

Protect the Creative Product of Your Mind™

## Business Law Considerations for Startups

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## Housekeeping

- Dumb questions exist
  - They are those that remain burning in your brain but unasked
    - To have at your disposal a lawyer who bills \$275/hour and *not* ask questions is dumb
  - Interrupt with questions, comments, etc.
- Break times
  - This is a two- or three-hour presentation, and it is heavy-duty material; we'll take a 10-minute break after about an hour
  - If required, feel free to leave and come back during the discussion
- I will be here after the class to answer any further questions

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## Nancy Baum Delain

- Intellectual Property & Business Law practice
  - JD from Franklin Pierce Law Center, Concord, NH, 2003
  - Registered Patent Attorney
- 20+ years' experience in computer industry as a technical documentation specialist (writer/editor/manager)
  - MS from RPI in Technical Writing, 1981
- 2 years' experience in a virology research lab at Rockefeller University, a think tank in NYC with a faculty containing several Nobel laureates
  - AB from Smith College in Biological Sciences (Zoology and Cell/Molecular Biology), 1978

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## Order of Presentation

- Startup Considerations
- Contracts
- Intellectual Property

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## Business Formation in New York

- New York recognizes four separate types of business entities
  - Sole proprietorship
  - Partnership
  - LLC/LLP
  - Corporation

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## Sole Proprietorship

- What is it?
  - A single-owner business entity certified by the county to do business in that county
  - Commonly called a DBA because the certificate issued by the county is a license to “Do Business As” an assumed business name (which may, in fact, be the owner’s name)
- How long does it last?
  - Until the owner stops “Doing Business As” in the county of registration, OR
  - Until the owner files a certificate with the County Clerk dissolving the DBA
- How is it taxed?
  - Form 1040, Schedule C

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## Sole Proprietorship

- **Advantages**
  - Easiest of all the business forms to set up
    - Register a DBA certificate with the county clerk of the county where the business will operate
    - Pay nominal fee to the county clerk's office
    - Obtain Employer ID number (EIN) from the IRS
    - If you sell goods or services for which you are required to collect sales tax, obtain a sales tax number from the NY Dept. of Taxation and Finance

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## Sole Proprietorship

- **Advantages (continued)**
  - Has the fewest formal requirements
    - No seals, no meetings
  - You are the BOSS
    - Very little state oversight leaves you free to operate your business as you see fit
  - Income is reported as personal income and is reported on Schedule C to the IRS

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## Sole Proprietorship

- **Disadvantages**
  - No protection of owner's personal assets
    - Total exposure for owner in the event of a catastrophic event such as a lost lawsuit
    - ALL of owner's assets are at risk
    - "Easily made, easily broken" business
  - Lack of credibility
    - More difficult to raise funds
    - More difficult to attract good customers
    - More difficult to get proper insurance for some types of businesses that elect to be sole proprietorships

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## Sole Proprietorship

- **Disadvantages**
  - Registration of the name at only the county level leaves business name up for grabs to anyone who registers a business at the state level
    - DBA is legally valid only in the county in which the DBA is registered
  - This causes confusion in the marketplace
    - Expect a trademark infringement lawsuit
    - Hard to win this suit, since the DBA owner did not act properly to protect the name of the business

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## Sole Proprietorship

- **Business types for which sole proprietorship can best work**
  - Small MLM franchisees
    - Amway, MaryKay, Herbalife, etc.
  - Freelance writers, artists, videographers, musicians, craftspeople
  - Businesses with few, if any, walk-in customers
  - Businesses with no employees other than the owner/owner's family
  - Businesses that are geographically restricted to one county
  - Businesses in which the owner's DBA is the owner's own name

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## Sole Proprietorship

- **Business types that should stay away from sole proprietorship**
  - Professional offices (doctors, lawyers, dentists, architects, real estate brokers, etc.)
  - Businesses with walk-in customers
  - Businesses that transport people and/or goods

