THE MONITOR

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5 Common Legal Issues to Consider When Starting a Business

To successfully launch, grow, and operate a business, entrepreneurs must find ways to comply with, and utilize, various laws and regulations to protect their business, while not letting legal issues distract them from running their business. Here are five common legal issues that entrepreneurs should think about when launching a business:

1. Business Types

The first thing to consider in starting a business is figuring out which entity structure to use. There are multiple types of business structures to choose from. The most popular structures in recent years have been limited liability companies ("LLCs") and C-corporations, which can protect business owners from corporate liability. Each entity type has its pros and cons when it comes to taxes, personal liability, and fundraising abilities.

For example, the LLC structure may be more favorable for businesses that prefer less record-keeping requirements and an easy distribution of profits and responsibilities between owners. However, LLCs come with some drawbacks in comparison to the C-corporation structure. LLCs may not be appropriate if the business owners are seeking to raise capital from a large number of investors. Further, the entire income of LLC members is subject to self-employment tax contributions, which can be avoided with a C-corporation.

The C-corporation structure may be more favorable for businesses that intend to raise venture capital or investor money as it allows investors to view the business as a maturely established company thereby making it easier to raise capital. The downside of a C-corporation structure includes double taxation, high cost to form, and extensive paperwork and record-keeping requirements.

It is important to properly form the company early in the process. Each state

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carries its own specific requirements for forming and running a company. Delaware has been a popular state for incorporating businesses due to its well-developed corporate laws. Nevertheless, depending on the type of the business, it may make sense to establish the company in the state where it regularly conducts business.

2. Founders' and Operating Agreement

Many business ventures fail due to the lack of well-written agreements between owners. If the business is owned by multiple people, it is crucial to ensure that each person understands their rights and responsibilities within the company at the outset of forming the company. Some of the issues that need to be addressed include how company decisions get made, either by unanimous vote or majority rule, how ownership is structured, and how the company's assets would be divided in the event of dissolution.

The rights and responsibilities of each business owner should be clearly defined in a written agreement and signed by each owner. Depending on the structure of the business and jurisdiction, articles of incorporation and shareholder agreements may be required.

3. Securities Law

Entrepreneurs are subject to various federal and state securities laws, especially when it comes to raising funds from investors. Federal and state securities laws require that the sale of equity securities must comply with certain disclosure, filing, and form requirements unless such sales are exempt. Non-compliance with these laws can result in significant financial penalties for the founders and the company. The most popular and useful exemption requires the founders to raise money from accredited investors. Accredited investors may either be

individuals or entities, but they must meet certain criteria defined by the Securities Act of 1933.

Those entrepreneurs seeking to secure financing from an individual accredited investor should make sure to check whether the investor has either (1) earned income exceeding $200,000, or $300,000 when combined with a spouse, during each of the previous two full calendar years, and a reasonable expectation of the same for the current year; **or** (2) a net worth greater than $1 million (either alone or combined with a spouse), excluding the person's primary residence.

4. Employment

New businesses often encounter problems from inadequate employment documentation. One common issue is misclassifying their workers as employees or independent contractors. Misclassifying workers may result in lawsuits from workers or regulatory actions by the government.

Whether a worker is considered an employee or an independent contractor is not determined simply by assigning the title to the worker but by how much control the employer exerts on the worker. Businesses should contemplate the following questions to properly categorize their employees' status:

a. Does the company control or have the right to control what the worker does and how the worker performs the work?

b. Does the company control the workers' business? In other words, who controls how the worker is paid, whether expenses are reimbursed, or who provides the necessary tools and supplies.

