

Things To Consider When Starting Up a Company in Idaho - A Lawyer's Perspective



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Adding Value to Idaho Start-up Companies

www.Startup-Idaho.com

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TABLE OF CONTENTS

1.	Introduction.....	1
2.	Formation of Business Entity – LLC, S-Corp, or C-Corp.....	3
	A. Formalities.....	4
	B. Ownership Restrictions.....	5
	C. Transferability of Ownership Interests.....	5
	D. Profit Distributions.....	5
	E. Voting Rights.....	6
	F. Taxation Issues.....	6
	G. Going Public or Raising Venture Capital.....	7
	H. S-Corp vs. C-Corp.....	7
3.	Founder Agreements.....	7
4.	Capitalizing Your Company.....	8
	A. Initial Capitalization.....	8
	B. Bank Debt Financing.....	8
	C. Small Business Administration (SBA) Guaranteed Loans.....	9
	D. Equipment Leases.....	10
	E. Venture Backed Debt.....	10
	F. Angel Investors and Venture Capital.....	11
	G. Private Equity.....	13
	H. Mezzanine Debt Financing.....	14
5.	Investment and acquisition valuation issues.....	14
6.	Leasing vs. Owning Your Business Facilities.....	16
7.	Licenses and Permits.....	17
8.	Contracts with your suppliers and customers.....	17

9.	Protecting Your Company’s Intellectual Property Assets.	18
	A. Patents, Copyrights, Trademarks, and Assignments of Intellectual Property.....	18
	B. Trade Secrets.....	18
	C. Non-Disclosure Agreements (NDAs) and Confidentiality Agreements.....	19
	D. Employment Policies and Agreements to Protect Your Intellectual Property.....	19
	i. Trade secrets and non-competition agreements.....	19
	ii. Assignment of intellectual property developed by employees.	19
	iii. Assignment of intellectual property developed by independent contractors and temporary employees.	20
10.	Employment Issues.	20
	A. Employee Handbooks.	20
	B. Hiring and Firing Employees.....	20
	C. Federal and State Employment Laws.	21
	i. Tax withholdings, unemployment taxes, and state registrations.	21
	ii. Minimum wage and overtime.	21
	iii. State wage laws.....	22
	iv. Immigration.....	22
	v. Federal anti-discrimination laws.....	22
	(a) Title VII of the Civil Rights Act of 1964 (Title VII).....	22
	(b) Age Discrimination in Employment Act of 1987 (ADEA).	23
	(c) Title I of the Americans with Disability Act of 1990 (ADA).	23
	(d) Equal Pay Act of 1963 (EPA).....	24
	(e) Retaliation.	24
	vi. Idaho anti-discrimination laws.....	24

(a)	The Idaho Human Rights Act (IHRA).....	24
(b)	Discriminatory wage rates based upon sex.....	24
vii.	The Family and Medical Leave Act of 1993 (FMLA).	25
viii.	Uniformed Services Employment and Reemployment Rights Act (USERRA).....	26
D.	Record Keeping Requirements.	26
E.	Employees vs. Independent Contractors and Temporary Employees.	27
F.	HR Consultants.	27
11.	Insurance.....	28
12.	Employee Benefits.....	30
13.	Other Resources.....	32
14.	Concluding Remarks.....	32

1. INTRODUCTION.

This manual is intended for start-up companies and emerging growth companies. The value of any company ultimately depends on the cash flows it can generate. However, before your company becomes profitable, it must weather many significant challenges. Growing a start-up is like raising a child. It must be nurtured, it must be fed (cash), and it must learn to become self-sufficient. But unlike a child, most start-ups do not have the time or money it takes to learn from their mistakes. This manual is intended to help you spot the critical legal issues you will face in the start-up phase of your company and provide you with knowledge to help you make informed decisions as you address those issues.

This manual will discuss issues related to the formation of your company, financing your company, how outside investors might value your company for investment and acquisition purposes, finding a location for your company's operations, government regulation of your business, protecting your company's intellectual property, employment policies and practices that you should consider, employment laws that may impact your business, and things you should consider regarding insurance coverage and employee benefits.