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## Partnership

- Comes in two flavors:
  - General Partnership
  - Limited Partnership

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## General Partnership

- What is it?
  - A multiple-owner business entity that may be certified by the county or by the state
    - Certification is NOT needed to form a valid general partnership
  - All partners in a general partnership participate to some degree in the management of the business of the partnership
- How long does it last?
  - Until the partners stop doing business as partners, OR
  - Until the partners file a certificate dissolving the partnership AND present to the public that they are no longer doing business as partners
- How is it taxed?
  - Partnership tax forms, with each partner reporting gains and losses commensurate with that partner's financial contribution to the partnership

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## General Partnership

- Advantages
  - Very easy to form
    - Present to the public as a partnership
    - No EIN needed for a partnership to be formed
      - If the partnership plans to do business with the public as a partnership, an EIN is needed
  - No formalities required to maintain partnership status
    - Just keep presenting to the public as a partnership
  - Easy access to partners' expertise within the partnership

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## General Partnership

- Disadvantage
  - Every partner in a general partnership is *personally liable for the debts of every other partner* in the general partnership, regardless of whether those debts are related to the business of the partnership
    - An example of the workings of partnership law:
      - If your partner in a general partnership files for personal bankruptcy protection, his creditors can come after all of his partners for satisfaction of the debts.

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## Limited Partnership

- What is it?
  - A multiple-owner business entity that may be certified by the county or by the state
  - No limited partner in a partnership may participate at all in any of the management of the business of the partnership
- How long does it last?
  - Until the partners stop doing business as partners, OR
  - Until the partners file a certificate dissolving the partnership
- How is it taxed?
  - Partnership tax forms, with each partner reporting gains and losses commensurate with that partner's financial contribution to the partnership

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## Limited Partnership

- Advantages
  - Those of partnership
  - No personal liability of the limited partners for the liabilities of other partners

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## Limited Partnership

- Disadvantages
  - No control by the limited partner over the management or operation of the business of the partnership, regardless of financial or other contribution to the partnership
  - “Silent partner” status
  - General partnership is presumed for all partners until limited partnership is proved
  - Partnership requires at least one general partner to conduct business

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## Partnership

- What businesses can use partnership as an effective business form?
  - Formerly, partnerships were often formed between professional people such as doctors, lawyers, architects, dentists, etc.
  - Now, partnership is generally used when corporations wish to form strategic alliances
    - Draconian partnership provisions do not generally have as much impact on a large corporation as they do on individuals
    - Insurance can help cover partnership liability between companies, but it generally will not do so between individuals

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## Partnership

- Businesses that should avoid general partnership
  - Sole proprietors
  - Any business wishing to avoid liability for partners’ financial decisions

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## Limited Liability Entities

- Come in two varieties:
  - Limited Liability Company (LLC)
    - Can have only one member or many members
  - Limited Liability Partnership (LLP)
    - Must have more than one member
    - Only available to certain professions
      - Doctor, Lawyer, Dentist, Chiropractor, Engineer, etc., as listed in the Education Law of New York State

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## Limited Liability Company (LLC)

- What is it?
  - An unincorporated business entity that provides the members with the protection of the “corporate veil”
  - Has its own legal existence, separate from that of its members
- How long does it last?
  - Until it is dissolved, either by the members, by the State, or by the courts
- How is it taxed?
  - Single member LLC may be taxed either as a pass-through entity or as a business entity by the federal government
  - Multiple member LLC is taxed as a business entity (generally as a partnership) by the federal government

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## Limited Liability Company (LLC)

- Formation formalities
  - File Articles of Organization+filing fee
  - Publish in two newspapers designated by the County Clerk of the county in which the LLC plans to have its main offices once per week for six consecutive weeks
  - File Affidavits of Publication+filing fee
  - Optional but HIGHLY recommended:
    - All members should sign Operating Agreement - within 90 days of formation
- Maintenance formalities
  - Franchise tax payable to NYS within 30 days of the end of the LLC’s fiscal year
  - Annual meeting of members

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## Limited Liability Company (LLC)

- Advantages
  - Less structured than is a corporation
  - Provides the “corporate veil” to protect owners’ personal assets
  - None of the partnership responsibilities toward creditors of members

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## Limited Liability Company (LLC)