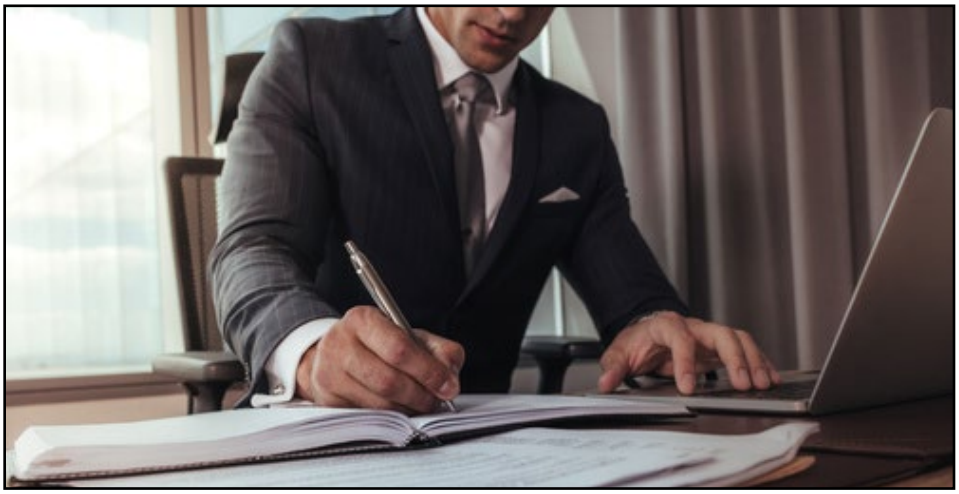
c. Is there a written contract of employee benefits such as a pension plan, insurance, or vacation pay?

It is also important to have a clear employment agreement with key employees that define and govern the relationship, including the ownership of intellectual property and restrictive covenants. Depending on the type of the business, entrepreneurs should consider creating stock option documents, employment offer letters, and confidential information and inventions assignment agreements.

5. Intellectual Property

Intellectual property ("IP") is an important asset of many businesses, which consists of patents, copyrights, trademarks, and trade secrets. Entrepreneurs need to consider appropriate steps to protect their unique technology, service, or product. In addition to filing patents, copyrights, and trademarks to protect the company's IP, businesses that routinely create IP should enter into confidentiality and assignment agreements with its employees to ensure that the work product belongs to the company, not the employees.

Georgia's New Restrictive Covenants in Employment Agreements



Restrictive covenants—most commonly encountered in the form of non-compete and non-solicitation clauses or agreements—can be useful economic tools for companies to protect legitimate business interests and influence control over labor; and yet to the individuals bound by such covenants, the imposition of meaningful restrictions on freedoms to engage in certain business and employment activities can cause fear, uncertainty, and potential exposure to liability for violation of such restrictions. As their name suggests, restrictive covenants are simply ***covenants*** made by a party which ***restrict*** its ability to perform some certain actions.

These contractual arrangements typically arise in the context of employment agreements, where business entities may benefit from post-employment limitations on separated employees, such as to disincentivize employee turnover, curtail expenses associated with advertising, hiring, and retraining new employees, and minimize the risk of harms departing employees can cause through misappropriation of trade secrets and other confidential and proprietary information, and stealing customers and clients. As these agreements serve critical business interests, companies that utilize, or desire to begin utilizing, restrictive covenants in connection with their employment practices should consult with an attorney familiar with restrictive covenants, who can draft deliberate provisions that serve precise business goals, while maintaining careful compliance with the exact requirements of Georgia's Restrictive Covenant Act. Even entities that have no particular desire, or currently perceive no need, to incorporate restrictive covenants into their employment practices, may benefit from consulting with an attorney to discuss the extent to which such agreements could potentially help avoid certain costly harms, to establish consistent and favorable employment practices and perhaps facilitate long-term savings on labor costs, or to prepare for prospects of long-term expansion or growth.

Employees subject to restrictive covenants, individuals who are unsure if their employment agreement contains a restrictive covenant (or one that is valid and enforceable as-

Portfolio Monitor

Johnson Fistel recognizes that there are inherent risks when investing in the stock market. But the risks that an investor assumes do not, and should not, include the risk that the company or its officers and directors will make false and misleading statements to artificially inflate the company's stock price or sell their own stock based on insider information.

