

Startup Pitfalls to Avoid

Investors, employees should look ahead and structure companies from the ground up

BY KALEY LAQUEA
LAW WEEK COLORADO

Colorado's booming startup culture has kept corporate counsel busy and shows no signs of slowing down anytime soon. But several aspects of a burgeoning company can often be overlooked and create difficult problems for investors, founders and employees down the road.

Sphero attorney Stacy Carter has spent her entire legal career working with startups, and says businesses getting off the ground are consistently met with the unexpected. It truly boils down to "being able to roll with the punches."

For example, when her company was suddenly evacuated from their office space due to a structural failure, she says in a larger established company there would be an entire real estate team dedicated to working out the problem with landlords and insurance, but that wasn't the case.

"No one knew it was going to happen that day. Everyone fills more than one role," Carter said.

Bryan Cave attorney Mark Weakley advises clients on both sides of the buying and growing process. He stressed the importance of document retention and essential legal files to keep, but he says one thing investors are particularly concerned about is the company's personnel structure.

"Do founders have an agreement between them on roles, responsibilities and how the company will be executed? Investors want to avoid messy founder issues," Weakley said.

Ballard Spahr partner Carin Cutler echoed this, adding that a slightly uncomfortable conversation or request from the outset can prevent larger issues between founders and owners down the line.

"It seems off-putting when you present a written agreement to your partner and say 'hey, sign here' before you jump

off a cliff together, but it's to protect both sides and to preserve the relationship so that everyone knows what the deal is going in," she said.

Cutler says when investments are made up front, the time, effort and counsel sought to put structure in place and memorialize these types of arrangements are often some of the most important ones made.

"You don't need a gold-plated version of everything at the outset, but key aspects of relationships among owners and founders and even early partners and customers that if you spend resources on will pay dividends down the road for you in avoiding issues," Cutler said.

Investors and founders can run into snags with employment laws and classifications as well.

Weakley says on the startup side, employers and company owners should familiarize themselves with state employment laws from day one, as investing clients two years down the road will want

to know how those things were handled.

"We see startups trip up on that before they're even aware of the issue," Weakley said.

He says that in some cases individuals may claim later on that they weren't paid appropriately according to state law, or ask for unemployment insurance, and in the event a company overlooks things like paying unemployment insurance to the state, it can cause problems.

"We see the following scenario — a company doesn't have much cash to pay wages or salaries to employees and so doesn't, and that's a violation of federal and state wage and hour laws. We advise companies if a worker is an employee that they be paid minimum by law. If a person is categorized as an independent contractor, then a worker is treated as such under Colorado law. Clients think calling a worker an independent contractor is all you need," Weakley said.

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Intellectual property can also be a stumbling block for companies trying to get off the ground. Weakley urges everyone involved — founders, contractors and employees to sign things like contribution and invention assignment agreements, which stipulates ownership for technology developed in the early stages of a company.

“When the secret sauce is invented by a number of players before a company is formed, it’s critical that the intellectual property is signed into the company and that is well documented. Investors want to know the ownership of the company among the founders and employees. It’s critical to look at, because their investors will,” Weakley said.

One trend Weakley has noticed in Colorado is more strategic investors coming to Colorado — large early stage investors like Blackstone, Google and Monsanto investing more in smaller startup companies.

“In Colorado, given the strong and growing startup culture and ecosystem, startups just need to be aware of what is beneficial about a strategic investor and what the downside can be. What they’re looking for can be very different from what a venture fund is looking for,” Weakley said. •

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the same thing.

“During the civil rights (movement), we’d be looking to Washington, D.C., to protect people’s rights, but now because of what’s going on at the federal level, you really have to be looking to the state for the kinds of protections that people need,” Levin said.

In addition to working at Levin Sitcoff, Levin worked in firms in California and Denver before starting the firm that eventually grew into Levin Sitcoff. He went to Cherry Creek High School and attended Stanford before going on to get his law degree from UC – Hastings.

And although he has worked in private practice his entire career, Levin points out his civic involvement with National Jewish Health, The Anti-Defamation League, Arapahoe House and the Judicial Performance Commission as examples of his public service. “Civil rights is part of my DNA,” he said.

There’s so much that can be done by the Attorney General and traditionally has been, and that’s something that I want to do,” Levin said. “Have that office be one that is proactive and acting on behalf of the people of the state.” •

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PROACTIVE PLAN
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“We want the word-of-mouth that it’s worth it,” Coyle said.

And as an added incentive, the goal is to have participation in the assessments return lower insurance premiums.

Dawn McKnight, who recently joined the office, said that there has been a decline in insurance incentive-based CLEs. The subcommittee and Office of Attorney regulation Counsel are working with the vice president of ALPS, the preferred professional liability insurance carrier of the Colorado Bar Association, as well as CNA which previously offered insurance discounts through other programs.

For the Office of Attorney Regulation Counsel, the focus on proactive work is foundational, as well. In addition to bringing on McKnight, the office added White to assist with the proactive education focus and is searching for someone else to take on education specifically. For attorneys looking to see the first wave of what is happening, a CLE will be held on July 9.

The Proactive Management Based Regulation subcommittee is also exploring the possibility of a rule that would protect the assessments from being used in discovery. •

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The state’s uninsured motorist statute requires insurers to offer the coverage “except that the named insured may reject such coverage in writing.” The Colorado Court of Appeals found in favor of Johnson in 2015, finding that the statute requires all individuals named as insureds on a policy must “expressly waive” UM/UIM coverage. That division also found that common law surrounding implied authority did not apply because the legislature, when writing the statute, expressed a clear intention that each motorist must speak for himself or herself in that context.

And in Colorado, the legislature has the authority to repeal or supercede common law but only by clear language or implication. The state’s highest court disagreed that the statute met that burden, finding that because Johnson authorized his friend to insure the car he also gave her an implicit consent to reject any coverage. So when State Farm rejected those claims, it was authorized to do so both by statute and common law, according to the Supreme Court.

“Nowhere does this statute mention the common law — much less expressly abrogate any part of it,” Gabriel wrote. “Nor does the statute clearly imply a legislative intent to abrogate common law agency principles.” •

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