- Disadvantages
  - Very new business form
    - NYS LLC law was enacted in 1994
    - VS.
    - NYS corporation law was enacted when NYS became a state
    - No one quite knows for sure how it will behave in court
      - It currently behaves like a corporation, but it has enough elements of partnership in it that it could turn on the whim of a judge....
  - Treatment across state lines can vary wildly

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## Limited Liability Partnership (LLP)

- What is it?
  - Similar to an LLC, an LLP is an unincorporated business entity that provides protection via the “corporate veil” to the partners
  - Has its own existence separate from that of its owner
  - Only available to certain professions
- How long does it last?
  - Until it is dissolved by the members, or by the State or by the courts
- How is it taxed?
  - Generally taxed as a partnership

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### Limited Liability Partnership (LLP)

- Formation formalities
  - Same as those for LLCs
- Maintenance formalities
  - Same as those for LLCs

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### Limited Liability Partnership (LLP)

- Advantages
  - LLP partners can have management control of the partnership without incurring the liabilities of general partnership

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### Limited Liability Partnership (LLP)

- Disadvantages
  - Like LLCs, LLPs are fairly new legal entities so no one is quite sure how they work just yet
  - Treatment across state lines can vary wildly

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## Corporations

- Come in two types:
  - C-corporations
  - S-corporations

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## Corporations

- Formation formalities
  - File Articles of Formation with the Secretary of State and pay the filing fee
  - Hold and document initial meetings
  - Optional but HIGHLY recommended:
    - Sign Shareholders' Agreement
- Maintenance formalities
  - Hold and document annual BOD and shareholder meetings
  - Pay taxes

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## C-Corporation

- What is it?
  - An incorporated entity
    - The entity is separate from its owner(s), having its own legal existence
- How long does it last?
  - Until it is dissolved by its shareholders, by the State or by the courts
- How is it taxed?
  - As a separate entity, it is responsible for income taxes based on the revenues it receives
  - If the corporation holds property, it is responsible for property taxes in most cases

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## C-Corporation

- Advantages
  - Well established legal entity, well recognized by the law and the courts
  - Consistent treatment in different states
  - With proper procedures, you can take a C-corp public
    - Unlimited number of shareholders
    - Unlimited as to what types of entities can hold shares

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## C-Corporation

- Disadvantages
  - Double taxation
  - Formal requirements for maintenance can be just stupid with a single-shareholder corporation

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## S-Corporation

- What is it?
  - A so-called “closely held” corporation
  - The classic small business form
- How long does it last?
  - Until the shareholders, the state or the courts dissolve it
- How is it taxed?
  - Can elect to be taxed either as a corporation (similar to a C-corp) or as a partnership

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## S-Corporation

- Advantages
  - Corporate veil
  - Reasonably uniform treatment across state lines
  - Small management team → quick action

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## S-Corporation

- Disadvantages
  - Limitations on number and types of shareholders
    - S corp can have up to 75 shareholders
    - S corp shareholders must be natural persons
      - Your LLC cannot hold stock in your S-corp

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## Corporation or LLC?

<p><b>Corporation</b></p> <ul style="list-style-type: none"> <li>• Eliminates personal liability; may have pass-through taxation</li> <li>• May be taxed as a separate legal entity or as a partnership. No individual taxation</li> <li>• Some hoops to jump through to form</li> </ul>	<p><b>LLC</b></p> <ul style="list-style-type: none"> <li>• Eliminates personal liability while keeping pass-through taxation</li> <li>• Taxed as a partnership for multiple members; taxed as an individual for single member</li> <li>• Some hoops to jump through to form</li> </ul>
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### Issues to Consider After Formation

- In what business is the entity engaged?
- How does the entity perform its business?
- How does the entity make money?
- Tax considerations

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### Issues to Consider After Formation

- Business
  - Your certificate probably says that you're in business for "any lawful purpose" unless you're forming a professional company
  - What IS your business?
  - Where will you get customers or clients?
  - How do you plan to market your business?
  - Can your business change over time?
    - How?
  - How flexible are you in terms of market demands?

