

WHAT EVERY BUSINESS SHOULD KNOW ABOUT KEEPING ITS CORPORATE HOUSE IN ORDER

**PRINCE GEORGE'S COUNTY
ECONOMIC DEVELOPMENT CORPORATION
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PROTECTING YOUR COMPANY

- I. Protecting your company by keeping its corporate records in order.
- II. Protecting your company's assets in dealings with your employees and other third parties – trade secrets, and confidentiality and non-compete agreements.
- III. Protecting your assets in ownership relationships – shareholders' agreements and buying and selling your company.



I. CORPORATE RECORDS HOUSEKEEPING



CORPORATE RECORDS HOUSEKEEPING

Corporate Records

- Are the Company's corporate documents in order?
- Does the Company keep an updated record book containing:
 - the Articles of Incorporation
 - the Bylaws
 - meeting minutes
 - stock ledger



CORPORATE RECORDS HOUSEKEEPING

Corporate Records

- **The failure to keep these records accurate and current could lead to numerous problems, including:**
 - (i) the imposition of fines or penalties by state corporation commissions;**
 - (ii) concerns by a prospective buyer with the lack of documented corporate history; and/or**
 - (iii) the inability to obtain financing at a critical time.**



CORPORATE RECORDS HOUSEKEEPING

- Shareholder and Director Meetings
 - Does the Company conduct annual shareholder and director meetings?
 - Are all directors and officers appointed regularly and in accordance with the Bylaws?
 - Does the Board authorize actions that require director approval, as required by the Bylaws and applicable law?
 - Do the Board and the shareholders understand and take advantage of corporate laws allowing for electronic meetings and action by written consent?



CORPORATE RECORDS HOUSEKEEPING

- Shareholder and Director Meetings
 - The failure to observe these corporate requirements could result in a challenge to the validity of the action taken or legal challenges by the shareholders that Board members have not met their fiduciary obligations.



CORPORATE RECORDS HOUSEKEEPING

- **Chain of Title of Stock Ownership**
 - **Has the Company issued stock certificates to all stockholders and cancelled all certificates of former stockholders?**
 - **If stock has been transferred from one stockholder to another is there documentation evidencing the transfer?**



CORPORATE RECORDS HOUSEKEEPING

- Chain of Title of Stock Ownership Cont'd
 - The Company should have a clear chain of title verifying current ownership and all previous stock transactions since its inception.
 - The inability to demonstrate a documented chain of title is likely to raise concerns with a prospective purchaser or a lending institution, and could jeopardize the transaction.



CORPORATE RECORDS HOUSEKEEPING

- Issuing New Stock
 - Does the Company have enough authorized shares to issue additional stock?
 - Is an amendment to the Articles of Incorporation necessary?
 - Has the Board approved the issuance of additional stock?
 - Is the Company required to give “preemptive rights” to existing stockholders, which grant them the right to maintain their respective percentages of ownership?



CORPORATE RECORDS HOUSEKEEPING

- **Stock Bonus Plans**
 - Does the Company have a stock bonus plan? If so, is it clearly stated; does it fit the Company's needs; and does it provide proper incentives for executive staff?
 - Does the Company issue stock options, and if so, are they compliant with applicable laws and regulations?
 - Whatever method is selected should be fair and clearly stated in a written agreement or plan in order to avoid costly disputes.
 - Has the Company considered alternatives to issuing stock, such as a phantom stock plan?



CORPORATE RECORDS HOUSEKEEPING

- State Registrations
 - Is the Company conducting business in any states in which it is not registered?
 - Has the company registered to do business in all states where it is conducting business?
 - Does the company have a current registered agent in each state in which it is authorized to transact business?



CORPORATE RECORDS HOUSEKEEPING

- **State Registrations Cont'd**
 - **Many states impose penalties and fines on companies that are not authorized to do business in the state.**
 - **Also, the failure to register could affect the ability of a company to bring a lawsuit and the failure to have a current registered agent could cause the company to miss important documents from the Secretary of State, including service of complaints and notices to file annual reports.**



CORPORATE RECORDS HOUSEKEEPING

- Liens and Security Interests
 - Does the Company have a clear understanding of what creditor liens exist on its assets?
 - The Company should also make sure that state records regarding outstanding liens are accurate and current.
 - Has the Company checked to ensure there are no judgment liens against it?



