

# The DC Bar Pro Bono Center and Arnold & Porter present

*Small Business Legal Issues:  
A Training for Attorneys*



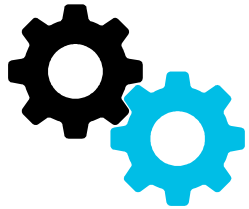
October 28, 2019



# Intellectual Property

# Types of Intellectual Property

## Patents



## Trademarks



## Copyrights



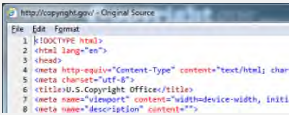



Copyright 2019

## Trade Secrets



# IP Comparison Chart

Type	Cost to Obtain	How to Obtain	Some Possible Subjects	Example
<b>Patents</b>	\$\$\$	Prepare and file patent application (best to use a patent attorney)	Products, devices, processes, etc.	Computer Mouse 
<b>Trademarks</b>	\$\$	Some protection from using mark. More by marking with ™. More from filing trademark application and obtaining registration (can use ®).	Brand names, recognizable logos, trade dress, etc.	Google logo 
<b>Copyrights</b>	\$	Some protection from fixing on tangible medium. More from marking with "<name> Copyright 2019." More from registration at copyright.gov	Written works, audiovisual works, etc.	Websites 
<b>Trade Secrets</b>	\$\$	Must keep secret. Can use physical means (e.g., safes, encryption, etc.) or non-physical means (e.g., contracts, employment agreements)	Anything that gives a competitive advantage by being kept <u>secret</u> from competitors	Coca-Cola formula 

# Patents

# Overview

Can be very valuable



**Gives patent owner right to stop others from making, using, or importing the protected product.**

— (Does NOT give owner the right to practice the invention)



## Requirements:

### Novelty

**“No one has ever done exactly this before”**

&

### Non-Obviousness

**“It would not be obvious to combine existing knowledge to do this”**

*(this is an elusive and subjective requirement)*

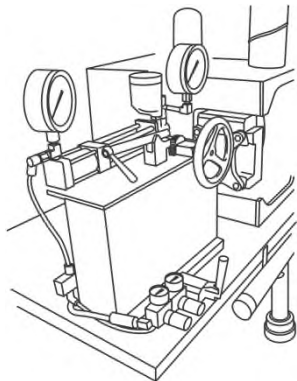
## Short term:

20 or 15 years

# Types

## Utility (most common)

- To protect processes, machines, compositions of matter, and other products.
- Most expensive and time-consuming to obtain
- Usually most valuable



## Provisional Application (a type of Utility application)

- Very few requirements, so can be drafted inexpensively
- Will never be examined and will never issue as a patent
- Can be used to quickly get a filing date for your concepts
- **Expires in 1 year = 1 year to file full application**
  - In order to gain the benefit of the filing date of the Provisional Application, a Non-Provisional Utility Application claiming benefit of the provisional application must be filed before expiration of the provisional application.
- Early filing date only counts for the subject matter actually disclosed in the provisional application.

## Types (cont'd)

### Plant (very uncommon)

- To protect new and distinct asexually reproduced plants.

### Design

- To protect ornamental designs embodied in or applied to an article of manufacture (e.g., the ornamental design of a chair)
- Relatively easy, inexpensive, and quick to obtain.
- Requires drawings of all sides of the article.
- Can be pursued simultaneously with a Utility Application, each covering different parts of the article.
- Only valuable against people copying your ornamental design (e.g., look of chair), but not your functional design (e.g., how a chair works).



# International Protection

**International Protection is available through individual countries (“States”) and some groups (e.g., European Union).**

- There is no “International Patent,” but there is an international application that acts as a starting point.
  - Application under the Patent Cooperation Treaty (“PCT Application”) grants you additional time before you choose to “nationalize” that application into individual countries.
  - Just filing a PCT Application will not, by itself, issue as any patent.
- If you file in the U.S. first, you generally must file in foreign countries within 1 year (for Utility applications) or 6 months (for Design applications).



# Term

## Utility Patents

- Expire 20 years from filing date.
  - Since Utility patent applications can “claim the benefit of” or “claim priority to” an earlier pending application, the term is calculated from the filing date of the earliest U.S. application to which priority is claimed (excluding provisional applications).
- Owner must make maintenance payments at years 3, 7, and 11, or patent expires early.
  - Maintenance fee payments can be paid late up through years 4, 8, and 12.

## Plant Patents

- Expire 20 years from filing date, like Utility patents.
- No maintenance fees are required.

## Design Patents

- 15 years from date of issuance.
- No maintenance fees are required.

# When to File

## Best Practice = file before disclosing to the public

- (e.g., offering to sell, publishing in a paper, actual sales)

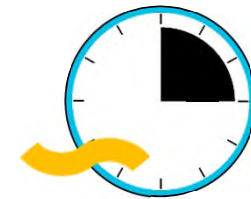
## Can file in U.S. up through 1 year anniversary of first public disclosure.

- (However, someone can still beat you to the patent office if they independently invent.)

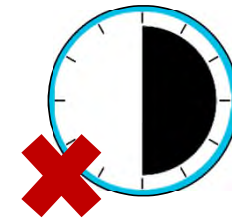
## Beyond 1 year after first public disclosure, you CANNOT obtain a patent.



Before Disclosure



1 year after Disclosure





Beyond 1 year after  
Disclosure

# Costs

## Filing

### — Official Costs

- **Large Entity** = 100% of fee cost. Utility filing can cost about \$1720\* 
- **Small Entity** (fewer than 500 employees)\* = 50% of fee cost (or \$860)\* 
- **Micro Entity** (Small entity with fewer than 5 previous applications and gross income under 3x median income, or under approximately \$189,537)\* = 25% of fee cost (or \$430)\*

Most Common Business Clients  
at Pro-Bono Clinics

Most Common Individual Clients  
at Pro-Bono Clinics

### — Attorney Costs (highly recommended due to complex nature of patents)

- Depends greatly on subject matter and complexity.

\* Numbers are based on approximate data as of October 22, 2019

## Costs (cont'd)

### Prosecution

- Expect some additional costs (mostly Attorney fees) for responding to rejections and other “Office Actions” from the patent office.

### Issuance and Thereafter

- Expect some costs to issue an allowed application.
- Expect to pay maintenance fees, if you want your patent to remain in force.
- Possibility to recover costs through licensing, litigation, or sale of patent.



# Remedies

## Damages

- At least a reasonable royalty, possibly more (e.g., lost profits, price erosion, etc.)
- Sometimes attorneys' fees, but not usually

## Injunction

- Possible at the district court
- Possible through the International Trade Commission
  - Very fast paced and expensive litigation, but can quickly stop all import of infringing goods.



# Ownership

## Ownership starts with the inventors.

Inventors can **assign** rights to others, such as an employer.

It is often a good idea to include, in an employment agreement, provisions for the employee to automatically assign and agree to assist in the prosecution of any patents based on inventions conceived of by the inventor during the course of employment.



## More Information

- United States Patent and Trademark Office (USPTO)
  - [www.uspto.gov](http://www.uspto.gov)
- United States Code
  - 35 U.S.C. §101, *et seq.*
- Manual of Patent Examining Procedure (MPEP)
  - [mpep.uspto.gov](http://mpep.uspto.gov)
  - Section 600 for parts of an application
  - Section 900 for prior art
  - Section 1500 for Design patents



# Trademarks

# Overview

## Value depends on mark recognition



**A trademark (or service mark) is a name, logo, or other symbol used to identify a source of goods (or services).**

- Some of the most common uses are company names and product brands.

