TOP TEN (LEGAL) TIPS FOR STARTUPS

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You've got a great idea, one that can revolutionize the world, disrupt markets, and set you up for life. But where to begin? There are plenty of different tips you can find from seasoned entrepreneurs who will tell you to be flexible in your business plan (the word you'll hear several thousand times is 'pivot'), to put people before things, or explain how to take criticism and set big goals (big, hairy *and* audacious). A quick Google search reveals lists of 12, 19, and 25 tips! As with any general advice, you need to try it on and see what fits you and your particular circumstance.

It's all too easy to rush headlong into a new project, get excited by an idea and decide that you'll see how it plays out and deal with the fine print later. The problem is that some issues are much more time consuming – and costly – to address after the fact. So, we've pulled together our own list of the top ten (legal) tips for startups in order to help navigate around common pitfalls and position your startup for long-term success.

1. What can you do *before* striking out on your own

Many startups are launched by individuals immediately after leaving another position. Many even start while some or all of the founders are still working other jobs. It's not just common, it makes sense: until your new venture is making money, you'll still have bills to pay. In either situation it's important to understand the kinds of restrictions your current or former engagements may have placed on you in terms of intellectual property ownership, non-competition and non-solicitation provisions.

One of the first things you need to do is consider your employment agreement. If your new business is at all related to your former or current employment, you'll want to be particularly careful about restrictive covenants, like non-compete and non-solicit clauses.

These provisions can be used to prevent you from starting a business that competes with a current or a former employer for some period after your employment has ended. While the non-compete is generally limited in terms of geographic scope and industry, the non- solicit (or non-hire as it is sometimes called) can impact how or whether you're able to take any other employees with you, and how you deal with customers of the former employer. Even if you are in the clear, what about your co-founders?

Next up are your confidentiality obligations, which you may find in your employment agreement, a stand-alone

non-disclosure agreement, or any other contract of service. Generally speaking, employees owe a duty of confidentiality over proprietary information regardless of whether there is a signed agreement in place, but if there is a signed agreement this will spell everything out more specifically. Whether or not you have a non-compete, it is important to consider whether information you have (such as client lists, or other specific client information) might be considered confidential and protected. If it is and you use this information in your new business, you might open yourself up to a lawsuit.

Finally, consider whether your current and former agreements contemplate intellectual property ownership. This isn't limited to high level, patentable inventions, but can include any sort of work product. Some agreements may say that anything you create during the time you're employed belongs to the company. Other agreements will use phrases like "during the course of employment" or "using the information, equipment or facilities of the company". The company may have a hard time enforcing this in court, but the more you can do to steer clear of this sort of assumption, the better. What you need to do to keep your IP clean may vary depending on your contract, but helpful tips include:

- avoid creating something that is dependent on something your employer does or makes;
- avoid working on your new project during work hours; and
- avoid using work materials or resources (such as computers, email or other tools).

2. It's never too early to start protecting your intellectual property

Even if you are the only person that has anything to do with your new startup idea, it's valuable to start thinking about how to protect your intellectual property right from beginning. One key factor is to establish ownership from the outset. Whether you are dealing with multiple founders, contractors, employees or other advisors that might be contributing feedback, it's important to always be clear about who owns what. Many people don't realize, for example, that if you engage a contractor to provide services that involve building out your idea, unless the contract specifies otherwise, that contractor may have some ownership claim over the output of the work they performed.

One way to guard against some other person inadvertently owning part of your prototype, design or secret sauce is to adopt a standard form agreement that you can have everyone involved in the project sign: founders, employees, and contractors alike. Sometimes this document may in the form of an IP Assignment Agreement, or a more comprehensive Protection of Corporate Interests document, which can also include confidentiality and non-compete provisions. Using an agreement like this early can help you avoid hiccups down the road when an investor or other third party starts asking you to provide documents establishing your startup's ownership of core intellectual property.

You can also protect your intellectual property by using confidentiality agreements, founders' agreements and protecting your name, each of which has a section below.