There are a number of questions listed below that you should think about when starting your company. When considering these questions, especially how you intend to finance your company and structure its ownership, think about where you want your company to be in five to ten years. Having answers to these questions will help your lawyer and other professional advisors better serve your company.

Financial issues:

- Have you considered how much money it will take to start your business and how much money it will take to make your company self-sustaining?
- What are the options available to finance your company? What are the pros and cons of each of those options?
- Do you know how to put a business plan together? Do you understand the importance of monitoring your cash flow? Do you understand the pros and cons of financing your company with debt versus equity? Do you understand financial statements? Do you know how to put a financial statement together? Do you know what a bank or a professional investor is looking for when deciding whether they will loan you money or invest in your company? Do you know how to market your product or idea? Are you aware of the various community resources available to help you with these things?

Ownership issues:

- Is this a business you intend to own for many years and provide your family with sustainable income or are you looking to sell the company? If you intend to sell your company, do you know who is most likely to acquire it and on what terms?

- Do you care if one of the founders transfers his/her ownership to someone else and, if he/she does, do you want the person who acquires that interest to have a say in your business?
- Have you considered what happens if one of the owners dies or becomes incapacitated?
- Have the founders considered the impact of a minority ownership interest and how that may affect voting rights and valuation issues?
- Will you own 100% of the company from the beginning or will you start with partners? Will you be adding additional owners in the future?
- If you will have partners, have you considered the process of removing someone from the ownership of the company and what will happen if you do?

Laws and regulations that may apply to your business:

- Do you know what laws will apply to your company if you try and sell ownership interests to third parties that will not actively participate in your business?
- Are you aware of the various taxing agencies that your company will need to report to and the financial consequences if you do not?
- Does your company need to obtain a license or permit? Do you know where to go to obtain that license or permit?
- Do you know which government agencies will regulate your business?
- Do you know about the employment laws that will govern your business and what you need to do to comply with those laws?
- Do you know the difference between an employee and an independent contractor? Do you know what legal consequences your company might face if you misclassify an employee as an independent contractor?

Securing office space, insurance, and employee benefits:

- Do you know what terms to ask for when trying to find space for your company's operations?
- Are you aware of the various insurance products that can protect your company from a devastating loss, protect your company from risks associated with litigation, or help you mitigate the losses associated with the death of a key employee?

- What benefits are available to incentivize your employees? Can your company afford to provide those benefits? What additional laws will apply to your company if you provide benefits?

Protecting your company's intellectual property:

- Are there things about your business that you don't want your competition to know about?
- Do you know what you need to do to keep others from using your ideas or products without paying for them?
- Is there a brand or mark that distinguishes your company from the competition and do you know what you need to do to prevent your competitors from using your brand or mark to your detriment or diminishing the value of your mark?
- Do you know what you need to do to keep your employees from using your confidential business information?
- Are there ways for you to prevent a departing employee from taking your company's customers or employees to a competing entity?

The primary author of this manual is [Clay Gill](#), a partner at the law firm [Moffatt, Thomas, Barrett, Rock & Fields, Chtd.](#) Other Moffatt Thomas partners that helped edit this manual include [Mike Roe](#), [Gerry Husch](#), and [Christine Nicholas](#). Mr. Gill and the other attorneys at Moffatt Thomas are committed to adding value to Idaho start-up companies. They will do so by assisting you in implementing critical agreements, policies, and practices at affordable flat fee rates so that you can incubate, protect, and grow your idea into a tremendous success.

Moffatt Thomas would also like to recognize key industry representatives who provided valuable insights and comments to the prior drafts of this manual. They include Whitt Barnard, Bill Beck, Norm Beckert, Ian Blasch, Pete Butler, Meg Carlson, Grant Cornell, Jason Crawforth, Bruce Eastman, Chris Fenner, Rod Grzadzieleski, Chris Hall, Korri Hall, Joe Harbacheck, Michael Hennessy, Jeff Huhn, Paul Hyde, Carl Ledbetter, Kevin Learned, Greg MacMillan, Leslie Jennings Major, Vince Martino, Glenn Michael, Mark Miller, Ben Quintana, Decker Rolph, Mark Solon, Phil Syrdal, Rick Vycital, Beau Ward, Brad Wiskirchen, Clay Young, and Raino Zoller.