**Trademarks protect the public. When they order a “Coke” they know they are getting a “Coke” and not a “Pepsi.”**

**First user of the mark generally prevails.**

**Infinite term:**

∞ years

*As long as you keep using the mark and updating the registration.*

# Protection

- Some protection can come from simple use.

- Protection is based on extent of use



- Additional benefits can come from the use of <sup>TM</sup>.

- Anyone can use <sup>TM</sup>. It puts the public on notice that you own the mark.



- A small benefit can come from registering the mark as a trademark with the state.

## Protection (cont'd)

### **The best U.S. rights come from registering the mark with the United States Patent and Trademark Office (USPTO).**

- Can use the ® symbol.
- Mark is presumed valid and that you are the owner.
- The public is put on notice of your claim of ownership of the mark.
- Can bring an action in Federal court.
- Can use the U.S. registration as a basis for an international registration.
- Can record the registration with the U.S. Customs and Border Protection Service to prevent importation of infringing foreign goods.

Application Process



# Distinctiveness

## The strength of a trademark (and ease of obtaining registration) relies heavily on the mark's distinctiveness

### — Generic Terms

- Functions as the name of the product or service itself. (e.g., “aspirin” or “facial tissue”)
- Not distinctive. Cannot obtain trademark protection.

### — Descriptive Terms

- Words that describe goods or characteristics of the goods. (e.g., “SHOELAND” for a shoe store).

### — Suggestive Marks

- Words that suggest, rather than describe, quality or characteristics of a product. (e.g., “COPPERTONE” for suntan lotion).

### — Arbitrary Marks

- Common words used in an uncommon way. (e.g., “APPLE” for computers)

### — Fanciful Marks

- Made-up words. (e.g., “Kodak”)

Strongest  
Marks



Not Distinctive

May Be  
Distinctive

Inherently  
Distinctive

## Goods and Services

- Trademarks are used to identify the source of goods or services.
- Trademarks are tied closely to the goods or services they signify.
- Multiple owners can co-exist using the same mark for different goods or services.

### EXAMPLE

- Frank uses the mark “GREEN FENCE” for his apple orchard.
- Susan uses the mark “GREEN FENCE” for her internet security business.

Frank and Susan can co-exist without infringing on the others' rights. A consumer buying computer software named “GREEN FENCE” will not be confused and think it came from Frank's apple orchard.

- Goods and Service must be denoted when registering a mark.

# Pre-registration

- Before looking to register a mark, it can be helpful to see if someone else is already using it.
  - Search the internet to see who may be using it.
  - Search the USPTO's Trademark Electronic Search System (TESS)
  - Search state corporation commissions to determine if someone has registered a company with the name of your mark.
- Make sure your mark has some distinctiveness.
- If already using mark, determine dates of first use generally and first use in interstate commerce (e.g., first sale across state lines)

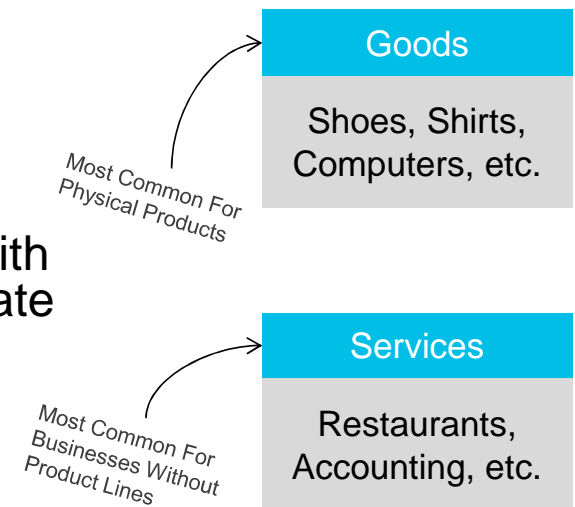
# Federal Registration

## Categories:

- Goods and Services are split up into “international classes.”
- Each application must list the goods/services applied for.

## Overall Requirements:

- Must use mark in interstate commerce (e.g., selling goods with the mark across state lines or advertising services across state lines)
- The mark must be distinct (so a consumer can identify the source of the goods based on the mark)
- Mark must not be registered already for the same or similar goods/services.





# Federal Registration (cont'd)

## Mark Types:

- Can be logos (“design marks”), words (“wordmarks”), sounds, and some others (e.g., Burberry check pattern)
  - In some cases, a logo can itself be a design mark and can contain a wordmark. As long as there is sufficient design to the words (e.g., one of the letters is made to look unique), one may be able to obtain trademark protection as both a design mark and a wordmark for the same logo.

## Application Types:

### Standard Application

- Applicant is using the mark in interstate commerce.
- Registration can issue very soon after allowance, without additional evidence of use after allowance.

### Intent-to-Use Application

- Not yet using the mark in interstate commerce.
- Applicant gets “constructive use” date back to the filing of the application.
- Good as a placeholder until actual use of mark.
- Can request for more time after “allowance.”
- Must file evidence of use before registration.

## Federal Registration (cont'd)

**Federal registration covers the entire United States, but does not trump the rights of a prior user in that prior user's geographic area.**

### EXAMPLE

- In 2000, Bob opens up “**TANGERINE COMPUTERS**” in Richmond, Virginia as a small, single-location computer store.
- In 2010, Jane begins using “**TANGERINE COMPUTERS**” as a mark for her computer store in Los Angeles, California.
- In 2014, Jane registers the mark “**TANGERINE COMPUTERS**” for use in computer and electronic stores.

Jane can stop others from using “**TANGERINE COMPUTERS**” throughout the United States, except Jane cannot stop Bob from using the mark to advertise his store in Richmond, Virginia. Jane may, however, stop Bob from expanding to other locations in Virginia or outside the state.

# Federal Registration Costs

## Filing

- Official Costs
  - Depend on number of classes of goods/services applied for (about \$225-400 per class)\*.
- Attorney Costs (recommended, but not always necessary)
  - Depends on complexity of trademark portfolio.

## Prosecution

- Expect some additional costs for responding to USPTO and filing additional documentation.

## Issuance and Thereafter

- Expect to pay small ongoing costs for filings at 5-6 years and every 10 years afterwards.

\* Numbers are based on approximate data as of October 22, 2019

# International Registration

- International Trademark Registration exists through the Madrid Protocol
  - Must have a U.S. application filed first.
  - Covers many countries.
  - Can obtain country-by-country protection.
- 



# Ownership

- The company or individual using the mark owns the mark.
- A trademark can be transferred or assigned, but must be transferred along with all “goodwill” associated with the mark.
- Any logos that make up a trademark may be separately protectable (and owned) under copyright law.



Be sure you have rights to a logo or other work of art before relying on it as part of your trademark.

## More Information

- United States Patent and Trademark Office (USPTO)
  - [www.uspto.gov](http://www.uspto.gov)
- United States Code
  - 15 U.S.C. §1051, *et seq.*
- Trademark Manual of Examining Procedure (TMEP)
  - [tmep.uspto.gov](http://tmep.uspto.gov)
- Trademark Search
  - [http://tmsearch.uspto.gov/bin/gate.exe?f=login&p\\_lang=english&p\\_d=trmk](http://tmsearch.uspto.gov/bin/gate.exe?f=login&p_lang=english&p_d=trmk)

# Copyrights

# Overview

**Value depends on underlying work**

**Copyrights allow an owner to stop others from copying, distributing, creating derivative works from, or performing a piece of work.**

**Copyright protection exists once the work is fixed in a tangible form.**

- Tangible form includes a form able to be communicated with the aid of a machine or device (e.g., film and a movie projector).

**Long term:** Life of Author + 50/70 years



# What can be copyrighted?

## Any “original work of authorship” can be copyrighted

- Copyrights only extend to aesthetic features of a useful article, not the useful aspects.

### Examples:

- Literary Works (e.g., books or computer programs)
- Musical Works
- Dramatic Works
- Pantomimes and choreographic works
- Pictorial, graphic, and sculptural works
- Audiovisual works
- Sound recordings
- Architectural works



# Marking

**Marking a work as copyrighted is not required, but provides benefits, as it puts the public on notice of your claim of copyright.**

- Use “©” symbol or equivalent (e.g., the word “Copyright” or “Copr.”).
- Must contain year the work was first published or created.
- Must contain copyright owner (e.g., author or other legal owner).
- Optionally, add “all rights reserved” to further deter would-be infringers by indicating that your work is not freely available to copy.

## Marking Example

2019 © Nixon Peabody LLP, all rights reserved

# Registration

**Copyright Registration is only required in order to bring a lawsuit in the United States regarding a copyrighted work.**

- Copyright owners obtain benefits that can reduce the expense of litigation and increase potential damages against an infringer if they had registered their works before infringement by the infringing party.
- Therefore, it is a good idea to register your works if you ever have any intention of enforcing your copyrights in the works.



## Registration (cont'd)

**The Copyright Office, a part of the Library of Congress, is in charge of Copyright registrations.**

[www.copyright.gov](http://www.copyright.gov)

- Registration involves filling out registration paperwork, paying a fee, and submitting a copy of your work.
  - Some works can be submitted digitally, but others may require hard copies be sent to the Copyright Office.
- The official fees are minimal (e.g., around \$35-\$85)
- Using an attorney is recommended, but not necessary.





# Ownership

## Generally, author is the owner

- **Employer** generally owns the copyright of work related to the job by the employee while on the job.
- A **contractor** can transfer copyright according to a written agreement (called a “work made for hire”)



## Additional Information

**It is good practice to record when a work is first created and fixed to a tangible medium.**

- Copyright Office
  - [www.copyright.gov](http://www.copyright.gov)
- 17 U.S.C. §101, *et seq.*



# Trade Secrets

## Overview

**Value depends on secret**

**Trade Secrets are a form of pseudo intellectual property. There is no registration.**

**Trade Secret protection stems from state common law and statutes**

**Can be anything that derives a value from being secret**

— Client lists, secret formulas, etc.

**Term:** Lasts as long as secret is kept secret





# QUESTIONS?



Matt Kitces  
[mkitces@nixonpeabody.com](mailto:mkitces@nixonpeabody.com)

NIXONPEABODY.COM | @NIXONPEABODYLLP



This presentation contains images used under license. Retransmission, republication, redistribution, and downloading of this presentation, including any of the images as stand-alone files, is prohibited. This presentation may be considered advertising under certain rules of professional conduct. The content should not be construed as legal advice, and readers should not act upon information in this publication without professional counsel. ©2019. Nixon Peabody LLP. All rights reserved.



# Legal Perspectives on Small Business Entities

Carey W. Smith

October 28, 2019

# I. Introduction and Goals

- Understand the Difference Between “State Law Purposes” and “Federal Income Tax Purposes”
- Understand Key Aspects of the Most Prevalent Business Entities for State Law and Tax Purposes

## II. “Tax Purposes” vs. “State Law Purposes”

- Whenever you say what kind of entity something is, you have to know whether you mean under state law or under federal income tax law. Sometimes the same; sometimes different.
  - Most common example – a limited liability company (LLC) for state law purposes is usually a partnership for federal income tax purposes

## II. “Tax Purposes” vs. “State Law Purposes” (continued)

- There are other contexts that may introduce yet another type of entity (beyond scope for today)
  - Federal Income Tax vs. State Income Tax
  - Federal Income Tax vs. Other Federal Taxes
  - State/Local Income Tax vs. Other State/Local Taxes
  - Foreign Tax Characterization

## II. “Tax Purposes” vs. “State Law Purposes” (continued)

- Main Types of State Law Entities
  - Sole proprietorship
  - General partnership
  - Limited partnership
  - Corporation
  - Limited liability company
  - Others (LLP, LLLP, contractual relationship, tenancy in common, trust, estate)

## II. “Tax Purposes” vs. “State Law Purposes” (continued)

- Main Types of Entities for Tax Purposes
  - Partnership
  - C corporation
  - S corporation
  - Disregarded entity
  - Individual
  - Others (trust, REIT, REMIC, various other entities that have special tax treatment)

## II. “Tax Purposes” vs. “State Law Purposes” (continued)

- Vocabulary and concepts overlap; make sure that you know whether you are talking about tax or state law
  - Formation
  - Contributions/Distributions
  - Sales or other transfers of ownership interests
  - Liquidation/Dissolution/Termination
  - Merger/Conversion/Division/Spin-Off



## II. “Tax Purposes” vs. “State Law Purposes” (continued)

- Don’t judge book by its cover – a given state law entity can be treated various ways for tax purposes
  - State law general or limited partnership or LLC can be a partnership, C corporation, S corporation or disregarded entity for tax purposes
  - State law corporation can be a C corporation, S corporation or disregarded entity for tax purposes

### III. Key Features of Selected Entities for State Law Purposes

# Sole Proprietorship

- Also known as “sole trader” or “proprietorship”
- No legal distinction between an individual and his or her business
- Simple; no filings or agreements needed to form the “entity”
- Unlimited liability

# General Partnerships

- Preliminary Considerations
  - Default classification for a business association with two or more owners
  - A business association formed under another specific statute is not a general partnership
  - Generally an undesirable entity form

# General Partnerships (continued)

- Governing Law
  - Revised Uniform Partnership Act (“RUPA”)
  - For example, effective in D.C. for all general partnerships formed after January 1, 1998
  - Case law

# General Partnerships (continued)

- Formation
  - No public filing necessary
  - Association of two or more persons to carry on as co-owners a business for profit forms a partnership
    - Intent to form a partnership not relevant
    - Contribution of capital not relevant
    - Existence of written partnership agreement not relevant

# General Partnerships (continued)

- Informal Partnerships
  - Receipt of a share of profits
    - General presumption that a partnership exists, with enumerated exceptions (e.g. payments for services as an employee or independent contractor)
    - Drafting point: use of “independent contractor” clauses
  - Defectively organized limited partnership, limited liability company or corporation (governing law may be unclear)
  - Partnership by estoppel
    - Holding oneself out as, or allowing others to represent that one is, a partner

# General Partnerships (continued)

- Liability for Partnership Obligations
  - Unlimited joint and several personal liability for all obligations of the partnership incurred while a partner
  - Right of contribution
    - Credit risk
    - Generally, partnership itself has primary liability
  - No “corporate veil”



# General Partnerships (continued)

- Management and Control
  - Management decentralized
    - All partners entitled to participate in decisions
    - All partners have authority to bind the partnership
  - May be internally modified by agreement

# General Partnerships (continued)

- Fiduciary Relationships
  - Duty of loyalty
    - Refrain from competing with the partnership
  - Duty of care
    - Limited standard: gross negligence, willful misconduct or knowing violation of law

# General Partnerships (continued)

- Limited Liability Partnerships
  - Also governed by RUPA
  - Filing of Statement of Qualification
  - Similar to general partnerships in many respects (e.g., decentralized management, fiduciary duties)
  - No liability for obligations of LLP
    - Partner liable for own actions
  - Common uses
    - Law firms and accounting firms

# Limited Partnerships

- Preliminary Considerations
  - Purely a creature of statute
  - One or more general partners and one or more limited partners
  - Common uses
    - Hedge funds
    - Private equity, venture capital and real estate funds
    - Family limited partnerships

# Limited Partnerships (continued)

- Governing Law
  - Various versions of Uniform Limited Partnership Act (ULPA) or Revised Uniform Limited Partnership Act (RULPA)
  - Case law

# Limited Partnerships (continued)

- Formation of the Limited Partnership
  - Certificate of Limited Partnership (or equivalent)
    - Name (must include “Limited Partnership” or “LP”)
    - Name and address of registered agent for service of process
    - Name and address of each general partner
  - Partnership agreement often lengthy and complex
    - Generally written, not oral

# Limited Partnerships (continued)

- Limited Liability
  - General partners (unlimited liability)
  - Limited partners (limited liability)
    - Investment in partnership at risk
    - Clawback of distribution if limited partner knew at the time that the partnership would be insolvent after distribution
    - Clawbacks may be contractually agreed to in partnership agreement
  - Limited partners may forfeit limited liability protection
  - Use of LLC or corporate general partner

# Limited Partnerships (continued)

- Management and Control
  - Vested in the general partner(s)
    - Day-to-day business and affairs
    - Broad authority (except as may be limited in the partnership agreement)
  - Certain fundamental actions generally require consent of limited partners
  - Voting rights of limited partners in partnership agreements



## Limited Partnerships (continued)

- Limited partners' right of reasonable access to partnership books and records (inspection rights)
  - Information regarding financial condition, tax returns
  - Name and address of each partner
  - Other information “as is just and reasonable”
  - Subject to nondisclosure of trade secrets and other confidential information

# Limited Partnerships (continued)

- Fiduciary Relationships

- General Partners

- To limited partners
    - To partnership
    - To other general partners
    - Can be limited or eliminated in agreement

- Limited partners (none)

# Limited Partnerships (continued)

- Continuity of Existence
  - Term is perpetual unless otherwise stated in agreement
  - Death or withdrawal, etc. of limited partner (generally no effect)
  - Death or withdrawal, etc. of general partner without timely appointment of successor (generally triggers dissolution)
  - Events of dissolution specified in partnership agreements

# Limited Partnerships (continued)

- Transferability of Interests
  - Consent of the general partner(s) generally required for full transfer
  - Economic interests generally transferable without such consent

# Corporations

- Preliminary Considerations
  - Creature of statute (state law)
  - Governance of internal affairs and owners' liability
  - Legal entity separate from its owners

# Corporations (continued)

- Formation of a Corporation
  - Pre-incorporation stockholders and other agreements
  - File certificate/articles of incorporation with secretary of state / state corporation commission
  - Hold organizational meeting
  - Elect Directors
  - Adopt bylaws

# Corporations (continued)

- Governing Law
  - State corporation statutes
    - Mandatory rules
    - Default rules
    - Optional rules
  - Case law

# Corporations (continued)

- Limited Liability; Agency
  - Limited liability of stockholders
  - Authority: Corporations act through their agents
    - Actual authority
    - Apparent authority based on reasonable belief created by the corporation
    - Vicarious liability



# Corporations (continued)

- Piercing the Corporate Veil
  - Failure to observe corporate formalities
  - “Alter ego” common law doctrine
    - Disregard of “separateness”
    - Commingle assets
    - Use for personal purposes
  - Thin/inadequate capitalization
  - Formed or used to defraud creditors or other third parties

# Corporations (continued)

- Management and Control

- Board of Directors
  - General rule: business and affairs of corporation are managed by or under the direction of the board of directors who are elected by the stockholders
  - Officers: agents; usual and regular decisions
- Stockholders: limited control rights; elect directors and approval of certain extraordinary decisions and actions
- Separation of ownership from management and control

# Corporations (continued)

- Fiduciary Duties
  - Board of Directors & Officers
    - Duty of care
    - Duty of loyalty (incl. good faith)
    - Business judgment rule
      - common law rule/presumption (often codified) that in making a business decision, directors acted on an informed basis, in good faith, and in the honest belief that the action was taken in the best interests of the corporation, absent evidence of a violation of their fiduciary duties
      - precludes courts from second-guessing directors' decisions even if they ultimately prove to have been unwise
  - Controlling Stockholders
    - applicability of business judgment rule subject to limitations

# Corporations (continued)

- Continuity of Existence
  - Generally perpetual existence
  - Dissolution by voluntary action
  - Involuntary dissolution/suspension

# Corporations (continued)

- Transferability of Interests
  - Presumption: freely transferable
  - Transferability may be limited by circumstances
    - Statutes and Regulations
    - Contract
    - Illiquid securities / lack of markets

# Limited Liability Companies

- Certain Preliminary Considerations
  - Relatively new business form
  - Creature of statute (state law varies)
  - Characteristics of corporations and partnerships
  - Considerable organizational and operational flexibility

## Limited Liability Companies (continued)

- Formation of the Limited Liability Company
  - Filing of certificate of formation (or equivalent)
    - Name of limited liability company
    - Address of registered office
    - Name and address of registered agent for service of process
  - Perpetual existence is default unless otherwise specified or subsequently terminated
  - Limited liability company agreement (or operating agreement)
    - Not required but recommended
    - Functions as both charter and bylaws

# Limited Liability Companies (continued)

- Limited Liability
  - Owners are called members
  - Equity interests have various names, e.g. units, interests, percentage interests, membership interests, shares
  - Generally, members have limited liability
  - Analogous to corporations, in that only in exceptional circumstances will members be subject to personal liability
    - veil piercing
    - tortious or wrongful conduct
    - improper distributions
    - any contributions required by the LLC agreement



## Limited Liability Companies (continued)

- Management and Control
  - Considerable flexibility to structure management and control
    - Member-managed
    - Manager-managed
    - Board of managers
  - Contractually expand or restrict members' rights
    - Greater flexibility than with corporations
    - Limited statutorily mandated rights and restrictions
  - Corporate meeting, minutes and related formalities generally not required

# Limited Liability Companies (continued)

- **Fiduciary Duties**

- Delaware LLC Act provides as default rule (i.e. baseline) that managers of LLC owe traditional fiduciary duties of loyalty and care to the LLC and its members, in the same manner as directors or officers of a corporation
- Delaware LLC Act does allow members and managers to alter or even eliminate any such fiduciary duties in the LLC agreement
- By contract, members and managers generally are not precluded from conducting business or competing with the LLC
- Nevertheless, there is an implied covenant of good faith and fair dealing that cannot be waived or bargained away

## Limited Liability Companies (continued)

- Transferability of Interests
  - Generally permissible, except as otherwise provided in the LLC agreement
    - Commonly restricted
  - Although a member's economic interest may be transferable without member consent, the assignee acquires no management rights or to be admitted as a member
  - Consent of the members and/or compliance with other LLC agreement requirements generally required for admission as a member and management rights

## IV. Overview of Types of Entities for Federal Income Tax Purposes

- Partnerships
- C corporations
- S corporations
- Disregarded entities
- Election of tax characterization

# Partnerships (for *tax* purposes)

- 2 or more partners
- Pass through tax treatment – taxable income, gain, loss, deduction are allocated to partners via information return filed by partnership
- Flexibility of economic deal, matched by complexity in tax provisions
- Cannot use this form for a publicly traded entity

# C Corporations

- 1 or more shareholders
- Double taxation – treated as separate person for tax purposes
- Can be preferable or necessary for foreign or nonprofit owners (“blocker” corporation)
- Only choice for a publicly traded entity (with few exceptions)
- Consolidated group can aggregate income, losses etc. for income tax filing and payment

# S Corporations

- Similar to partnerships with several exceptions that generally make this form simpler but less flexible. Key differences:
  - Restrictions on ownership (1 to 100 shareholders; no p'ships, corps or foreign)
  - Single class of stock requirement (for economic rights; voting classes are OK)
  - No flexibility on allocations
  - No tax basis for corporate debt (limits ability to use tax losses)
  - Can convert from C to S corporation without triggering immediate tax
  - Losing S status tosses entity back under C corporation rules

# Disregarded Entities

- 1 owner
- Cannot be a state law corporation (exceptions: QSSS, QRS)
- Disregarded as entity separate from owner; results go on owner's tax return
- Usually "SMLLCs" because under state laws, LLCs can have 1 member
- But state law partnership can be disregarded entity if all of its partners are the same entity for tax purposes
- Entities can be formed and terminate for tax purposes without forming/terminating for state law purposes, or vice versa.



# Election of Tax Characterization

- “Check the box” regulations – Treas. Reg. Section 301.7701-3
  - “Per se corporation” treated as corporation
  - “Eligible entity” by default is treated as partnership or disregarded entity, depending on number of owners
  - Eligible entity may elect to be treated as corporation

# Election of Tax Characterization

- Subchapter S Election
  - Corporation is treated as C corporation unless S status is elected
  - Unanimous consent of shareholders is required
  - Timely filing is important

# Election of Tax Characterization

- Other Elections
  - Corporation may elect to be treated as a REIT
  - If REIT owns 100% of a corporation, it is treated as a QRS (disregarded entity) absent an election
  - REIT can elect to treat partially or wholly owned subsidiary as a TRS (C corporation)
  - If S corporation owns 100% of a corporation, it can elect to treat subsidiary as QSSS (disregarded entity)

## **V. Certain Choice of Entity Considerations in Structuring Business Ventures**

# Certain Choice of Entity Considerations in Structuring Business Ventures

- Choice of Structure Considerations
  - Tax treatment of the entity, its owners and its employees
  - Liability of the owners for the obligations of the entity, or limitations thereon
  - The extent to which the entity lends itself to centralization or decentralization of management

## Certain Choice of Entity Considerations in Structuring Business Ventures (continued)

- Choice of Structure Considerations
  - The extent to which the entity lends itself to continuity of existence of the enterprise or limitations thereon
  - The legal requirement that the type of business must be conducted in a particular form
  - The number of co-owners of the entity
  - The extent to which the entity lends itself to a complex capital structure or the issuance of different kinds of securities

## Certain Choice of Entity Considerations in Structuring Business Ventures (continued)

- Choice of Structure Considerations
  - The extent to which the entity facilitates various types of employee compensation
  - The nature of the duties of constituents to the entity, and to other constituents of the entity
  - The extent to which the entity is subject to record-keeping requirements and other formalities
  - The additional costs of tax filings and entity license fees
  - The extent to which the entity lends itself to anonymity of ownership

## Certain Choice of Entity Considerations in Structuring Business Ventures (continued)

- Entity Comparisons
  - Limited Partnerships
    - Pass-through tax treatment
    - Limited liability for investors
    - Centralization of management



## Certain Choice of Entity Considerations in Structuring Business Ventures (continued)

- Entity Comparisons
  - Corporations
    - Limited liability for investors
    - Centralization of management and separation of management from ownership
    - Shareholders control of management is limited and exercised through their election of the corporation's directors

## Certain Choice of Entity Considerations in Structuring Business Ventures (continued)

- Entity Comparisons
  - Corporations
    - Shareholders can participate in the business (absent circumstances invoking the doctrine of piercing the corporate veil).
    - Significant statutory rules and formalities for exercising internal management functions and owner control
    - Centralized control structure may not be the most suitable for development stage enterprise

# Certain Choice of Entity Considerations in Structuring Business Ventures

- Entity Considerations (Cont.)
  - LLCs
    - Limited liability
    - Pass-through tax treatment
    - Great flexibility in management structure
    - Members of an LLC may fully participate in management
    - Not restricted as to how many and what type of investors they may have

# Certain Choice of Entity Considerations in Structuring Business Ventures

- Entity Considerations (Cont.)
  - LLCs
    - Not obligated to adhere to many “corporate” formalities
    - Limitations on transferability of interests

## Certain Choice of Entity Considerations in Structuring Business Ventures (continued)

- Example 1. New small business with single individual owner. Wants to minimize tax complexity/filings. Wants to limit personal liability.
  - Single member LLC with individual as owner may be best choice. Allows limited liability but is disregarded for federal income tax purposes, so individual reports the business' results on individual tax return.

## Certain Choice of Entity Considerations in Structuring Business Ventures (continued)

- Example 2. Same facts as Example 1, except that there are 2 owners that are married and file joint federal tax return.
  - Single member LLC is unavailable unless couple is willing to have only 1 of them own the entire business. (In community property states, couple is allowed to jointly own LLC and still treat as a disregarded entity for tax purposes.)
  - Assuming 2 owners of LLC, it will be treated as a partnership for tax purposes and will file its own tax return.
  - Even though there is some expense for accountant preparing partnership returns, it is not much more complicated because 100% of the results from business will flow to the “married filing jointly” return

## Certain Choice of Entity Considerations in Structuring Business Ventures (continued)

- Conclusion
  - No “silver bullet”
  - Certain statutory default rules can be contractually altered
  - Entity choice and structure generally not irreversible or irrevocable

## VI. Conclusion; Q&A





## Small Business Training for Attorneys: Employment Law

Joshua F. Alloy

[Josh.Alloy@arnoldporter.com](mailto:Josh.Alloy@arnoldporter.com)

(202) 942-5895

Arnold & Porter

October 28, 2019



Applicable Laws

Wage and Hour Issues

Employee or Independent Contractor?

Discrimination, Harassment and Retaliation

Questions



Clients are looking for practical advice

Perfect is the enemy of the good

“Thou shall not” is a tough place to start

As a general rule, there are exceptions to every rule

<b>Federal Employment Law Statutes</b>	<b>Minimum Employees</b>
Age Discrimination in Employment Act (ADEA) - 29 U.S.C. § 621	20
Americans with Disabilities Act (ADA) - 42 U.S.C. § 12101	15
Civil Rights Act of 1964 – Title VII - 42 U.S.C. §§2000e et seq.	15
Consolidated Omnibus Budget Reconciliation Act (COBRA) - 29 U.S.C. §§ 1161 et seq.	20
Consumer Credit Protection Act - 15 U.S.C. §§ 1671-1677	1
Electronic Communications Privacy Act of 1986 - 18 U.S.C. §§2510-2522	1
Employee Polygraph Protection Act of 1988 - 29 U.S.C. §§2001 et seq.	1
Employee Retirement Income Security Act (ERISA) - 29 U.S.C. §§ 1001 et seq.	1
Equal Pay Act (EPA) - 29 U.S.C. §206	1
Fair Labor Standards Act (FLSA) - 29 U.S.C. §§201 et seq.	1
Family Medical Leave Act (FMLA) - 29 U.S.C. §§201 et seq.	50 or more within 75 mile radius
Federal Income Tax Withholding	1
Federal Insurance Contribution Act (FICA)	1
Federal Unemployment Tax Act	1
Health Insurance Portability and Accountability Act of 1996 (HIPAA)	1
Immigration and Nationality Act - 8 U.S.C. §§ 1101 et seq.	1
Immigration Reform and Control Act of 1986 (IRCA)	1
Labor-Management Relations Act of 1947 - 29 U.S.C. §§ 141 et seq.	1
Occupational Safety and Health Act (OSH Act)	1 - Individual sections of the Act may have different requirements
Older Workers Benefit Protection Act (OWBPA)	20
Pregnancy Discrimination Act (PDA)	15
Uniformed Services Employment and Re-Employment Rights Act of 1994 (USERRA)	1
Worker Adjustment and Retraining Notification Act (WARN) - 29 U.S.C. §§2101 et seq.	100



## Some Local DC Laws

1. Human Rights Act
2. Family and Medical Leave Act (20 or more employees)
3. Accrued Sick and Safe Leave
4. Paid Family Leave\* (July 1, 2020)
5. Parental Leave Act
6. Minimum Wage Amendment Act
7. Wage Payment and Collection Act
8. Wage Theft Prevention Act
9. Continuation of health benefits law (Mini-COBRA) (less than 20 employees)
10. Fair Criminal Record Screening Amendment Act ("Ban the Box")
11. Fair Credit in Employment Amendment Act

## Minimum Wage

	District of Columbia	Virginia	Maryland
What is the minimum wage?	\$14.00 (as of July 1, 2019)	\$7.25 (same as federal minimum wage)	\$10.10 (as of July 1, 2018) \$11.00 (as of Jan. 1, 2020) (\$12.50 - 50 or fewer employees, or \$13 - 51 or more employees in Montgomery County; \$11.50 in Prince George's County)
Are there exceptions to paying the minimum wage?	Yes, there are limited exceptions to the minimum wage for specific circumstances with respect to workers with disabilities, full-time students, youth under age 20, tipped employees and student-learners		
Does it apply to me?	Yes, the federal minimum wage law applies to employees of enterprises that have annual gross sales of at least \$500,000, and it also applies to employees of smaller employers if the employees are engaged in <u>interstate commerce</u> ; state minimum wage laws typically apply to all employers in the state.		



Service • Integrity • Leadership

Pro Bono Program

	District of Columbia	Virginia	Maryland
How often do I have to pay my employees?	Semimonthly	<u>Salaried</u> employees = monthly <u>Hourly</u> employees = semimonthly or biweekly	Semimonthly or biweekly
If an employee is terminated, how soon do I have to pay them final wages?	Next working day	On or before the next regular payday	On or before the day the employee would have been paid if the employee had not been terminated
What if the employee resigns?	The earlier of next regular pay day or 7 days from date of termination	On or before the next regular payday	On or before the day the employee would have been paid if the employee had not resigned
What happens if I don't follow any of these rules?	Penalties	Penalties	Penalties



Service • Integrity • Leadership

## Pro Bono Program

	District of Columbia	Virginia	Maryland
<b>Do I have to give an employee notice or a reason to terminate him/her?</b>	No, DC is an employment at will jurisdiction	No, Virginia is an employment at will state	No, Maryland is an employment at will state
<b>Do I have to pay overtime?</b>	Yes, at the rate of one and one half times the regular hourly wage for work in excess of 40 hours in a seven-day workweek (except for certain salaried employees)		
<b>Instead of overtime, can the employee use “comp time”?</b>	Yes, but only if it is used within the same work week as the extra hours worked		
<b>Do I have to pay extra if an employee works weekends or nights?</b>	No	No	No





Service • Integrity • Leadership

## Pro Bono Program

	District of Columbia	Virginia	Maryland
Do I have to give my employees vacation time off with pay?	No	No	No
How about sick leave with pay?	<b>Yes, Sick and Safe Leave Act</b> <ul style="list-style-type: none"> <li>• &lt;25 EEs = 3 days (1 hour for every 87 hours worked)</li> <li>• 25 – 99 EEs = 5 days (1 hour for every 43 hours worked)</li> <li>• 100+ = 7 days (1 hour for every 37 hours worked)</li> </ul>	No	Maybe
Do I have to provide my employees with breaks or a meal period?	No	No, unless the employee is under the age of 16	No, unless the employee is under the age of 18
What is the youngest age at which a person can be employed?	Minimum age for non-agricultural work is 14 under the Fair Labor Standards Act (FLSA)  Child labor rules do not apply to youth employed as actors or performers in motion pictures, theatrical, radio or television productions; delivery of newspapers; babysitting; and in businesses owned by their parents		

## When do I have to pay overtime?

All time worked above 40 hours in a week shall be compensated at a rate of not less than 1.5 times an employee's regular rate, unless the employee is "exempt" from overtime

Administrative Exemption	Professional Exemption	Executive Exemption
<ul style="list-style-type: none"> <li>• Primary duty is the performance of office or non-manual work directly related to management policies or general business operations of the employer or the employer's customers; and</li> <li>• Primary duty includes the exercise of discretion and independent judgment with respect to matters of significance</li> </ul>	<ul style="list-style-type: none"> <li>• Learned professional – performs work requiring advanced knowledge in a science or learning field customarily acquired by a prolonged course of specialized intellectual instruction and study</li> <li>• Creative professional – primary duty is the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor</li> </ul>	<ul style="list-style-type: none"> <li>• Primary duty is managing the enterprise or a customarily recognized department or subdivision</li> <li>• Customarily and regularly directs the work of at least two or more other full-time equivalent employees; and</li> <li>• Has the authority to hire or fire other employees or whose suggestions and recommendations carry particular weight</li> </ul>

In addition, employees must generally be paid on a salary basis - \$23,660 per year (\$455 per week) – a predetermined fixed salary subject only to very limited permissible reductions.

**\*Effective Jan. 1, 2020 – goes up to \$35,568 per year (\$684 per week)**

## Employee or independent contractor... why does it matter?

Employee	Independent Contractor
<ul style="list-style-type: none"><li>• You must withhold income taxes, withhold and pay Social Security and Medicare taxes and pay unemployment tax.</li><li>• You must pay minimum wage and overtime (unless exempt)</li><li>• You must maintain employment records, including hours worked.</li><li>• Depending on employer size, you must provide health coverage</li><li>• You will be subject to employment laws</li></ul>	<p>← You don't have to do this</p>

## **Employee vs Independent Contractor: General Rules**

1. Most workers are employees
2. An individual is an independent contractor if he or she is in business for him or herself and is not economically dependent on the business of the employer.



## The Department of Labor's Test

1. The degree of control exercised or retained by the employer.
2. The permanency of the relationship.
3. The extent of the relative investments of the employer and the worker.
4. Whether the work performed requires special skills, initiative, judgment or foresight.
5. The worker's opportunity for profit or loss depending on his or her managerial skill.
6. The extent to which the work performed is an integral part of the employer's business.



Consider all information that provides evidence of the **degree of control** and **independence...**

Behavioral	Financial	Type of Relationship
<ul style="list-style-type: none"> <li>• When and where to do the work</li> <li>• What tools/equipment to use</li> <li>• What workers to hire or to assist with work</li> <li>• Where to purchase supplies</li> <li>• What order or sequence to follow when performing the work</li> <li>• More or less detailed instructions</li> <li>• Evaluate how work was performed or end result</li> <li>• Training required</li> </ul>	<ul style="list-style-type: none"> <li>• Significant investment in equipment used</li> <li>• Unreimbursed expenses</li> <li>• Opportunity for profit or loss</li> <li>• Services available to the market</li> <li>• Paid hourly or flat fee</li> </ul>	<ul style="list-style-type: none"> <li>• Written contracts</li> <li>• Employee benefits</li> <li>• Indefinite or for specific project or period</li> <li>• Services provided as key activity of the business</li> </ul>

The business does not have to actually direct or control the way the work is done as long as the business has the **right** to direct and control the work



# Anti-Discrimination, Anti-Harassment and Anti-Retaliation

## Maintaining a Culture of Respect

**What is  
considered  
discrimination?**

Unfair treatment of or preference for an individual because of his/her personal characteristics protected by law

**What is  
considered a  
protected status?**

A personal characteristic protected by federal or applicable state or local law; examples include age, race, color, religion, creed, gender, national origin, disability, citizenship, veteran status, marital status, familial status and sexual orientation



Service • Integrity • Leadership

Pro Bono Program

## Maintaining a Culture of Respect

### What is considered harassment?

Verbal, physical, visual or other conduct that denigrates or shows hostility or aversion toward an individual because of his or her protected status, and such conduct:

- creates an intimidating, hostile or offensive work environment
- interferes with an individual's work performance or
- otherwise adversely affects an individual's employment opportunities

### What is sexual harassment?

Unwelcome sexual advances, requests for sexual favors and other verbal, physical or visual conduct of a sexual nature when, for example:

- Submission to such conduct is made either explicitly or implicitly a term or condition of an individual's employment
- Submission to or rejection of such conduct is used as the basis for employment decisions affecting such individual
- Such conduct has the purpose or effect of interfering with an individual's work performance or creating an intimidating, hostile or offensive working environment

*Sexual harassment may include a range of **subtle and not so subtle** behaviors and may involve individuals of the **same or different gender**. It includes **conduct intended to be friendly or humorous** that is, however, unwelcome or offensive to anyone who witnesses it.*



## Maintaining a Culture of Respect

### What is retaliation?

Threats or other conduct taken in response to, or to get even with or punish an individual for engaging in activity protected by law, including:

- reporting or threatening to report discrimination or harassment,
- assisting in making a discrimination or harassment complaint,
- cooperating in a discrimination or harassment investigation,
- refusing to engage in discrimination or harassment, or
- filing a complaint with the Equal Employment Opportunity Commission or other government agency

### Does this apply to me if I only have a few employees?

It depends, some federal and state laws apply for all employers and others apply to employers with a certain threshold of employees. However...

*The DC Human Rights Act covers **all employers** and prohibits discrimination based on **20 actual or perceived traits**: race, color, religion, national origin, sex, age, marital status, personal appearance, sexual orientation, gender identity or expression, family responsibilities, genetic information, disability, matriculation, political affiliation, familial status, source of income, place of residence or business, status as a victim of an intrafamily offense, or credit information.\**

\* Some traits are applicable to some areas, like housing, but not necessarily to employment.



*Service • Integrity • Leadership*

*Pro Bono Program*

## Maintaining a Culture of Respect

### **What if someone has a disability?**

An employer cannot discriminate against qualified individuals with a disability

- Physical or mental impairment that substantially limits a major life activity;
- Record of such an impairment;
- Regarded as having such an impairment.

Employers must provide an employee with a disability with a reasonable accommodation unless doing so would cause undue hardship. Examples include:

- Modified workspace or equipment
- Modified work schedule
- Modified marginal (not essential) job functions
- Unpaid leave.

### **How should I investigate a complaint?**

Conduct a prompt, thorough and impartial investigation. Some tips include:

- Get the facts; ask “who, what, when, where, and why”
- Always ask “is there anything else?”
- Assure no retaliation
- Do not promise absolute confidentiality
- Preserve evidence
- Document the meeting

## Maintaining a Culture of Respect

### **What about the hiring process?**

#### Job Applications

- Questions must be job related
- Cannot ask about prior criminal history or record
- Cannot ask about disabilities (but can ask if they are able to perform the essential functions of the job, with or without an accommodation)
- Cannot ask about citizenship status (but can ask if they are legally authorized to work in the United States)

#### Interviews

- Questions should track job requirements or be related to the work
- Avoid questions that may elicit information regarding a protected category (marriage, children, religion, race, etc)
- Be careful with “cyber vetting” candidates

#### Background Checks

- Must comply with the Fair Credit Reporting Act and state/local law – obtain written consent and provide mandatory disclosures
- Review EEOC guidance and local rules and regulations
- Many cities and states have passed legislation prohibiting certain criminal background checks and credit checks
- Use caution in relying on background check results in making employment decisions.

## Can I...

**Can I require an employee to sign a nondisclosure or confidentiality agreement?**

Yes, employers have the right to protect the confidential information of the business.

**Can I require my employees to sign a non-compete agreement?**

Generally yes, but be careful. Non-compete agreements should be narrowly tailored and reasonable in its limitations as to the scope, geographic area and time period in which the employee may not compete. For non-competes signed at the start of employment, consideration is the job. Some states allow continued employment to satisfy the consideration requirement, but some states require additional consideration in the form of additional compensation or benefits.

**Can I hire unpaid interns?**

It depends. Generally, unpaid interns at for-profit companies are considered employees, unless they are students, provided training similar to what they would receive in an educational environment, are the primary beneficiary of the relationship, are not displacing regular employees, and the employer is not receiving an immediate advantage from using them. Some courts have used a balancing test to determine which party benefits more from the internship.



**Questions?**

**Thanks for volunteering!**



## **Real Estate for Small Businesses: *A Guide to Leasing (and Subleasing)***

**Amy B. Rifkind**

**(202) 942-6137**

**[Amy.Rifkind@arnoldporter.com](mailto:Amy.Rifkind@arnoldporter.com)**

**October 28, 2019**

*This summary is intended to be a general summary of the law and does not constitute legal advice. You should consult with competent counsel to determine applicable legal requirements in a specific fact situation.*

# Why Lease/Sublease Rather than Buy?

## ■ Pros:

- Simplicity: Single agreement with Landlord (lease); obligations limited to leased premises; no property management obligations
- Flexibility: Ability to expand or contract premises (via options, subleasing, expiration of lease term, etc.)
- Financing of Improvements: Allowance often provided by Landlord for initial improvements (Tenant pays back over the lease term through rent)
- Balance Sheet: No mortgage
- Limited Liability: Tenants are not exposed to liability in the same manner as owners of real property (environmental risks, code enforcement, casualty, condemnation, etc.)

## ■ Cons:

- Control: Must rely on Landlord to perform obligations under the Lease; no direct relationship with property manager or service providers; no alterations unless approved by Landlord; no/limited signage rights; etc.
- Financial: No appreciation and limited ability to depreciate costs of improvements

# The Leasing Process: An Overview

- Hire a broker to find space
- Tenant and broker establish Tenant's goals
  - space needs and growth/reduction projections
  - location (accessibility of public transit, etc.)
  - preferred amenities
  - term (including coordination with existing leases)
  - rental rate range
  - parking requirements
  - project-specific needs (grant and contract award specifications, if any)
  - Timing
- Broker finds space
- Landlord and Tenant (or, often, their brokers) negotiate and sign letter of intent
- Negotiate and sign lease (including exhibits)
- Build-out
- Occupancy



# The Tenant Leasing Team: Key Players

- Broker
- Attorney
- Architect
- Contractor (and subcontractors)
- Insurance/Risk Consultant

# Letter of Intent (aka Term Sheet)

- Who is Tenant; who is Landlord
- What space is to be occupied (attach drawing or schematic)
  - “4,000 sf on the 5<sup>th</sup> floor of the Building (defined above) in the location shown on Exhibit A”
- What is the rent (basic rent, escalations and pass-throughs)
- How long is the lease (\_\_\_ years)
- When does it start; when does it end
  - (commencing on \_\_\_\_\_, expiring on \_\_\_\_\_)
- When is the Tenant entitled to take possession
- When does rent commence
- Will there be rent abatements