3. It's never too early to start thinking about confidentiality

As important as they are, patents, trademarks and copyright registrations will not protect certain forms of important information such as your knowledge, ideas, certain trade secrets, marketing strategies or customer lists. One of the surest ways to protect this information is to keep it to yourself, but this is not always practical when you're growing a business. If you do need to share information that you otherwise want to keep confidential, the best practice is to enter into a non-disclosure agreement (an NDA, or sometimes just called a confidentiality agreement) with any intended recipient prior to sharing. You may not need to make your mother sign an NDA when you tell her about your new idea at Sunday dinner, but NDAs are helpful when you're dealing with anyone professionally, such as an employer, contractor, consultant, manufacturer, supplier, distributor, licensee, or advisor.

NDAs should always be tailored to your needs. A good NDA will set out, among other things, how the recipient will know what is actually confidential; the purpose for which the recipient is able to use your confidential information; the time period of your discussions or how long the recipient must keep the information confidential; whether the recipient may share the information with certain individuals to complete the job; and, whether that person will also be subject to the confidentiality obligations. The answers to these questions may vary depending on the reason you are sharing the information and how important it is to you.

Entering into an NDA is important but so is knowing an NDA alone will not keep your information confidential. You should also create and follow a practice of handling your confidential information. Access to this information should be controlled, monitored, and restricted to those who need to know, while you otherwise ensure that your confidential information does not become known outside of your disclosure. If it does, the information may no longer be considered confidential. This can be particularly important with potentially patentable material, as your own prior disclosure could ultimately defeat your patent claims: remember that the best way to keep a trade secret a secret is to shut up about it already. Using NDAs and establishing best practices will go a long way to protect your confidential information, but the reality is that once your information has been shared, it's out there. Strongly consider the information that you are giving up before you do so.

4. Why is a founders' agreement so important?

A founders' agreement is an important document that sets out a variety of expectations and obligations amongst the founders in your startup. If you decide to incorporate right away, you may move straight to a more formal shareholders' agreement, but often times with a startup you'll want to test the water first before

jumping in (see #1, you may still have another job). Either way, each agreement provides clarity, which is important at this stage.

Sometimes achieving clarity is easy, as you're all contributing exactly the same time, energy, effort and cash. Usually though, it's not that simple, so having the conversation early as to what you're all putting in, and what you're all getting out can save a lot of headaches down the road. Entering into this type of agreement sooner is better, but late is better than never. And if you're smart about it, you can always renegotiate as circumstances change (i.e. if one of you gets a big promotion and can't contribute as much while another wants to turn this idea into a full time job).

There are several areas you will want to consider, even at an early stage. Ownership is perhaps the most delicate topic to discuss when entering into business with other people but it is important to have a mutual understanding of how ownership is allocated, earned and divided. You will want to set out the current ownership of the company and how you will determine ownership as the business grows. For example, who owns what percentage of the company? Is the percentage ownership subject to vesting based on continued participation and performance in the business? Have any of the founders invested assets or cash into the business and if so, when and how will this be accounted for? If a founder leaves the company for any reason, does he or she first have to offer his or her shares back to the company, or the other founders? At what price will this sale take place?

It is also important to have a clear understanding of the founders' roles and responsibilities, including expectations of each founder's time and capital commitment and what happens when a founder is not living up to these expectations. Consider how your roles may evolve as the Company grows: do all of the founders wish to become CEO? In case things don't work out, it may be easier now to set out the circumstances under which a founder may be removed as an employee of the Company (typically a board decision). Similarly, while collaboration at the early stages work well, it will likely become important to delineate decision making authority. To this end, a founders agreement should set out what the major and day-to-day decisions of the business are made and how these will be made. Depending on the decision, this could be by majority vote, unanimous vote, or you may set out certain decisions that are made solely in the hands of the CEO or another founder.

Compensation is another area to consider. Will the founders earn a salary, now or in the future, and how will this be determined? And on a broad scale, what is the overall goal and vision for the business and company? Having these conversations and ensuring all parties hold the same expectations may end up being more valuable than entering into the agreement itself.

5. The importance of protecting your name

In some businesses, say if you're setting up a real estate holding company, the name you use isn't very important. However in most businesses the name, and the goodwill built in that name, are incredibly important. Registering your name with BC Registry Services (whether for use as a company, partnership or sole proprietorship) is a good step, and helps guard against someone else in the province registering a name that's too similar. Registering with the BC Registry, while useful, is also limited. If your startup aims to reach beyond the province, you may want to consider registering your name as a trademark.

Once registered, a trademark affords you with national protection for your name with respect to your claimed wares and services. Trademarks are issued by jurisdiction, so consider whether (or when) you're concerned with protecting the name in other locations (such as the US, or Europe). You can register multiple trademarks if you have a logo or slogan that you'd like to protect as well.