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2. FORMATION OF BUSINESS ENTITY – LLC, S-CORP, OR C-CORP.

This is your first decision. You must decide if you want to run your company as a proprietorship, a partnership, a limited partnership, a limited liability company (LLC), a Subchapter S corporation (S-Corp), or a Subchapter C corporation (C-Corp). In the old days, the

decision was fairly straightforward. Proprietorships and partnerships were subject to one tax at the ownership level, but provided no limited liability protections, i.e., each owner was jointly and severally liable for the debts of the proprietorship or partnership. Conversely, corporations provided limited liability protections, where the owner's liability was limited to his or her capital contribution, but the company was subject to a double taxation, first at the corporate level and secondly at the ownership level as dividends were paid to the owners.

With the advent of S-Corps and LLCs, the entity selection process is a little more complicated, but only because the law now allows owners of S-Corps and LLCs to incorporate with limited liability protections while still maintaining the single taxation benefit previously only allowed for partnerships and proprietorships. But to obtain these advantages, the S-Corp or LLC must be properly structured to meet the IRS's requirements for single taxation benefits and certain formalities must be followed to maintain the limited liability protections allowed by the applicable law.

Because of the single taxation and limited liability benefits allowed for certain qualifying S-Corps or LLCs, proprietorships and partnerships are very uncommon. These days, partnerships are typically entered into by two or more entities that wish to split profits on a single joint venture with a limited duration. Likewise, limited partnerships are most commonly used by individuals or companies that have already purchased an ownership interest in something else (a company or real estate) and then later seek to sell ("syndicate") portions of their interest in the form of limited partnership interests.

Because this manual is focused on start-up companies, it will discuss the two most commonly used ownership structures for start-ups, S-Corps and LLCs. However, if there is a strong likelihood that your company will raise money from angel investors, venture capital investors, or other similar institutional investors, you may want to consider organizing your company at the outset as a C-Corp to avoid issues with reorganization costs and personal tax liabilities that may be incurred as part of any reorganization from an S-Corp or an LLC to a C-Corp. As will be explained later in this manual, institutional investors will rarely invest in an LLC or an S-Corp.

A. Formalities.

An S-Corp is a corporation that meets the criteria of Subchapter S of the IRS Code, which allows the S-Corp to be taxed only once at the ownership level. Further, to maintain limited liability protection, S-Corps are required to follow the same formalities as a C-Corp, meaning your company must, among other things, elect a board of directors to manage the affairs of the company (a requirement of centralized management), hold board of director and shareholder meetings, and maintain minutes of those meetings. The rights and obligations of a shareholder to an S-Corp are defined in the company's articles of incorporation (also known as a "charter") and by-laws and the laws of the state in which the company is incorporated.

An LLC, on the other hand, does not require any formalities other than those agreed to by the owners. Thus, an LLC does not require a board of directors. Rather, an LLC can be managed by all of the owners collectively (member managed) or by one or more managers (manager managed). Even though LLCs are not obligated to follow the same formalities as corporations, it is still prudent to follow basic formalities, such as filing annual reports, holding meetings of the

members and managers, and keeping separate bank accounts for the LLC, to maintain the limited liability protections of the LLC. The rights and obligations of an owner of an LLC are defined in the LLC's operating agreement and the laws of the state in which the LLC is organized.

B. Ownership Restrictions.

S-Corps have several restrictions on ownership. First, an S-Corp may not have more than 100 shareholders. Second, all of the shareholders must be U.S. residents. Third, only individuals and certain trusts and estates can hold a shareholder interest. Thus, corporations and LLCs may not hold an ownership interest in an S-Corp. Fourth, S-Corps may not have more than one class of stock outstanding. While S-Corps are only allowed to have one class of stock, the shares of an S-Corp can have different voting rights, but may not have different rights to distributions or liquidation preferences.

An LLC has no ownership restrictions, meaning non-resident aliens can hold an ownership interest in an LLC, as can other corporations and LLCs.

