



Small Business & Entrepreneurship Seminar Series

July 3, 2013
Session 1



Wake Forest University

Community Law & Business Clinic

and the

Winston Salem Urban League





Agenda

1. Introduction to Liability
2. Types of Business Entities
3. Intellectual Property
4. Business Models





Disclaimer

- Neither the faculty/staff nor students of the Community Law and Business Clinic, nor the Wake Forest University School of Law, represent you in any capacity legal or otherwise. We are not your attorneys.
- Information in this presentation is not to be construed as legal advice, and does not take the place of a competent attorney.
- If you have legal issues, please retain and consult a licensed attorney.





What is this session designed to do?

- Provide a general picture of pertinent areas of law
- Designed to help you determine when you need legal assistance
- Not designed to teach you how to do your own legal work





Hypothetical Situation



- S began making strawberry jam for family members during the holidays
- The jam was so good that friends of the family began asking for jars as well
- S saw the demand for the jam and began making larger batches and selling them out of her home in 2010
- In a recent batch of jam, S did not realize that the pressure cooker temperature was too low, resulting in botulinum toxin contaminations in most of the jars of jam
- Several customers were made ill by the toxin, and one needed medical attention costing more than \$250,000



The Concept of Liability

- Liability – a legal responsibility or obligation
- Personal liability can arise in:
 - Contract law
 - Criminal law
 - Debtor-creditor obligations
 - Tort law judgments (personal injury)
 - Agents (those acting on behalf of others)
- One of the main reasons to incorporate a business is the limitation of personal liability for actions/debts/etc. of the business entity or business associates
- Business entities such as LLCs and corporations protect the personal assets of owners from liability due to creditors, etc.



Liability in Strawberry Jam Hypo



- Assumptions

- S had no business entity, insurance, etc.

- S has some issues:

- Personal liability for defective product (product liability)
- Breach of warranty (?)
- Tax (state and federal)
- Local permitting penalties
- State Food Code violations
 - *3-201.12 Food in a Hermetically Sealed Container.*

FOOD in a HERMETICALLY SEALED CONTAINER shall be obtained from a FOOD PROCESSING PLANT that is regulated by the FOOD regulatory agency that has jurisdiction over the plant.

- Federal food safety and labeling laws

Exceptions to Limited Liability

- Individual action to injure someone
- Personal guarantee of loans
- Withheld but undeposited employee wage taxes
- Intentional fraud or malfeasance
- Piercing the corporate veil



Piercing the Corporate Veil

- Limited liability in the corporate form will not be found if:
 - The business is grossly undercapitalized
 - The business is being used as an extension of personal affairs (borrowing money, not having joint accounts, etc.)
 - Corporate formalities are not followed
 - Meetings
 - Creating and keeping track of shares (if a corporation)
 - Holding meetings and recording minutes thereof
 - Keeping business records accurate and up-to-date
 - Making decisions and signing documents in your capacity as corporate officer/owner/etc.



Liability Takeaways

- Do what you can to minimize your personal liability
 - Consult an attorney, accountant or other qualified professional
- Personal liability is possible even when a business entity exists





Business Entities

- Overview
 - Types of entities
 - Characteristics and pros and cons of each
 - Situations where certain entities are appropriate



Common Business Entities



Entity Type	Origination	Liability	Tax Treatment	Management
Sole proprietorship	No legal documentation necessary	Personal	Individual	Owner/operator or other
General Partnership	No formal agreement needed	J&S	Individual	Equal management control
Limited Partnership	Certificate of partnership filed with SoS	GP-J&S LP-Limited	Individual	General partner
Limited Liability	Articles of organization filed with SoS	Limited	Pass-through	Members or manager(s)
Corporation	Articles of incorporation filed with SoS	Limited	Corporate and individual	Directors and officers
"S" Corporation	Articles of incorporation filed with SoS and IRS form 2553	Limited	Pass-through	Directors and officers



Sole Proprietorship/dba



- How to form
 - Does not require formal creation; register dba and obtain proper licenses/permits
- Pros
 - Easy to set up and maintain (little paperwork/formalities)
 - Simple tax structure
 - Complete control over business
- Cons
 - No limitation of personal liability (!)
 - Difficult to obtain funding
- Where appropriate:
 - Pure service settings
 - Proper insurance coverage for all aspects of business



Partnerships



- How to form
 - Register name of business
 - Obtain licenses and permits
 - Draft and sign a partnership agreement
 - Default for more than one person working together

- Pros
 - Easy to set up
 - Pass-through taxation

- Cons
 - No limitation of personal liability (!)
 - Joint and several liability
 - Difficult to obtain funding

Partnerships, cont.

