

Legal Issues with Early Employees in Startups

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Classification of Employees or Contractor

- Employee vs. Contractor in Massachusetts
 - Note, Massachusetts is MUCH more strict than other states, see:
http://www.mass.gov/Cago/docs/Workplace/independent_contractor_advisory.rtf

The Wage Act

- In Massachusetts, the Wage Act (MGL ch. 149, Section 148) requires:
 - Payment of wages in cash
 - Payment every two weeks (with limited exceptions)
 - Payment upon termination of employment, including accrued vacation
 - Officers and Directors of Company responsible
- Recent decisions/changes:
 - Violation of Wage Act subject to 3x penalties + attorneys fees
 - Wage Act cannot be waived (*Stanton v. Lighthouse*)
 - Wage Act issues can be subject to mandatory arbitration

Classification as Exempt or Non-Exempt

- Classification of Employees as Exempt or Non-Exempt important compliance requirement; relates to requirement for overtime
- Certain exemptions for professionals based on pay, position
- General source of regulations: Federal Fair Labor Standards Act (see <http://www.dol.gov/esa/whd/regs/compliance/fairpay/presentation.ppt>)
 - More specific rules in California

Intellectual Property Rights and Employment

- Employment-based NDA's are NOT the same as a "business NDA"
- MUST have a confidentiality clause
- MUST have an assignment of inventions
- Different forms may be required in different states
 - For example, special CA wording re

Low Initial Salary/Benefits

- Consider Wage Act
 - Don't say wages are deferred
 - Don't provide cash wages below minimum wage
 - Don't forget to pay taxes
 - WAIVER OF WAGE ACT DOESN'T WORK

Cash vs. Stock Compensation

- Direct substitution of stock for cash may:
 - Violate the wage act
 - Cause tax problems for recipient
- Stock options
 - May not directly cause tax problems for the recipient but can be somewhat complicated when valuations are uncertain
- Tradeoffs between restricted stock and stock options

Status of Founders

- Founders as such are not exempt from the wage act
- Founders may be liable for violations with respect to others and also be entitled to rights themselves
- But don't compound the issue by creating additional salary/wage issues

Volunteers/Interns/Etc.

- There are always additional potential issues with such types of arrangements
 - Unclear status
 - Lack of clarity on IP ownership
 - Whether or not these arrangement are a disguised non-compliant employment arrangement

Other Things to Worry About

- Non-US residents as equity owners
 - May results in disqualification of Subchapter S status
- Immigration status/nationality of participants
 - is work in US consistent with their visa status?
 - Note - “work” is different than status as officer or director or shareholder
 - potential export control or security issues

Conclusion