C. Transferability of Ownership Interests.

Subject to the IRS Code's limitations on S-Corp ownership and any [applicable securities laws](#), the stock of an S-Corp is freely transferable, allowing shareholders to sell their interests without obtaining the approval of other shareholders. However, many closely held S-Corps have shareholder agreements that place restrictions on the transferability of its shares, such as requiring a selling shareholder to give the company and/or other shareholders a right of first refusal, i.e., any selling shareholder must first give the company and/or other existing shareholders the right to purchase their shares before they can be purchased by someone else.

In contrast, members of an LLC must first obtain the consent of the remaining members before they can effectively sell their interests. For instance, while the Idaho LLC Act allows a member to assign his or her ownership interest, that assignment does not give the assignee the right to vote on LLC matters until the other members approve the assignee as a member of the LLC. Instead, the assignee simply acquires the right to any distributions to which the assignor is entitled. Further, the assignor remains a member of the LLC, unless and until the assignee is approved as a member.

D. Profit Distributions.

S-Corps can only distribute profits and losses to its shareholders according to their ownership interests. Thus, if Shareholder A owns 80% of the company and Shareholder B owns 20% of the company, any distribution of profits or losses must go 80% to Shareholder A and 20% to Shareholder B.

LLCs, on the other hand, can distribute profits and losses however the owners desire. Typically, the owners of an LLC will agree upon the method of distribution of the profits and losses in the LLC's operating agreement. If the owners do not agree amongst themselves how profits and losses will be allocated, the LLC act of the state of organization will determine how profits and losses are to be distributed.

E. Voting Rights.

C-Corps, S-Corps, and LLCs can establish different voting rights for the shareholders or owners of the company. S-Corps can do so without violating the S-Corp requirement that it only have one class of stock outstanding. If voting rights are not established by an agreement amongst the owners of an LLC, the Limited Liability Company Act of the state in which the LLC is organized will determine how voting rights are to be determined. Likewise, if voting rights are not set forth in a corporation's articles of incorporation, voting rights are determined by the corporate act of the state in which the corporation is incorporated.

F. Taxation Issues.

Because of the complexities of the [tax laws](#), this manual should not be relied upon for tax advice. Rather, you should consult with your tax advisor before selecting the appropriate tax structure for your company. For example, an LLC can elect for tax purposes to be treated as a proprietorship, partnership, S-Corp, or C-Corp, depending on the facts and circumstances of how the LLC is structured. Likewise a corporation can elect to be treated as an S-Corp or a C-Corp for tax purposes, again depending on the facts and circumstances on how the corporation is structured. But for a general discussion of the differences between an S-Corp and an LLC, if your company is a success, an S-Corp election may give you greater tax benefits. Generally, an owner of an LLC that elects to be treated as a partnership or proprietorship for tax purposes must pay self-employment taxes on their share of the LLC's earnings (owners of non-professional LLCs who are not actively involved in the LLC's business may be exempt from these self-employment taxes). However, an S-Corp is only required to pay employment taxes for the salaries that are paid to the owners (assuming those salaries are fair market value).

But this tax advantage may be outweighed by the obligations imposed upon an S-Corp for payment of employment taxes. Employment taxes in an S-Corp must be paid whenever salaries are paid. The self-employment tax obligation of an owner of an LLC that elects to be taxed as a partnership or proprietorship is only due once a year, when the owner files his or her tax return. LLC owners should be cautioned, however, that employment taxes for all non-owner employees must be paid whenever their wages are paid.

Whether your entity chooses to be taxed as a proprietorship, partnership, or S-Corp, you must remember that the company's earnings will be allocated to the owners for tax purposes. Thus, profitable years can cause serious tax consequences for the owners. Most S-Corps and LLCs electing to be taxed as a proprietorship, partnership or S-Corp, distribute enough cash to their shareholders or members to pay the tax obligations they incur as a result of the company's earnings being allocated to them. Before agreeing to such distributions, the owners should consider the cash flow consequences to the company and creating a cash reserve to ensure sufficient funds to make any such distributions to the owners. The same type of cash budgeting principles should be applied with a C-Corp, making sure the C-Corp keeps a sufficient cash reserve to meet its tax obligations as they come due.