Our Portfolio Monitor is designed to alert institutional and individual investors when one of their investments may be affected by securities fraud, corporate waste, or other wrongdoing. Our Portfolio Monitor is available to both U.S. and foreign investors. There are no minimum portfolio requirements or costs to participate.

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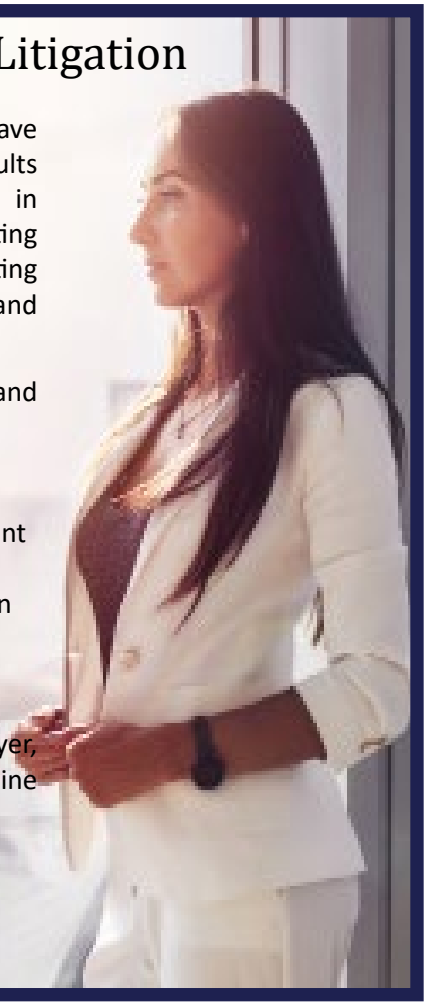
written), and prospective employees contemplating whether to sign or accept, or to negotiate, the terms of an employment agreement containing a restrictive covenant, are likewise well-served to contact an attorney who can advise on the validity and enforceability of such covenants under Georgia law, the practical implications of the limitations imposed thereby, and the potential legal ramifications of a breach. Perhaps now more than ever, those bound by restrictive covenants must be diligent in ensuring comfortability with the limitations to be imposed, and avoid violating such covenants, in light of the well-recognized trend under Georgia law encouraging adoption and implementation, as well as liberal enforcement, of such covenants against Georgia employees.

The attorneys of Johnson Fistel, LLP are highly experienced in the realm of restrictive covenants, including (1) working with businesses and management to draft restrictive covenants, assess the sufficiency of covenants currently in-place, assess whether to adopt such covenants, and to litigate against violators of such covenants; as well as (2) working with employees and other individuals to best ensure and protect their legal rights through careful analysis of restrictive covenants and employment agreements, negotiation of restrictive covenants to achieve more manageable limitations, and litigation on behalf of those alleged to have breached a restrictive covenant. If you have a potential restrictive covenant issue, contact Johnson Fistel, LLP today to determine how we may be able to help assess and secure your legal rights.

Employment and Labor Litigation



The attorneys at Johnson Fistel have obtained successful and efficient results for both employers and employees in litigating employment disputes, negotiating separations and severance, and evaluating employment policies, practices, and contracts.

Johnson Fistel can help employers and employees with the following issues:

- Minimum Wage & Overtime Pay
- Misclassifications (Employee/Independent Contractor)
- Discrimination, Harassment & Retaliation
- Employment Contracts, Severance & Separations, & Restrictive Covenants.

Whether you're an employee or an employer, please contact us today to determine whether we may be able to assist you.

Please visit our website for FAQs about employment law: https://www.johnsonfistel.com/faq/

Upcoming Lead Plaintiff Deadlines

Johnson Fistel is investigating many potential cases arising under the federal securities laws. If you would like more information, or if you wish to participate in an action, please contact us as soon as possible to ensure that your rights are fully protected. Listed below are matters that the firm is investigating and the applicable deadlines for filing a motion with the court to be appointed as a "lead plaintiff" under the Private Securities Litigation Reform Act of 1995.