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### Issues to Consider After Formation

- Performance
  - Do you do it all or do you hire employees?
  - What kind of equipment do you need?
  - What kind of customer do you need?
  - What kind of service does that customer need?
  - Who is your competition?
  - How can you out-perform your competition?

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## Issues to Consider After Formation

- Revenue
  - You need money to stay in business
  - How much will you charge for your goods or services?
  - How do you know that the market will bear your price?
  - Can you use price to attract your customer?
  - How can you get a fair price for your goods or services?
    - What IS a fair price for your goods or services?

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## Issues to Consider After Formation

- Tax considerations
  - Pay your taxes
    - Or the taxing agency WILL put you out of business and possibly in jail
  - Different taxes for different entities
    - Franchise tax on corporations and LLP/LLCs don't exist on partnerships and sole proprietorships
  - Sales tax
    - To collect sales tax, you need a state-issued sales tax ID number
      - Contact the Dept. of Taxation and Finance to obtain a sales tax ID
  - Payroll taxes:
    - YOU are responsible for payment of employer's portion of your employees' payroll taxes (FICA, state, federal taxes)
    - YOU are responsible for getting payment to the taxing authorities (federal, state, and local) on time
    - Voluntary pre-tax withholdings (usually used for child care or medical costs) can REDUCE your payroll tax bill and cost you essentially nothing
    - Several payroll outsourcing suppliers exist; use one of them unless you are comfortable with payroll taxes and want to spend your time doing them for your employees

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## Doing Business Across State Lines

- May need to register as a "foreign entity" in the state
- Qualifying to do business in another state
  - Certificate of Authority + filing fees
  - Publish
  - Annual reporting fees (can be expensive)
  - Pay tax on revenue generated by business within the state
  - Appointing a Registered Agent
- Lawsuit possibilities in the state
  - Being sued
    - Personal jurisdiction
    - Website --> personal jurisdiction?
  - Suing others

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**BREAK**  
**10 minutes**

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**Business Agreements**

- What IS a contract?
  - Promise
  - Secured by consideration
  - Legally binding (usually)

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**Business Agreements**

- Every business has at least one contract
- Four ways to form a contract
  - Bilateral agreement
    - The contract you think of, often memorialized in a signed writing
  - Detrimental reliance
    - One party acts to its own detriment in reliance on the word of another
  - Unilateral offer accepted by performance
    - Reward offer is a good example
  - Formal
    - Sealed writing
    - Not used much

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## Business Agreements

- Fourteen ways out of a contract:
  - Infancy
  - Incapacity
  - Mutual Mistake
  - Unilateral Mistake (this one's hard to pull off)
  - Misrepresentation
  - Fraud
  - Duress
  - Unconscionability
  - Illegality
  - Lack of legal consideration
  - Statute of Frauds
  - Impossibility
  - Impracticability
  - Rescission

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## Business Agreements

- Discuss the ramifications of any contemplated business agreement, including the “fine print,” with your attorney *before* you sign
- When you do sign a contract, follow through on your end of the bargain
  - Remedies exist at law and in equity for not fulfilling a contract obligations
    - Money damages and judgments
    - Specific performance can be enforced

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## Business Property

- Tangible property
  - Desks, lamps, chairs, office supplies, business equipment, real property, inventory, accounts receivable, cash on hand, etc.
  - Protected with insurance
    - You need adequate insurance to cover replacement cost
- Intangible property
  - Intellectual property
    - Contracts, company know-how, inventions, trade secrets, trademarks and service marks, copyright, trade dress, goodwill
    - Replacement-cost insurance is unavailable
    - Intangible property forms 80-97% of the value of most businesses

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### Protecting Tangible Property

- Put it under lock and key
- Have inventory control systems in place
- Monitor employees and visitors to prevent theft
- Have adequate replacement-cost insurance

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### Protecting Intangible Property

- What you can't see, smell, touch, hear or feel — or, for the most part, insure — makes up the main value of your business
- Insure your life
  - Protect your family
  - Protect your business
- Insure your income

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### Protecting Intangible Property