G. Going Public or Raising Venture Capital.

Very few companies ever go public because of the time and cost to do so. Further, many companies prefer to remain private so that they can keep their financials confidential, which a public company cannot do because of certain reporting requirements. In any event, if you intend to take your company public, you may want to consider an S-Corp over an LLC because of the ease of converting an S-Corp into a C-Corp. Converting to a C-Corp is mandatory before any S-Corp or LLC can be taken public.

Likewise, for a variety of reasons, most angel investors, venture capitalists, and private equity firms will require your company to convert to a C-Corp before they will invest in your company. Thus, if you anticipate financing your company with money from these types of institutional investors, you may want to select a C-Corp rather than an S-Corp or LLC. When making this decision, you should consult with your tax advisor about tax liabilities you may incur by later converting an LLC or S-Corp into a C-Corp and whether it makes more sense to simplify the process by structuring your company for tax purposes as a C-Corp at the outset.

H. S-Corp vs. C-Corp.

S-Corps are creatures of the IRS Code, and are only exempt from corporate tax if the requirements of the IRS Code are met, e.g., its shareholders must be individuals who are U.S. residents, it must not have more than 100 shareholders, and it must not have more than one class of stock. C-Corps must pay the applicable taxes on its earnings, and thus there are no ownership restrictions. C-Corps can also have different classes of stock. This is one reason why venture capital firms demand a C-Corp structure, i.e., they can obtain preferred stock that gives them liquidation preferences, voting privileges, and board seats. And while a C-Corp can have more than 100 shareholders, if it has more than 500 shareholders and \$10 million in assets, it must file annual and periodic reports with the Securities and Exchange Commission, even if it is not a publicly-traded company.

The actual operation of a corporation, whether it be structured as a C-Corp or an S-Corp for tax purposes, are the same. For example, both S-Corps and C-Corps must elect a board of directors, hold board of director and shareholder meetings, and keep minutes of those meetings. Further, the rights and obligations of shareholders to both an S-Corp and C-Corp are defined in the company's articles of incorporation, bylaws, and the corporation act of the state in which the company is incorporated.

3. FOUNDER AGREEMENTS.

Starting a business with other founders is like entering a second marriage. The last thing you need in the start-up phase of your company is an expensive legal battle amongst the founders over ownership issues or intellectual property disputes. So put the proper agreements in place at the outset (consider them your prenuptial agreements) so you know what is going to happen when a founder leaves the company (as will likely happen). These agreements should address what will happen with a founder's ownership interest and intellectual property rights when he or she leaves the company, either through a voluntary resignation, a termination for cause, or a termination without cause. And if the company agrees to buy back a founder's ownership

interest, the company must consider what that will do to the company's cash position and how that may impact its ability to raise outside investments. Most third party investors have no interest in putting money into a company if it will be used to pay off a departing founder's interest. There are several creative ways to address these issues, including deferred payments that are triggered only if the company meets certain financial thresholds. Additionally, you must use care in defining how the founder's ownership is to be valued in any buy-back agreement. While the terms fair value, fair market value, EBITDA, book value, debt, normalized capital expenditures, and working capital are terms commonly used by business valuation experts and accountants, all are subject to differing interpretations depending on who is doing the calculation, and some valuation terms are more susceptible to subjective interpretation or financial manipulation than others. You should also use special care when addressing the departure of a founder who contributed intellectual property to the company. While a founder contributing intellectual property might think it is fair that ownership reverts back to the founder upon termination, that founder must also consider that any agreement which creates a potential cloud over intellectual property ownership rights will seriously jeopardize the company's ability to raise subsequent investments from outside investors. Outside investors typically have teams of accountants and lawyers who are looking for these types of things when they are advising their clients on the prospects of investing in your company.

4. CAPITALIZING YOUR COMPANY.

The owners must agree when forming the company how it will be capitalized. Typically the owners will contribute cash, other assets, agree to perform certain services for the company, or a combination of all three. You must remember that all great ideas initially need cash. Cash is required to pay your bills and your employees. And once the cash runs dry, the business will shut down no matter how great your idea.

A. Initial Capitalization.

The most obvious source of initial capitalization is from the founders of the company. Properly capitalizing your company at the outset is important for a variety of reasons. For one, you may lose the limited liability protections of your company if it is not adequately capitalized at the outset. Further, raising money later from outside investors is more complicated and expensive because you must either comply with the [applicable securities laws](#) or qualify for an exemption from those laws.

