



Counselors at Law

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“Start-Ups & Emerging Businesses: The Basics”

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1st. The Name

It sounds obvious but the name of your new company is a key asset and extra consideration should be used in choosing the name of your new venture. Your name is not only be how customers identify you, it will become an asset of your business, which will carry value on your books for potential investors – If chosen wisely.

Before choosing a name, keep in mind the following. In order for a mark to become recognized by the US Patent and Trademark Office (“PTO”) and therefore become an asset of the company, it must pass a certain “subjective” tests. In general, the rule is that the more unique and fanciful the name is the more likely it will be recognized by the PTO and therefore can become an asset. The rating ranges for marks are as follows:

Most Likely to Succeed →	“Fanciful” Terms: These are terms that are totally manufactured, nonsense words. e.g., EXXON or KODAK;
	“Arbitrary” Terms: These are existing words that are being used outside of their natural contexts, and they have no relationship to the functionality of the product they represent. e.g., CAMEL cigarettes, APPLE computers;
	“Suggestive” Terms: These are existing words that have a relationship to the product they are trying to describe; however, it takes some degree of imagination to associate the name with the product. e.g., ROACH MOTEL insect traps , COPPERTONE sunscreen;
Least Likely to Succeed →	“Descriptive” Terms: These are existing words, which are directly related to the description or functionality of the product. e.g., RAISIN BRAN cereal, SHREDDDED WHEAT cereal; and
Simply Cannot Succeed →	“Generic” Terms: These are the actual words to describe the product in common speech and cannot become trade marked. e.g., Computer, CD Rack, Ceiling Fan.

The first step for anyone is to create list of names and then check these names to see (i) if the Universal Resource Locator (“URL”) is available which, can be done at www.register.com; (ii) if the someone in your state is already using the name (who may not have purchased the URL) which, can be search online within Massachusetts for Massachusetts companies at www.corp.sec.state.ma.us; (iii) if anyone has filed this name for federal trademark recognition with the PTO, -- PTO’s trademark database can be accessed and search on-line at www.uspto.gov. And, then if you satisfied you have a name you can use, it is advisable to have a trademark searching company conduct a full common law / federal trademark search and issue you a report. One such trademark search company is Thomson & Thomson (www.thomson-thomson.com) such search cost about \$ 400 US dollars.

2nd, Using & Protecting Your Name

Marks Are Never Verbs: Since marks are not verbs, they should never be used as such. Accordingly, one can say “make a copy on the Xerox photocopier” or “make a copy” but one should not say “Xerox the report.” One can say “remove the spot with SPRAY ‘N WASH” but one should not say “SPRAY ‘N WASH” the spot.”

It is important to use either the (a) TM or SM symbol (if the mark is not yet registered), or (b) the ® symbol (if the mark is registered). These symbols put others on notice that a company or individual considers the mark to be a trademark or service mark in which certain rights are claimed.

The TM and SM symbols may be used with any mark, whether or not that mark is pending registration at the state or federal level. The TM symbol stands for ‘trademark’ and should be used with marks that protect goods, whereas the SM symbol stands for ‘service mark’ and should be used with marks that protect services.

Although one of the benefits of an application for a mark, and subsequent federal registration, provides others with constructive notice of one’s rights in a mark, the ® symbol can – and should - be used once the mark obtains federal registration.

Following are uses that require statutory notice:

- (a) Publications: The notice should appear on web pages, the cover of magazines, newspapers, newsletters and books, as well as on the masthead page;
- (b) Advertising, Catalogs, Brochures, Instruction Manuals, etc: The notice should appear with the first or most prominent use of a mark on each page of advertising. The notice need not be repeated each time the mark is used on the page;
- (c) Labeling: The notice should appear whenever a mark is used on a label, tag, media device, container, decal, bag, nameplate, and when it is burned or stamped directly on the product;
- (d) Product Lists: The notice should appear whenever the good or service appears on a list of goods or services; and
- (e) Package Design: The notice should appear with the most prominent use of the mark or may appear with all uses of the mark.

“®” = Registered Trademark/Service Mark: This symbol is used to designate trademarks and/or service marks that have been finally registered and recognized by the US Patent and Trademark Office (“PTO”). Therefore, these marks have obtained a certain level of nationwide federal protection and, through various treaties, certain limited international protection. This is a catch-all symbol for both trademarks and service marks that have been officially recognized by the PTO.

“™” = Unregistered Trademark: This symbol is used to designate trademarks that have not been registered which may or may not be currently used and which may be pending review by the PTO. They have limited rights under state and local laws, which are less than those of registered marks. If and when the PTO formally recognizes a trademark, then the TM symbol is replaced with the ® symbol.

“SM” = Unregistered Service Mark: This symbol is used to designate service marks that have not been registered which may or may not be currently used and which may be pending review by the PTO. They also have limited rights under state and local laws, and, as with finally recognized trademarks, if and when the PTO formally recognizes a service mark, then the SM symbol is replaced with the ® symbol.