II. PROTECTING ASSETS – VIS A VIS EMPLOYEES AND OTHERS (TRADE SECRETS, CONFIDENTIALITY AND NON- COMPETITION AGREEMENTS)



CONFIDENTIALITY & NON-COMPETITON AGREEMENTS

- Understand/Identify the Legal Issues
- Limit/Protect Dissemination of Confidential Information
- Use Written Agreements Where Feasible
- Be Cautious of the "Trust Me" Approach
- Take Prompt Action to Enforce Your Rights



CONFIDENTIALITY & NON-COMPETITON AGREEMENTS

WHAT REMEDIES DO YOU HAVE?

- Trade Secret Act
- Common Law Torts
- Contractual Remedies
- Intellectual Property Statutes



WHAT IS A TRADE SECRET?

- Formula, drawing, pattern, program, compilation, device, method, technique or processes used in one's business
- Derives independent economic value from not being known to others
- It's your "secret sauce"



FACTORS TO DETERMINE WHETHER SOMETHING IS A TRADE SECRET

- The extent to which the information is known outside of the company's business
- The extent to which it is known by employees and others involved in the company's business
- The extent of measures taken by the company to guard the secrecy of the information
- The value of the information to the business and its competitors
- The amount of effort or money expended by the business in developing the information
- The level of difficulty for others to properly acquire or duplicate the information



EXAMPLES OF TRADE SECRETS

- Source code for software programs
- Certain types of client or customer lists
- Marketing plans, sales strategies
- Business and financial information
- Bidding policies and procedures
- Price lists



GENERALLY NOT TRADE SECRETS

- General knowledge or information that is known generally in an industry
- Skills and abilities necessary to perform the job
- Publicly available information



STATUTORY / COMMON LAW REMEDIES

UNIFORM TRADE SECRETS ACT (“UTSA”)

- Law that protects the misappropriation of confidential information or “Trade Secrets”
- Most states have adopted some version of the UTSA
- Provides a uniform definition of what a trade secret is
- Clarifies, among other things, how a trade secret can be misappropriated and remedies for misappropriation
 - “misappropriation” generally speaking means discovery of information through improper means (e.g., theft, wiretapping or fraud) or a breach of confidentiality



COMMON LAW DUTY OF LOYALTY

- Employee has a duty NOT to engage in activities which conflict with an employer's interests (competition)
- Duty not to usurp business opportunities for personal gain
- Can prohibit from competing and diverting business during employment and from soliciting employees and customers for competing business
- Limited protection once the employee is no longer employed



PURPOSE OF AGREEMENTS

- **Minimize Uncertainty**
 - Defines rights and duties of disclosing party and recipient
 - Use of an agreement reinforces owner's treatment of the information as a trade secret and demonstrates owner's taking reasonable precaution to protect it
- **Deterrence**
- **Contractual Remedy**
- **Added Litigation Benefits**



NONDISCLOSURE AGREEMENTS

- **Restraints upon the disclosure of confidential, proprietary and trade secret information by recipient**
- **Who should sign – anyone who has access to company confidential and proprietary information**
 - **Employees**
 - **Consultants**
 - **Potential Business Partners**
 - **Potential Customers**



NONDISCLOSURE AGREEMENTS PROVISIONS TO INCLUDE

- **Definition of Confidential Information**
- **Exclude Info that is not “Confidential”**
 - **Already in the Recipient's Possession**
 - **Available for Public Use without a Breach of the Confidentiality Agreement**
 - **Obtained from any Other Person having No Obligation of Confidentiality**
- **Restrict Dissemination on a “Need to Know” Basis**



NONDISCLOSURE AGREEMENTS PROVISIONS TO INCLUDE

- **Duty of Care**
- **Mutual**
- **Prohibit Disclosure, Copying or Use of Confidential Information**
- **Protect Written and Oral Proprietary Information**
- **Return Material**
- **Remedies – Injunctive Relief**
- **Laws & Choice of Jurisdiction**



NON-COMPETITION RESTRICTIONS

- Attempt to preserve the employer's business relations and goodwill with customers; prevent employees from working for competitors; taking the employer's secrets, customers, employees ("non-solicitation" or "anti-employee raiding") after the employment relationship ends
- Generally disfavored by courts as against public policy
- Must be narrowly drafted



NON-COMPETITION RESTRICTIONS

- **LIMIT TO KEY EMPLOYEES**
 - **The Extent to which the Employee Possesses Confidential Information**
 - **The Extent of Employee's Contacts with the Company's Customers**
 - **Employee's Position and Duties**
 - **The Length of Time the Employee was with the Company**



NON-COMPETITION RESTRICTIONS

- **Consultants – may require special considerations**
 - **Cannot control consultants – they are independent contractors**
 - **Secure narrowly tailored non-compete and non-disclosure/non-use covenants**
 - **Limited to use of confidential/trade secret information**