Company	Deadline
Namaste Technologies Inc. (OCTMKTS: NXTTF)	Dec. 5, 2018
Huazhu Group Ltd. (NASDAQ: HTHT)	Dec. 7, 2018
Alphabet, Inc. (NASDAQ: GOOGL)	Dec. 10, 2018
Stitch Fix, Inc. (NASDAQS:FIX)	Dec. 10, 2018
Trevena, Inc. (NASDAQ: TRVN)	Dec. 10, 2018
Camping World Holdings, Inc. (NYSE: CWH)	Dec. 18, 2018
Dycom Industries, Inc. (NYSE: DY)	Dec. 24, 2018
McKesson Corporation (NYSE: MCK)	Dec. 24, 2018
Bank OZK (NASDAQ: OZK)	Dec. 25, 2018
Nektar Therapeutics (NASDAQ: NKTR)	Dec. 29, 2018
China Zenix Auto International Limited(OTCMKTS: ZXAIY)	Dec. 30, 2018
Align Technology, Inc. (NASDAQ:ALGN)	Jan. 4, 2019
Evoqua Water Technologies Corp. (NYSE: AQUA)	Jan. 5, 2019
Ryanair Holdings plc (NASDAQ: RYAAY)	Jan. 5, 2018
Sonus Networks, Inc. (NASDAQ: SONS)	Jan. 7, 2018
Tesaro, Inc. (NASDAQ: TSRO)	Jan. 8, 2018
Altice USA, Inc. (NYSE: ATUS)	Jan. 18, 2018
GreenSky, Inc. (NASDAQ: GSKY)	Jan. 26, 2018

Taking Stock of Virtual Currency: Are Coins "Securities"?

The recent upsurge in initial coin offerings ("ICOs") used to raise capital in place of initial public offerings and other traditional fundraising measures—roughly $20.8 billion this year, according to Coinschedule.com—has investors wondering whether the federal securities laws apply to virtual coins purchased through ICOs.

To be regulatable under federal securities laws, including the Securities Act of 1933 and the Securities and Exchange Act of 1934, the instrument must be a "security." Both Acts define a "security" as encompassing commonly known financial instruments traded for investment, including, among other things, an "investment contract," which is itself not defined in either Act.

Although Congress has not definitively stated whether virtual coins are securities, the test for whether a financial instrument constitutes an "investment contract" under federal securities laws, and thus a security, is well established. This test was first announced in a 1946 Supreme Court decision, *SEC v. W. J. Howey Co.*, 328 U.S. 293, 66 S. Ct. 1100 (1946), in which the Court held that the offer of a land sales and service contract constituted an "investment contract" within the meaning of federal securities laws. The *Howey* Court outlined the "essential ingredients of an investment contract" as being (1) "an investment of money;" (2) "in a common enterprise;" (3) "with profits;" and (4) "to come solely from the efforts of others."

Last month, in the first criminal prosecution of its kind, *United States v. Zaslavskiy*, No. 17CR647(RJD), 2018 U.S. Dist. LEXIS 156574 (E.D.N.Y. Sep. 11, 2018), established that virtual currencies may be subject to federal securities laws using a *Howey* analysis. In *Zaslavskiy*, the SEC alleged in the indictment that Zaslavskiy

committed securities fraud by making false and misleading statements in connection with two separate ICOs through which Zaslavskiy promised coin purchasers profits from his companies' investments in real estate and diamonds.