- Company know-how
  - The collective knowledge within the company of how the company does business
    - Processes & procedures
    - Data
  - Often reside only in the brain of the owner or key management personnel
  - Protect them
    - Write them down
    - Keep them secure, protected from unauthorized disclosure
    - Have non-disclosure agreements in place with all employees who have access to company know-how

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## Protecting Intangible Property

- **Inventions**
  - Protect by patent or by maintaining the invention as a trade secret
  - Patent = exercise in disclosure
    - Must disclose best mode of practicing the invention as of the date of filing the patent application
    - Can keep improvements from that day forward as trade secret company know-how
    - Patent gives the holder the right to prevent others from making, using, selling, offering for sale, or importing the invention for a limited time
    - Patent cannot be renewed
  - Trade secret dies with disclosure

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Protect the Creative Product of Your Mind™

## Protecting Intangible Property

- **Trade secrets**
  - Best kept trade secret of all time?
    - Formula for Coca-Cola
  - Trade secret is just that: a secret
  - Only protection is through secret
    - If another legitimately invents your trade secret and patents it, you can lose the rights to the secret
    - If secret is disclosed, purposefully or not, the cat's out of the bag and your trade secret is gone forever

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## Protecting Intangible Property

- **Trademarks and service marks**
  - Identify a good or service as coming from your company
    - Valuable goodwill in the marketplace
  - Trademarks/service marks exist to prevent consumer confusion
  - Can be registered federally if you are engaged in interstate commerce, i.e., if you have the mark on a website
  - If you do not engage in interstate commerce, the mark can be registered in the state in which you do business
  - Trademarks are first come, first served
  - Unlike a patent, to keep a trademark, you must continually use it in commerce

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## Protecting Intangible Property

- Examples of registered marks



imagination at work

Fly the Friendly Skies.

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## Protecting Intangible Property

- Examples of unregistered marks



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## Protecting Intangible Property

- Trademarks and service marks
- Use it or lose it
- How to obtain a mark
  - Decide on a mark to associate with your company
  - Have a trademark search done
  - If the search comes back clean, begin using the mark on everything you put into the stream of commerce (goods, services, stationery, website, advertising, all of it) **with the ™ designation**
  - Register the mark when you begin doing business across state lines
    - For this purpose, Canada is NOT a state
    - Massachusetts IS a state, as is Ohio, Pennsylvania, Vermont, New Jersey, etc.

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## Protecting Intangible Property

- A trademark has a grammatical part of speech associated with its usage. Is that part of speech a:
  - Noun?
  - Verb?
  - Adjective?
  - Preposition?

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## Protecting Intangible Property

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## Protecting Intangible Property

- **Examples of Lost Marks**
  - Plastic clingy wrap
    - CELLOPHANE
  - Moving staircase
    - ESCALATOR
  - Pain reliever (and blood thinner, as it turns out)
    - ASPIRIN
- All lost to improper usage

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## Protecting Intangible Property

- **Marks In Danger**
  - Facial tissue
    - KLEENEX®
      - We do not get a kleenex; we get a KLEENEX facial tissue
  - Photocopier, the act of photocopying
    - XEROX®
      - It is not a xerox, and we do not xerox anything; it is a XEROX copy and we make a photocopy
  - Internet search engine
    - GOOGLE®
      - It's not possible to google anything. We use the GOOGLE search engine
- All may be lost to improper usage

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## Protecting Intangible Property

- **Trade dress**
  - The protectable appearance of goods, services, décor, etc. that is associated with business goodwill
  - Protectable under trade dress law
    - Federal
    - State

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## Protecting Intangible Property

- **Copyright**
  - Of all the registrations for intellectual property, copyright is probably the easiest to obtain
  - Protects works of authorship (books, music, architecture, artwork)
    - Does NOT protect taglines
  - Cheap to get really good protection: \$45 registration fee to the Library of Congress
  - In return for registration, statutory damages are available for infringement (\$750-\$30,000 per infringing act), trebled if you can show willful infringement

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## Planning

- What happens if you get into a car crash on your way home tonight?
  - Suppose you die (we all will, one day)
  - Suppose you don't die but can't work
  - Suppose you will be able to work again in a while
  - Suppose you won't

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## Questions?

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## Business Law Considerations for Startups

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