing the Proper Employment Agreements and Policies.

Wage and hour laws, the Massachusetts Equal Pay Act, and anti-harassment policies are just a few of the big ticket items that startups should pay close attention to in the realm of human resources. It is recommended that you set up policies or hold trainings to ensure that everyone at your business is well educated on these issues. These topics are so important that the recently

updated National Venture Capital Association (NVCA) Investor Rights Agreement includes an optional provision that would obligate startups to have anti-harassment policies in place.

4. Creating Agreements Among Co-Founders.

The agreements among co-founders can set forth terms of a founder's separation from the company, or what happens to a co-founder if he or she is not living up to expectations. These agreements can have provisions regarding vesting of restricted stock options based upon continued participation in the business. Additionally, these agreements can touch on voting provisions, drag-along rights (which enable a majority shareholder to force a minority shareholder to join in the sale of the company), tag-along rights (which guarantee minority shareholders the right to sell their shares in the company at the same time and under the same conditions as the majority shareholder), vesting provisions (including forfeiture of unvested options at the purchase price and repurchase of vested options at fair market value at the time of repurchase), and can set forth restrictions on transfer and exceptions to those restrictions.

5. Adhering to All Applicable Laws.

Startups should also confirm that they are in material compliance with all applicable laws, from securities laws (which include filing certain paperwork with the Securities and Exchange Commission from time to time), to privacy laws, including the new European General Data Protection Regulation (GDPR) laws that recently went into effect.

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