B. Bank Debt Financing.

Debt financing is typically issued by a bank or a similar financial institution. Banks traditionally issue loans that are secured and must be repaid within seven years, unless extended for additional years. Banks typically secure their loans by taking a first priority security interest in the company's assets such as real estate, equipment, inventory, and accounts receivable. This gives the bank a preference to those assets in the event of a liquidation or bankruptcy. Banks will also often require the owners of a small, privately held company to personally guarantee the loan, especially if the company has a limited history of profitability. The amount that a bank will loan is typically a set percentage of the value of the collateral securing the loan, including the value the bank attributes to any personal guarantee. Further, the interest rate is typically pegged to

something at or above the current LIBOR rate (London Interbank Offered Rate) or Prime rate, depending on the perceived risk of nonpayment on the loan.

Banks typically offer two different types of business loans, term loans and a line of credit or a working capital loan. A term loan typically requires repayment of the entire loan, both principal and interest, within seven years. A line of credit usually requires repayment within one or two years, but is commonly extended for an additional number of years if the company remains in compliance with the terms of the loan, including the financial ratios or covenants required by the bank. A line of credit is commonly used to help a company manage cash flow issues associated with: (i) time lags between getting paid on its invoices (accounts receivable) and keeping current on its outstanding bills (accounts payable) and (ii) seasonality of the business. Term loans are typically used to finance plant and equipment expenditures or acquisitions.

For more information on bank debt financing available to a start-up or emerging growth company, contact:

- [Dannea L. Aylsworth](#), Assistant Vice President, Commercial Relationship Manager, [Zions Bank](#), (208) 501-7551.
- [Dave Bruce](#), VP/Manager Commercial Lending, [Mountain West Bank](#), (208) 855-9106.
- [Todd Cooper](#), Business Banking Manager, [Wells Fargo](#), (208) 393-2188.
- [Launee Freeland](#), Business Solutions Officer, [Idaho Trust Bank](#), (208) 350-2018.
- [Jeff Huhn](#), Vice President, [Bank of the Cascades](#), (208) 319-2424.
- [Rob Perez](#) or [Stuart Kerber](#), [Northwest Bank](#), (208) 332-0708.
- [Willis Robinette](#), Senior Vice President, Southern Idaho Commercial Banking, [Banner Bank](#), (208) 424-2360.
- [Justin Smith](#), Vice President and Team Leader, [US Bank](#), (208) 383-7023.
- [Val Welch](#), Vice President Relationship Manager, (208) 334-7228, or [Mary G. Monroe](#), Senior Vice President Relationship Team Manager, [Key Bank](#), (208) 364-8773.

C. Small Business Administration (SBA) Guaranteed Loans.

Many financial institutions offer loans that are partially guaranteed by the [Small Business Administration \(SBA\)](#). To qualify for these types of loans, you must prove that you were not able to obtain financing elsewhere on reasonable terms and demonstrate that you are able to meet the SBA criteria for the issuance of the loan, most important of which is your ability to repay the loan. SBA guaranteed loans are typically used when a company does not have sufficient collateral to obtain a bank loan. These types of loans take longer to close because of the

additional paperwork associated with SBA loans and the requirement that you obtain approval from both the financial institution and the SBA. Additionally, SBA regulations require personal guarantees from the owners. The SBA guaranteed loans include both term loans and lines of credit or working capital loans

For more information on SBA loans, contact:

- [Danea L. Aylsworth](#), Assistant Vice President, Commercial Relationship Manager, [Zions Bank](#), (208) 501-7551.
- [Dave Bruce](#), VP/Manager Commercial Lending, [Mountain West Bank](#), (208) 855-9106.
- [Jeff Huhn](#), Vice President, [Bank of the Cascades](#), (208) 319-2424.
- [Rob Perez](#) or [Stuart Kerber](#), [Northwest Bank](#), (208) 332-0708.
- [Willis Robinette](#), Senior Vice President, Southern Idaho Commercial Banking, [Banner Bank](#), (208) 424-2360.
- [Justin Smith](#), