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Here We Grow Again

Discover the legal issues fast-growing businesses confront.

BY PAUL G. KLUG AND BRIAN R. SALMO

Fast-growing businesses often encounter unique and accelerated business-related issues, such as a shortage of capital and human resources, due to their rapid expansion. Proactively dealing with the legal ramifications of these and other issues is often painless and can help ensure that a company and its stakeholders are properly aligned. On the other hand, a company that only reacts to the legal ramifications of these issues ends up spending more resources resolving the problems, which could have been avoided.

A fast-growing company often needs capital and seeks equity investments, which raises numerous securities law issues. Equity raises must comply with both federal and state securities laws. Those laws differ depending on, among other things, the size of the offering and the residency of the investors. A company raising capital should address the securities laws issues ahead of and during the raise to protect itself. At the conclusion of any funding round, the company should thoroughly update its list of owners to accurately reflect the new ownership structure.

A rapidly growing company also encounters issues regarding employees and human resources. For instance, growing companies often rely on independent contractors to provide services. Generally, independent contractors' products are not work-made-for-hire, which means they are not automatically owned by the company. It is important that these contractors—who may be referred to as consultants, vendors, or partners—sign an agreement that provides that all work and products they develop or provide are owned by the company. These agreements are sometimes referred to as work made-for-hire, invention assignment, or intellectual property assignment agreements. Without one such document, the company will find itself negotiating for the ownership of the property, such as a website or blueprints, which the company paid the contractor to create. The company should make similar agreements with its employees.

As a company grows, it should continually review and update its employment policies and handbook. A growing company should review its policies at least annually to make sure the policies reflect current laws and are appropriate for the company's number of employees; certain laws may become applicable at different employee thresholds. Also, the company must follow the policies it has enacted. In some cases, having a policy and not following it can cause more liability than not having one at all.

A quickly growing company may grant ownership interests to compensate, incentivize, and retain key employees. Before doing so, the ownership and management should think through the issues that come up with employee ownership and make sure appropriate agreements, such as a shareholders' agreement or a buy-sell agreement, are in place. The company needs to determine if an employee will receive the ownership interest in exchange for providing services or if an employee will pay cash. Should an employee have the right to vote on company matters? Additionally, granting ownership could cause unintended tax consequences for both the employer and employee. A popular course of action is to require the employee to provide services and achieve defined milestones in order to earn ownership interest and cause the ownership to vest. If the milestones are not achieved, some or all of the ownership interests should remain unvested and be forfeited.

Another employee ownership issue is what happens to the vested ownership interest of a terminated employee. Does the company have the right to buy back the ownership interest, and if so, at what price and on what terms? Making an employee an owner in a growing business can help the company gain, keep, and motivate top employees, but current and prospective owners should proceed cautiously because there are many legal issues to be addressed.

Management of fast growing companies has more than enough to do, often operating on a tight budget. Nevertheless, a fast-growing company should proactively address the legal issues in order to minimize or possibly eliminate the expense of resolving unintended legal consequences. MB

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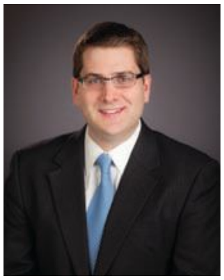

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