3rd. Selecting a Business Entity

When to Incorporate: Founders of companies often make the mistake of waiting for venture capital before they decide to incorporate. Particularly in this economy, not only is forming a corporate entity early significantly more attractive to venture capitalists, (by providing a track record for assessment of value) it may also avoid a taxable event for the founders of the corporations when the business takes in the capital. Reasons to form a corporation early are as follows:

- Limitation of Liability: One of the primary reasons to form a corporation is to limit the liability of the founders. One should not lose their home because their business fails. Investing funds to incorporate at the onset protects your personal assets – So long as you adhere to the corporate governance requirements of your specific corporation which will vary by type and jurisdiction;

- Taxable Event; VC Capital: An advisable course of action is to issue founders' stock (or equity interest) as early as possible allowing the company to develop and meet milestones. These factors can be used in assessing the disparity in founder's equity price (usually .01 a share) and that of the investors (hopefully much higher). If there are no factors which can be attributed to the valuation increase in the company, then the founders may find that the IRS will deem that the founders have issued themselves stock "significantly below" market value and tax them appropriately; and

- Contracting: Most any company needs to enter into contracts be it a lease, a nondisclosure agreement, sales contract. It is almost always better to have the entity enter into the contract and not the individual founders, for a variety of reasons. As a general rule, contracts entered into by a founder in their role as a "promoter" of the business prior to incorporation of the entity **NEED** to be assignable to the corporation once formed. Thereby, you should specifically have an assignment clause in every agreement allowing assignment, ideally without permission.

What Kind & Where to Form a Corporation. There are a number of business entity types [sole proprietorships](#) ("d/b/a"), [general partnerships](#), [limited partnerships](#), [business trusts](#), [non-profit organizations](#), [limited liability corporations](#), [S corporations](#) and [C corporations](#). Additionally, there are a number of places that one can incorporate the Commonwealth of Massachusetts, State of Delaware, Bahamas, and Ireland. For this discussion we will look, **briefly**, at the pros and cons limited liability corporations, S Corporations and C corporations.

- Limited Liability Corporations: There are two types of LLC, member-managed and manager-managed. With exception of how the operating agreement will be drafted and day-to-day control they are pretty much equal. All LLC must have in their corporate name followed by LLC, Ltd, or spell out "Limited Liability Corporation". Unless an LLC affirmatively elects to be treated as a C corporation short after establishment, the LLC shall be treated as a partnership for tax reasons (or sole proprietorship d/b/a if the state allows for a single-member LLC, which the Commonwealth of Massachusetts does not.). However, the founder will enjoy "limited liability" so long as they establish the corporation correctly, specify certain clause in the operating agreement and adhere to the corporate governances of an LLC. LLC allow for foreign investors and investment for differently entity types. A negative aspect of an LLC is that there is no stock to issue (it has membership interest) to motivate employees, through a stock option plan. And, prior to taking in investor capital the founders will most likely be required to reorganize as a C corporation. LLC make sense when you want to avoid double taxations, issue multiple classes of membership, act as a partnership and keep the protection and operating structure of a corporation. If you starting an LLC make sure of the following:

- (i). In the Operating Agreement you want an [Indemnification of Directors Clause](#);
- (ii). In the Operating Agreement you want a [Limitation of Liability Clause](#);
- (iii). Make sure you have an separate operating account that is funded;
- (iv). Make sure you obtain [Director's Liability Insurance](#) and [Professional Liability Insurance](#); and
- (v). Strictly adhere to the state/country corporate governance requirements, which includes going through the formalities of operating like a corporation, meeting minutes, foreign certificate filings, etc.

- **S Corporation:** Once again, has the flow-through taxation aspects which founder want in order to avoid double taxation (see the C Corporation below) and has stock therefore an S Corp can offer stock option plans to founder and employees. However, some of the negative aspects of the S Corporation are that they may only have a single class of stock and must have fewer than seventy (75) stockholders all of whom must be U.S. resident individuals, estates or certain types of trusts, qualified retirement plan trusts, or charitable organizations. Once an S Corporation issues a second type of stock, usually preferred stock, it is automatically treated as a C Corporation for tax reasons. If you are starting a S Corporation make sure you do all the items listed above in the LLC sections and the following:

- (i). In your Articles of Organization have a “Blanket Preferred Stock” clause; and
- (ii). Create and have founders sign a “Stock Holder Agreement” early on.

- **C Corporation:** Strongly favored by venture capitalists, since most VC funds are partnerships or business trusts and cannot participate in a S Corporation and they will want to purchase preferred stock. C Corporation may have varieties of classes of stock, common stock, preferred stock, which may also vary by rounds of investment Series A, Series B, *etc.* However, a C Corporation is treated as a stand alone entity and is taxed as such, referred to as “Double Taxation”. This basically means all funds that the corporate entity takes in are taxed at a corporate tax rate and all funds provided to founders and employees are once again taxed at their individual tax rate. If you are starting a C Corporation, there are a variety of issues that must be addressed with your chosen legal counsel.

