Questions for Early-Stage Companies

Building on our prior articles, there are many legal issues faced by early-stage companies. Business owners would be wise to address these important questions as they start-up and develop their business.

What choice of entity is proper for your start-up company?

For a new business, one of the key legal issues is how to structure the venture, to secure adequate capitalization, divide equity among the founding members, and provide a foundation for future investments and growth. The choice of legal entity for a start-up entrepreneur generally will be either a corporation (C-corporation or S-corporation) or a limited liability company based upon the entrepreneur's goals and needs.

Both forms of entities provide a set of rules for the governance of the entity and limited liability for its owners, officers, directors and managers acting within the lawful scope of their employment or position. Choosing the appropriate entity will affect such things as entity and owner taxation, the availability of equity compensation for key employees and consultants, and the ability to attract outside investors, among other issues. In situations where an early stage company wants to offer deferred compensation plans for its employees, including incentive compensation plans such as stock options and ESOPs , the company should first consult with its legal and accounting advisors concerning the various ERISA, Pension Protection Act and Section 409A treasury regulations that would apply to nearly all plans that defer compensation.

Is your early-stage company properly protecting its intellectual property rights?

In many cases, an early stage company's intellectual property rights are its most valuable assets and initially more significant than its tangible physical property (like inventory or equipment). Yet many companies do not take adequate precautions to protect these rights from the beginning of the enterprise. Federal and state patent, trademark and copyright laws, as well as state trade secret laws provide the basis for the rights and protections of owners of intellectual property rights.

In particular, the owner of a trademark has the right to prevent other parties from using confusingly similar marks, logos, phrases and symbols on similar goods or services. For early-stage companies, taking the necessary and proper steps to protect its trademarks early in the process is of vital importance as the company begins to develop and enhance the goodwill associated with those marks.

In the U.S., rights in a trademark or brand are typically acquired through the use of the mark on or in connection with providing goods or services in commerce, and not by registration. In such a case, the company's use of the mark can rely on common law trademark rights to protect the mark, but only in the geographic area where the goods or services are being marketed or sold. Rather than relying on common law trademark rights, the better course of action to protect a company's trademark rights is to file either a state trademark application for registration of the mark — here, that would be with the Massachusetts Secretary of State — or a federal trademark application for registration of the mark with the United States Patent and Trademark Office (USPTO).

A Massachusetts state trademark registration will provide protection for your company's trademark only within the geographic boundaries of this state. However, filing for one or more state registrations is a cost-effective strategy sometimes for businesses just starting out that cannot afford the cost of a federal filing yet, or for truly local businesses whose reach will not likely expand beyond one or a few states. However, owning a federal trademark registration issued by the USPTO provides several advantages, not the least of which are providing protection for your company's trademarks nationwide, and the ability to object to any subsequent registration or use of any confusingly similar marks by any third-parties.

Another crucial area for start-up enterprises is the protection of its trade secrets, i.e., any business secret that gives your company a competitive advantage, and includes, for example, customer information, pricing policies, training manuals, formulas, recipes, and manufacturing processes. Trade secrets will remain protected so long as they are kept secret. As such, an early stage company should ensure that it has both internal and external controls in place with its employees and outside vendors to protect the company's trade secrets and intellectual property rights. This may include nondisclosure agreements, non-solicitation agreements (of both employees and customers), non-competition agreements (may be enforceable but only to the extent properly limited in time, scope and geographic area), work-for-hire agreements, and invention and development rights agreements.

Does your company qualify for minority-owned, women-owned or veteran-owned business certification status and, if so, what are the benefits?

Certified minority-owned, women-owned and veteran-owned businesses ("MBE/WBE/VBEs") may receive preferred contracting opportunities with federal or state contractors. Certification on the federal and state levels can be a valuable tool for MBE/WBE/VBEs. It enhances their ability to obtain contracts by their inclusion on federal and state databases, and increases their visibility to federal, state and private enterprises with contracting goals and requirements.

Massachusetts maintains a stringent certification process with strict requirements regarding the ownership, operation and control of MBE/WBE/VBEs. This certification process necessitates a thorough review of the company's organizational documents to ensure that the ownership, operational and control requirements are satisfied. In this regard, the Massachusetts Supplier Diversity Office is able certify companies as Minority Business Enterprises (MBE), Women Business Enterprises (WBE), Veteran Business Enterprises (VBE), or Portuguese Business Enterprises (PBE) if all the applicable requirements are met. Among other things, the applicant business must prove that it is at least 51% owned and dominantly controlled by adult minority, women, Portuguese or veteran principals who are U.S. citizens or lawful permanent residents.

Date Created
June 20, 2018