- Where appropriate:
 - Pure service business with more than one person acting as owner
 - Trust between partners and/or solid partnership agreement
 - Low risk of liability
 - Equal control of business desired
- Sidebar: General partnerships vs. limited partnerships
 - Limited partnerships allow for a general partner to control the entity
 - Other “limited partners” do not participate in management
 - Limited partners do not incur liability
 - Must file Certificate of Limited Partnership with SoS





Limited Liability Company (LLC)



COURTESY: WINSON-SALEM, CVE

- How to form
 - File articles of organization with SoS
 - Pay organization fee
 - Write operating agreement

- Pros
 - Maintain control of business
 - Pass-through taxation
 - Flexible (operating agreement)
 - Limitation of personal liability
 - Management can be member or manager-based

- Cons
 - More formalities to follow
 - Yearly reporting and registration required
 - Difficult to obtain funding

LLCs, cont.

- Where appropriate:
 - Anywhere that limitation of liability is desirable but the formalities and tax treatment of a corporation are too great a burden
- What about single-member LLCs?
 - Single member LLCs are allowed in NC
 - Best suited for compartmentalizing asset-based liability
 - Usually viewed by the IRS as a “disregarded entity”
 - Probably not the form you want



Sidebar: L3Cs

- Low-profit Limited Liability Company
- L3Cs are designed to have dual charitable and for-profit goals
- Provides investment vehicle for socially-minded investors and foundations
- Where appropriate:
 - Where a major portion of the company's goals will be socially beneficial
 - Due to the nature of the industry or business model, the profits are unlikely to be significant





Corporation



- How to form
 - File articles of incorporation with SoS
 - Pay fee
 - Write bylaws of corporation
 - Issue stock

- Pros
 - Best vehicle for which to obtain startup funding
 - Best for many owners
 - Limitation of liability

- Cons
 - More difficult to set up
 - Double taxation (corporation-level and individual-level)
 - Extensive formalities/record-keeping
 - Stock complications

Corporations, cont.

- Where appropriate:
 - Startups seeking funding
 - Where fractional interests or ownership transfers are likely
 - Where there is significant intellectual property





S-Corporation

- Distinguished from a corporation
 - File “S” election with IRS
- Pros
 - More favorable tax treatment; pass-through rather than double
- Cons
 - More difficult to set up
 - Limitations on number of stockholders, who can own the entity, etc.



Sidebar: Nonprofit 501(c)(3) Organizations



- Requires dual designations
 - State Non-profit Corporation designation
 - IRS recognition of the charitable nature of the enterprise
- Exempts organizations from income taxes, state sales taxes (in some cases) and other taxes
- 501(c)(3) status is extremely valuable once it has been granted, and should be protected by following IRS guidelines

So which entity is best suited for my business?



- It depends...ask a law student during our Wednesday hours at the Urban League Quality of Life Institute
 - September: 4, 11, 18, 25
 - Oct 2, 9, 16, 23, 30
 - November 6, 13, 20

- Hypo: Which entity is best for S's Famous Strawberry Jam?



Business Model

- Business model - the rationale of how an organization creates, delivers, and captures value.
- Differences from a business plan
- Business Model Canvas (BMC)
 - Use in a strategic fashion (not a tactical tool)
 - More information:
- Exercise: BMC for S's Famous Strawberry Jam



Elements of Business Model Canvas

- Key Partners
- Key Activities
- Value Propositions
- Key Resources
- Customer Relationships
- Customer Segments
- Channels
- Cost Structure
- Revenue Streams





Intellectual Property (IP)



- Any product of human intellect that the law protects others from using without authorization
- Includes:
 - Patents
 - Trademarks
 - Copyrights
 - Trade secrets
- The US Patent and Trade Office (USPTO) deals with all of the above except trade secrets (usually handled at a state level)



Hypothetical



- S's Famous Strawberry Jam
- What IP might S possess?
 - Recipes
 - Innovative (and improved) canning process and canning machine
 - Advertisements
 - Print
 - Television
 - Radio
 - Logo/trade dress
 - Website
 - Book: *Strawberry Jam and You*. New York: Penguin, 2013. Print and e-book.