NON-COMPETITION RESTRICTIONS

- Courts will apply a 3-Part Test to Determine whether a Covenant not to Compete is Enforceable.
 - From the employer's point of view - is the agreement no more restrictive than is necessary to protect the employer in some legitimate business interest?
 - From the employee's point of view - not unduly harsh or oppressive in curtailing the employees legitimate efforts to earn a living
 - Sound Public Policy (free trade, competitive market)



NON-COMPETITION RESTRICTIONS

- The burden of whether an agreement is reasonable is on the employer. The employer must have some legitimate interest to protect, for example:
 - Trade Secrets (as defined by statute)
 - Confidential or Proprietary Information
 - “Unique Services”
 - Customer Relationships
 - Client or Contact Lists
 - Goodwill developed by the Employee for the Employer Unique Services
 - Can’t be used to Prevent an Increase in Ordinary Competition



NON-COMPETITION RESTRICTIONS

- **How Must a Non-Compete Agreement be drafted to be Reasonable?**
 - **Duration of the Restraint**
 - **Geographic Scope**
 - **Extent of the activity being restricted**
 - **Consider further restricting to customers with whom the employee came in contact with, identified, or learned of, during his/her employment**
 - **Consider including a statement that a list of customers will be supplied upon request at the termination of the employment relationship**



NON-COMPETITION RESTRICTIONS

- **Enforcement**
 - Failure to promptly enforce could be deemed a “waiver”
 - Failure to promptly enforce could trigger other employees to breach
 - Failure to consistently enforce
- **Injunctive Relief**



NON-COMPETITION RESTRICTIONS

- What should you do to prevent litigation?
 - Obtain employee's written agreements with former employers
 - Debrief Employees prior to starting and upon exiting employment with the company
 - Covenants
 - Similar line of business
 - Departing Employees
 - Emphasis on company's policies
 - Inform the new employer in writing of employee's duties
 - Make sure an employee knows they can't take documents with them



III. PROTECTING ASSETS – SHAREHOLDERS' AGREEMENTS AND BUYING AND SELLING YOUR COMPANY



IMPORTANT AGREEMENTS AMONG OWNERS

- Shareholders' Agreements for Corporations
- Operating Agreements for LLCs



OWNERS' AGREEMENTS

- **Can Restrict Transfers of Ownership to Third Parties**
- **Can Ensure Right to Buy Back Equity Upon Termination, Retirement, Death, etc.**
- **Provisions for Valuing Stock / Membership Interests**



EXIT STRATEGY PROVISIONS

- Tag-Along and Drag-Along Rights
- Put and Call Rights



DRAG-ALONG RIGHTS

- **The Right to Force Other Equity Holders to Sell When (Majority) Owner Ready to Sell to a Third Party**
- **On Same Terms Offered by Third Party**



TAG-ALONG RIGHTS

- **The Rights of (Minority) Owners to Have Their Interests Sold Along With Other Equity Holders' Interests**
- **On Same Terms Offered by Third Party**



CALL RIGHTS

- **Can Force Other Equity Holders to Sell Their Equity Interests to You**

PUT RIGHTS

- **Can Force Another Equity Holder or the Company to Buy Your Shares/Interests**



PURCHASE OR SALE OF BUSINESS

- Purchase or Sale of a Business
 - Is the Company considering an acquisition of another business or selling some or all of its stock or assets?
 - Is the Company familiar with letters of intent and engagement letters for financial advisors?
 - Does the Company have a comprehensive due diligence list?
 - Is the Company aware of the different legal and business implications of structuring the sale of a business as an asset sale, stock sale or merger?



PURCHASE OR SALE OF BUSINESS

- Purchase or Sale of a Business
 - Many companies make the mistake of proceeding with an acquisition without fully understanding the legal, tax and financial consequences. Some companies also employ tax and legal advisors too late in the process, and consequently, find it difficult to negotiate terms to protect their interests without jeopardizing the entire transaction.
 - Legal and tax advice should be sought early in the process. Is the Company aware of the different legal and business implications of structuring the sale of a business as an asset sale, stock sale or merger?



SUMMARY

- **Is my corporate house in order?**
 - **Corporate records, taxes paid, state filings, credit facilities**
- **Assets protected?**
 - **Employees and vendors restricted by non-disclosure agreements**
 - **Shareholders' Agreements**
- **Ready to buy or sell my company?**

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QUESTIONS? AND ANSWERS!



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