# Letter of Intent Terms (cont.)

- Delivery Condition: Landlord improvements before occupancy (painting, carpeting, moving demising walls)
- Will Landlord provide a tenant improvement allowance?
  - Commitment by Landlord to fund a certain amount of the initial improvements in the premises (whether constructed by Landlord or Tenant)
- Security deposit (subject to Landlord review of financials)
  - Often significantly greater than 1 month of base rent for nonprofit tenants
  - Landlord may seek to review project, contract and grant awards
- Guaranties
- Options (FLEXIBILITY):
  - to expand or reduce square footage over time
  - to renew the term or terminate early
- (Largely) non-binding

## Factors That Influence Economic and Business Terms of Lease

- Size of Tenant: *Tenants leasing small premises generally will have less bargaining strength*
- Size of Tenant space in relation to overall size of building
- Motivation of Landlord: *High vacancy will make landlord more reasonable*
- General market conditions
  - Location of property
  - Vacancy rates in surrounding buildings

# Lease Negotiation Process

- Landlord customarily prepares first draft
- Frequently a form will be used
- Critical to have a lawyer review to:
  - Confirm business terms from letter of intent
  - Negotiate to delete onerous, non-standard clauses
  - Address particular Tenant concerns
  - Understand how the pass through of expenses and taxes works

# Rent

## Concepts:

- Gross Rent = the basic rent payable by Tenant that includes costs for operating expense and taxes.
- Net Rent = the basic rent payable by Tenant that is allocable exclusively to Tenant's lease of the property, exclusive of all other costs (e.g., exclusive of any operating expenses and taxes).

## Types of Deals:

- Full Service Lease = a lease where the base rent includes operating expenses and taxes for the base year (*i.e.*, a gross rent concept). Tenant only pays its proportionate share of the INCREASED costs of operating expenses and taxes over the base year because the base rent includes such costs for approximately the first year.
- Net Lease = a lease where the base rent paid to Landlord does not include any payment for operating expenses or taxes, even for a base year. Triple Net refers to base rent net of (1) operating expenses, (2) taxes, and (3) insurance (which is typically included in the calculation of operating expenses). Tenant is responsible for paying, for its share of operating expenses and taxes allocable to the premises IN ADDITION to the base rent.

# Key Lease Terms

- Operating Expenses

- Pass throughs of actual operating expenses
- Pro rata share
- Monthly payments
- Annual estimates
- Audits/reviews
- Exclusions (e.g., debt service, capital expenditures, excess management fees, amounts reimbursed by insurance, services provided exclusively to other tenants)

- Taxes

# Key Lease Terms (Cont.)

## ■ Services/Utilities

- Identify services to be provided (Landlord has no obligation to provide services that are not identified)
- Establish standard for services (e.g., janitorial specs; temperature ranges for heating and cooling)
- Landlord should not have a right to terminate services
- Address interruption of services
  - Rent abatement (rare)
  - Termination (even more rare)

## ■ Building hours and hidden expenses (“excess usage”)

- After hours HVAC, additional janitorial, additional electricity and water
- Tenant should be responsible to reimburse only for actual costs incurred by Landlord



# Key Lease Terms (Cont.)

- Maintenance and repair

- Landlord: building structures (including roof), building systems and common areas
- Tenant: premises only (good condition ordinary wear and tear excepted)

- Alterations

- Obtain right to make non-structural, interior or decorative alterations without consent or with reasonable consent
- Limit obligation to remove alterations and restore at end of term to situations in which Landlord requests restoration at the time it approves the alterations
- Limit or eliminate management or supervisory fee charged by Landlord for “monitoring” alterations work

# Key Lease Terms (cont.)

## ■ Assignment and Subletting

- Permit use by consultants and others (i.e. office sharing)
- Permit transfers to affiliates and successors
- Landlord approval not to be unreasonably withheld
- Recapture rights (try to limit or delete)
- Landlord right to retain all or some of any profits
- Continuing tenant liability

## ■ Insurance

- Tenant insures its property and also insures against claims of third parties occurring on its premises (avoid business interruption insurance)
- Landlord insures against damage to building, third party liability occurring in common areas
- Tenant's insurance agent should review
- Waiver of Subrogation -- each party looks only to its insurance for claims and cannot sue the other even if the damage or liability is caused by negligence of the other

# Key Lease Terms (cont.)

- Casualty
  - Termination right if premises is not restored within a specified time frame
  - Time period for repair or replacement
  - Rent abatement while premises remains unusable
- Condemnation
  - Termination rights
  - Condemnation awards (tenant not entitled)
- Subordination, Non-Disturbance and Attornment (SNDA)
  - Lease subordinate to rights of existing and future lenders (*generally required by lender and non-negotiable*)
  - Lender can foreclose if landlord is in default and can terminate the Tenant's lease
  - Tenant's subordination should be conditioned on non-disturbance
  - Non-disturbance: if Tenant is not in default under the lease, then lender (new landlord) will not terminate the lease
  - Attornment: Tenant consents to lender or successor as new landlord

# Key Lease Terms (cont.)

- Default

- Tenant needs notice and cure rights
- Remedies include termination, reentering premises, all rents to end of term
- Landlords usually object to an obligation to mitigate
- Generally no landlord default provisions

- Holding Over

- Purpose is to ensure Tenant timely vacates space
- 150% to 200% of prior year's rent is typical (usually includes additional rent)
- Holdover rent should be exclusive remedy; specifically exclude consequential and punitive damages

# Key Lease Terms (cont.)

- Security Deposits
  - Reachable only if there is an “Event of Default”
  - Reduced over time (sometimes)
  - Returned at end of term
  
- Initial Alterations and Work Agreements
  - Tenant allowance: reimbursements v. direct payments
  - Identify architect and contractor
  - Time frames
  - Punch list and acceptance of space prior to occupancy

# Contraction and Early Termination Options

## ■ Contraction Option

- Ability to give some space back to Landlord during the term (one-time or ongoing)
- Landlord will require payment of a fee (certain amount of rent, reimbursement of unamortized allowance and brokerage fees)
- Costs for separately demising the returned space

## ■ Early Termination Option

- Ability to terminate early (one-time or ongoing)
- Termination payment

## ■ Easiest to negotiate for these options at the Letter of Intent Stage

- Tie to an ascertainable metric or the occurrence or non-occurrence of an event

# Subleasing

- Structural Differences (vs. direct leasing)
  - Contract with existing tenant (your sublandlord)
  - Subject and subordinate to the prime lease
  - Requires consent by prime landlord
- Pros
  - Lower rental rate
  - Potentially more bargaining power
  - Lower negotiating costs
- Cons
  - Subject to all terms of the prime lease
  - Terminates with prime lease (unless prime landlord agrees not to disturb)
  - Sublandlord typically unsophisticated on leasing/subleasing matters
  - No privity with or recourse against prime landlord (the provider of services)
  - Typically a smaller allowance
  - Approvals required at two levels (sublandlord and prime landlord)

## Obtaining Early Termination Mid-Term

- Landlord (and market) specific outcome
- Landlord's Motivation: Maximize realized rental!
- Tenant's Strategy
  - Best to discuss with an attorney prior to approaching Landlord (avoid unintended consequences)
  - Demonstrate imminent default (share financials, give evidence of loss of contract/grant, etc.)
  - Actually default
  - Offer substantial termination fee (i.e. not just security deposit)
  - Depending on Tenant's mission, argue hardship
- Other considerations
  - Release of liability (conditioned on Tenant's timely vacation)
  - Sublease some or all of premises instead of seeking to terminate



# Work Agreements/Tenant Build-Out

- Design Process
  - Tenant's architect/Landlord's engineers
  - Landlord approvals
- Construction
  - Landlord v. Tenant
  - Landlord's management fee
  - Timing/delays
  - Operating expenses during construction
- Tenant Improvement Allowance
  - Costs in excess of allowance
  - Use of allowance for tenant installations, furniture, moving and possibly rent