Special Note: Why Delaware? Most venture capitalists desire a Delaware C Corporation and about eighty percent (80% +/-) plus or minus of all big business in the US are Delaware C Corporations. The reasons are as follows (i) Delaware has one of the nations most permissive and flexible corporate statutes; (ii) Delaware has a extensive history of common law pertaining to commercial matters; and (iii) Delaware allows for stockholder to act with the requirement of only a **minimum number** of shares providing written consent (Unlike Massachusetts and other states which requires **unanimous** written consent of all stock holders.)

Blue Sky Laws: Blue Sky Laws are the state security laws that govern the offering and sale of securities; this includes equity and debt of start-up entities. Most states permit offerings to a limited number of residents, but may impose information and filing requirements on the offeror. They are called “Blue Sky Laws” because it pertains to a speculative scheme, “which has no more basis than so many feet of blue sky” (*State v. Cushing 137 Me. 112, 15 A.2d. 740*).

4th, Nondisclosure Agreement

The first contract and policy any newly formed legal entity needs is a nondisclosure agreement. They are needed to protect a company intellectual property rights while courting investors, executives, and are almost certainly required by potential customers, vendors, and partners prior to in-depth negotiations. A sample nondisclosure agreement or you can download a protected electronic version at www.puritanfaust.com/sample_nda.html.

5th, Non-Competition & Assignment of Intellectual Property Contracts

After a nondisclosure agreement, a non-competition and assignment of intellectual property agreement is one of the first contracts any legal entity should develop and institute a policy around. They are essential to ensure that the work products the employees are developing are owned by the company, called “work-for-hire”. And, these agreements stop key players from jumping to a competitor with valuable knowledge, contacts, *etc.* However, it should be noted, that these documents need to be drafted carefully. In particular the non-competition clause, since many state dislike non-competition clause and may find the entire contract unenforceable. So ensure that your version of this agreement has a “blue-line” clause, which basically states if any provision of this agreement is found unenforceable it shall automatically be amended to adhere to what is enforceable or only to remove the portion of the agreement that is unenforceable. Here is what the Commonwealth of Massachusetts’ case law has to say about non-competition clauses:

- {Non-Competition Agreements} "are scrutinized with particular care because they are often the product of unequal bargaining power and because the employee is likely to give scant attention to the hardship he may later suffer through the loss of his livelihood." *Sentry Ins. V Firnstein*, 14 Mass. App. Ct. 706, 707 (1982).”
- Employee covenants not to compete generally are enforceable only to the extent that they are necessary to protect the legitimate business interests of the employer. *Novelty Bias Binding Co. v. Shevrin*, 342 Mass. 714, 716 (1961). Such legitimate business interests might include trade secrets, other confidential information, or, particularly relevant here, the good will the employer has acquired through dealings with his customers. *See All Stainless, Inc. v. Colby*, 1364 Mass. 773, 779-80 (1974). Protection of the employer from ordinary competition, however, is not a legitimate business interest, and a covenant not to compete designed solely for that purpose will not be enforced. *Richmond Bros, Inc. v. Westinghouse Bdcst. Co., Inc.*, 357 Mass. 106, 111 (1970).”
- “Contracts drafted by employers to limit the employment prospects of former employees — even those at a very high level — must be construed narrowly against the employer. *Sentry Ins. Co. v. Firnstein*, 14 Mass. App. Ct. 706, 707 (1982).”
- {Company} “bears the burden of showing its likelihood of success on the merits; that it will suffer irreparable harm if the injunctive relief sought is not granted; and that its harm, without the injunction, outweighs any harm to Gresham {Employee}, from his being enjoined. *GTE Products Corp. v. Stewart*, 414 Mass. 721, 722-23 (1993); *Packaging Indus. Group, Inc. v. Cheney*, 380 Mass. 609, 616-17 (1980).

Attachment “The Prisoners’ Dilemma”
{In Class Exercise}

Student’s Name: _____

Instructions: You and your co-founder of your newly found entity are being arrested by the Federal Bureau of Investigations (“FBI”) for violation of the Commonwealth of Massachusetts, State of Delaware and the State of Nevada “Blue Sky Laws”. You are separated from your co-founder and cannot communicate. The FBI is offering you a deal; you have the following options

(i). If you testify against your co-founder you will be granted immunity and you will receive no jail time; however, your co-founder is being offered this same deal and if both take deal you will both be found guilty of a minor white-collar crime and you will both serve six (6) months in a minimum security prison with other white-collar criminals ;

(ii). If you refuse to testify, and your co-founder testifies against you. You will receive five (5) for violation of SEC regulations in a regular state penitentiary; or

(iii) If you refuse to testify and plead the 5th Amendment and your co-founder pleads the 5th Amendment then there is insufficient evidence the case will be dismissed and neither of you will receive any jail time at all.

What do you do? Check One Box in the **BLUE** section only.

Co-founder #1	Co-Founder #2
Agree to Testify {_}	Agree to Testify {_}
Stay Silent {_}	Stay Silent {_}