Trademarks



- Trademarks™ - word, phrase, symbol or design or combination that identifies and distinguishes the source of goods of one party from those of others
- Service marks - same as TM but identifies and distinguishes source of service rather than goods
- Using marks
 - Can use™ at any time
 - Can use (SM) at any time
 - Can use ® once federally registered
- Examples of trademarks
 - Logos
 - Catchphrase
 - Word

Strong and Weak Trademarks



- Strong
 - Fanciful and arbitrary
 - Suggestive

- Weak
 - Descriptive
 - Generic

- Sidebar: Generification
 - A trademark that becomes a generic term for a product due to wide usage and lax protection from TM holder
 - Aspirin
 - Heroin
 - Escalator
 - Kleenex (?)

Why Register Trademarks



- A legal presumption of ownership of the mark
- Public notice of your claim of ownership of the mark;
- Listing in the USPTO's online databases;
- The ability to record the U.S. registration with the U.S. Customs and Border Protection Service to prevent importation of infringing foreign goods;
- The right to use the federal registration symbol “®”;
- The ability to bring an action concerning the mark in federal court; and
- The use of the U.S. registration as a basis to obtain registration in foreign countries.



Copyrights



- Definition of ©
 - Original works of authorship
 - Original = independently created and possess some degree of creativity
 - Fixed in a tangible means of expression

- Includes:
 - Literary works
 - Musical works
 - Dramatic works
 - Pantomimes and choreographic works
 - Pictorial, graphic, sculptural works
 - Motion pictures
 - Sound recordings
 - Architectural works

Copyrights, cont.



- Does NOT protect:
 - Works that have not been fixed in tangible form
 - Titles, names, short phrases and slogans, symbols, etc.
 - Ideas, procedures, methods etc.
 - Works consisting of entirely information that is common property

Copyrights, cont.



- Securing copyright protection
 - No publication or registration is needed to secure a copyright
 - Copyright protection is secured when the work is created
 - Created = fixed in a copy for the first time
 - May bear a notice of copyright if published (otherwise must note unpublished)
 - Publication = distribution of copies to public by sale or other transfer of ownership

- Use © (even though you don't have to)



Trade Secrets



- Created and enforced on state level, but standardized law created via Uniform Trade Secrets Act
- Trade secret = information that has economic value from **not being generally known** and is the subject of **efforts that are reasonable under the circumstances to maintain secrecy**
- Info that can be protected includes:
 - Formula
 - Pattern
 - Compilation
 - Program
 - Device
 - Method
 - Technique
 - Process

Trade Secrets, cont.



- Losing trade secret protection
 - Public access
 - Disclosure to others – this can be to an employee or another company who will use the trade secret, BUT if recipient agrees to keep confidential then trade secret retains its protections
 - Reverse engineer



Patents



- Written description of an invention filed with the U.S. Patent and Trademark Office
 - NOT just an improvement on a current invention – must show creativity
- ONLY the inventor can apply
- Must file FIRST
- Types of patents
 - Utility patents (20 yrs.)
 - Ex. new process, machine etc.
 - Design patents (new design for article of manufacture) (14 yrs.)
 - Ex. new design for a piece of furniture
 - Plant patents (20 yrs.)
 - Ex. new variety of a soy bean

Patents, cont.



- Disclaimer
 - The CLBC does not do patent law work
 - Patents require the services of an attorney who is a member of the Patent Bar

Patents, cont.



- Trade Secrets v. Patents
 - Disclosure
 - TS do not require kind of novelty or invention which is required for patentability (i.e. can simply make an improvement to an existing machine)
 - Patent monopoly is reward to inventor, TS merely protects against breach of faith
 - TS cannot stop someone who independently came up with the same info while patent holder can
 - If someone reinvents something and gets patent can stop an earlier inventor with only a TS from using



Why protect IP?

- Capture value
- Increase your ability to license
- Increase ability to access funding





S's Famous Strawberry Jam



- What IP protection should S seek for the IP of the company?



Conclusion



- Takeaways
 - Liability is a vital concept in running a business
 - Business entity selection can be very important as you begin/grow your business
 - Intellectual property should be properly protected to maximize value capture and protect your work

- More in-depth advice and information can and should be obtained from a licensed professional