Before getting to the registration phase, while brainstorming for potential names, make sure to use Google to full advantage. Try to avoid picking a name that's the same as or similar to an existing business (whether they've protected the name or not), particularly if they're in a similar industry. You may be able to register a company name in BC, or even a trademark in Canada, but if there is a company in the US or UK using the same name, in the same field, you may have a conflict in the not too distant future, if you want to expand into their jurisdiction. Not to mention the potential confusion you can create with your respective customers.

6. Why you should avoid using "standard agreements" you find online

One very common way to cut costs in the startup phase is to rely on documents found online, or through the founders' own previous engagements. However anyone proceeding down this route should do so with great caution. The internet can be a great resource for background research, such as to see what sort of terms and conditions other businesses are publishing for similar online services. However these have generally been tailored to the specific website or business, and just replacing a name and address can lead to problems where you inadvertently adopt language that's inapplicable, or miss something critical to your own business.

It is very important to ensure that employment and consulting agreements actually fit your business' needs, and while most are necessarily similar, they are not one size fits all. One great example is the company that uses a "standard" employment agreement found online. A problem arises when they terminate the employee, only to realize that the "at will" provision they used in the agreement taken from a California company is ineffective in Canada, and rather than 0 day notice they anticipated, or the 2 week notice that may have been applicable if they had limited notice to Employment Standards Act minimums, they could be on the hook for several months' notice under the common law.

Additionally, beware of unexamined boilerplate! It's not just legalese, and can have a very important impact on your living agreement, or your enforcement in case of a breach. The law is different between provinces, states

and countries, and what might be a default position in one jurisdiction may not be in another. It's easy to change a term here or there, but what do you do if there simply isn't a necessary term in the sample agreement? And how do you know what to leave in, and what to remove?

Generally we encourage clients to look around at terms and conditions, privacy policies, or other contracts that may be accessible. However, we recommend that if you find something you like somewhere else to use it as a starting point, get a proper review to ensure that it is properly tailored, and protects you appropriately, and only then use it as your own form.

7. Set up a company structure that works for you

Once you decide that this business is more than just an idea, you will want to consider incorporating and setting up a company structured to best fit your needs. While there are other options, such as sole proprietorships and partnerships, incorporation is the most common business structure used because you may benefit from limited liability. The process of incorporating a company is fairly straightforward. Once you chose a jurisdiction, you will chose a name, complete a name search in the corporate registry, and file the required forms with a filing fee with the registry, which will then issue you a certificate of incorporation. Once you have incorporated, the company must adhere to the applicable legislation in its incorporating jurisdiction, for example, the *Business Corporations Act* (British Columbia). After incorporating, you will have to keep up with your annual filings, which are not particularly difficult, but must be filed on time or your company will fall out of good standing and could be dissolved. Law firms often handle filings for companies while acting as the registered and records office.

Beyond corporate filings, it is important to consider the impact of a share structure on your company's goals. Often there is a fine balance between retaining control, issuing shares in return for investment and to also be an attractive target for investment or an exit. The share structure you set up may enable you to achieve the appropriate balance. For example, you may retain control while providing for shareholder benefits by creating more than one class of shares: voting shares without the right to receive dividends and non- voting shares with the right to receive dividends. You may issue the latter class (often called "preferred shares") to investors and retain the decision making power within the group of founders holding the voting shares (generally the "common shares"). Having an idea for a share structure that will work for your growth plan, is great, but you can also amend the share structure later (i.e. before your first financing), so it's not always necessary to complicate matters at the outset.

Once your company has more than one shareholder, it will be important to enter into a tailored shareholders' agreement that sets out additional rights and restrictions beyond the basic rights provided in the company's articles. For instance, a shareholders' agreement may provide pre-emptive rights, which can provide that

before the company can issue more shares, the existing shareholders' have the right to purchase those shares, protecting against dilution. Similarly, if you wish to keep the ownership circle close, the shareholders' agreement could require a selling shareholder to offer his or her shares to the other shareholders before selling to an outside third party. If you are considering an exit and you have issued or sold shares to employees, you may want to consider provisions in your shareholders agreement that either allow you to require the sale of a minority of shares if a purchaser offers to purchase a majority of the shares; or you may wish to protect the minority shareholders by giving them the right to sell their shares in a transaction if an offer is made to a majority of the shareholders so they don't get left behind. These provisions will likely become more complex as additional investors join your company and require certain rights be included in the shareholders' agreement.