The defendant, Maksim Zaslavskiy moved to dismiss the indictment, arguing, among other things, that federal securities laws were unconstitutionally vague as applied to virtual currencies and the virtual coins were currencies, not "securities," and therefore not subject to federal securities laws. The court rejected Zaslavskiy's arguments, finding the "test expounded in Howey has—for over 70 years—provided clear guidance to courts and litigants as to the definition of 'investment contract' under the securities laws" and a reasonable factfinder could conclude the allegations in the indictment satisfy Howey's definition of an "investment contract."

In reaching its ruling, the court bluntly stated, "Zaslavskiy's reading of the relevant law is overly narrow." The court further noted the inquiry into whether a virtual coin is an "investment contract"—i.e., a security—is highly fact specific and emphasized the *Howey* Court's admonition that the definition of a security "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." Simply stated, "labeling an investment opportunity as a 'virtual currency' or 'cryptocurrency' does not transform an investment contract—a security—into a currency."

Although the *Zaslavskiy* decision focused on the specific allegations in the SEC's indictment, if upheld, the ruling will likely have far-reaching implications. Under the *Howey* Court's analysis, as applied to virtual currencies by the *Zaslavskiy* court, although cryptocurrencies like Bitcoin and Ethereum likely will not be within the SEC's regulatory purview, many virtual coins will satisfy the *Howey* definition of an "investment contract." Specifically, commercial enterprises soliciting investors using cryptocurrency, in lieu of IPOs or other traditional mechanisms to raise capital, will likely be subject to federal securities laws, and promoters will be required to adhere to SEC rules and regulations.

The attorneys at Johnson Fistel, LLP are experienced in evaluating and pursuing securities fraud claims. If you have purchased a virtual currency in connection with an ICO and believe federal securities laws have been violated, have information on a promotor's possible fraudulent activity in connection with an ICO, or are interested in learning more about this topic, please contact the attorneys at Johnson Fistel, LLP at 619.230.0063.

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About the Firm

Johnson Fistel was founded on the following five core values: trust, hard work, determination, integrity, and excellence in everything we do. Our interests are aligned with those of our clients — their success determines our own. We embrace and embody those ideals in everything we do. Whether we're pursuing damages for or against a billion-dollar corporation or we're challenging a small transaction, Johnson Fistel devotes the necessary resources to secure the best result possible.

We believe we are only as good as our people, and Johnson Fistel recruits only the best, brightest, and most determined candidates possible. Our lawyers include those who started their training by working for esteemed judges in both state and federal courts, and have also worked at the largest law firms in the world. We pride ourselves on providing the same level of service with a greater level of efficiency. As a result, we have developed the reputation for delivering big-firm results with the efficiency and personal touch of a small firm.

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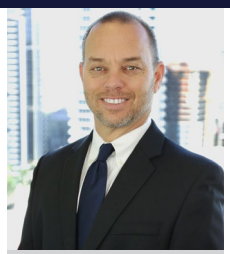
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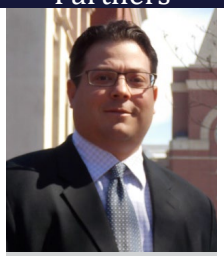
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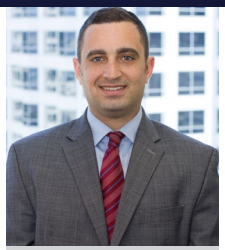
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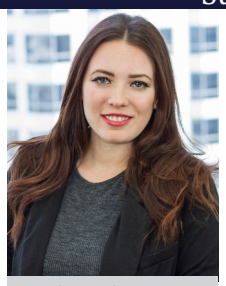
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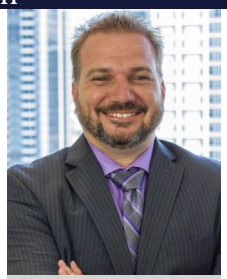
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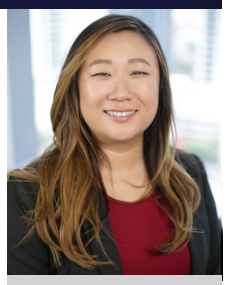
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