8. Understand the various roles you play in a small company

A large benefit of incorporation is the limited liability available under certain corporate forms. To maintain this limited liability, however, your company must be treated as a separate corporate "person". Once you incorporate, it is the company itself that will enter into contracts, take on debts, etc. so although you may be the principal shareholder and a director of your company, it is important to maintain the separate structure: contracts are entered into by the company in the company's name as approved by the board of directors, who are in turn appointed by the shareholders.

Though you may play all of these roles, you must understand and carefully consider your actions while wearing each separate "hat". As a director, you will owe fiduciary duties to the company that require you to act in the best interest of the company. You may also have certain obligations that conflict with your interests as a shareholder as the company grows. When your company has more shareholders than yourself, this distinction becomes key. It is important not to blur these lines because this could lead to what's called "piercing the veil" which essentially means liability may bypass the company and attach to you personally. Further, it is important to understand that directors have the authority to commit the corporation to obligations or liabilities in contracts. If there is more than one director of the company, you may wish to set out certain types is issues that will require all the directors or a majority of the directors to approve before making decisions or taking certain actions.

As a director, it is important to keep in mind that you may be liable for your acts or omissions, or even those carried out in your absence, unless you dissent. Provincial and federal laws impose liability onto directors for certain acts or omissions, including the company's failure to pay wages or remit certain taxes on behalf of its employees. Director and Officer insurance is available to companies and while it is an added cost, should be considered as your roles and potential risk grow.

9. Be careful about handing out equity compensation early on

Once upon a time, it seemed that every startup would issue options to every person who walked into their office. Depending on your perspective, this could be very egalitarian (a rising tide lifts all boats), or very coercive (you won't actually be paid anywhere near what you're worth unless you help us succeed). While this practice has stabilized, handing out straight shares can be just as dangerous because you can quickly find yourself diluted with very little room to move when you need real investment. This may be another reason to consider structuring your shares to separate voting and nonvoting shares, particularly if you plan to have employees to whom you would like to provide with equity in the company. This capital structure allows a founder the flexibility to align interests with equity in the company but also retain a certain level of the voting and control of the company.

Options and warrants are two similar forms of equity compensation that are not straight shares. Options and warrants both give the holder the opportunity (but not the obligation) to purchase shares at a certain price on certain terms. Generally, options will be offered to employees pursuant to an option plan that sets out the performance milestones or expiry dates and warrants will be offered to investors in a private placement. An option plan will provide important information regarding the holders' rights, for example, whether the options expire or must be bought back by the company on termination of employment. Once the warrant or option holder is able to and does exercise their warrant or option to purchase shares, they are generally also required to enter into the shareholders agreement.

Even if your company does not "go public" and begin trading its shares on a public market, all companies are required to comply with securities laws in each jurisdiction in which a holder of securities resides. There are strong penalties for failing to comply with applicable securities laws and this is an area where you should certainly consult an advisor.

10. Hire the right advisors

When it comes to your business, you're the expert, and working with the right advisors is how you augment those areas where you're not the expert. This applies to your legal counsel, your accountant, and any other professional advisors you may need to engage in the course of your business. Good legal counsel will work with you to resolve all of the above issues (and more) in an efficient and knowledgeable way, sometimes through direct legal work, and other times by providing general legal advice. Don't reinvent the wheel unless you have to, and when you do, use someone who knows how the wheel was built in the first place.

When seeking legal counsel, consider someone that you can have a full and frank conversation with. Your trusted advisors need to know what's important to your company, not just what you do, but how you do it. You shouldn't feel afraid to ask questions or have anything clarified. A good advisor is part of your team, and while they are a service provider, it's generally a bespoke service.

Also consider that price and value are not the same thing when it comes to professional services. An old friend from high school that does real estate conveyancing might have great rates, but they probably aren't the best person to be giving you advice on how to structure your company, because when it comes time to restructure it down the road, it can get expensive. This applies to accountants as well. The accountant that's done a great job on your personal taxes may not be the best person to handle your SR&ED claims, or look into different tax credit schemes.

by Michael E. Reid and Morgan T. McDonald

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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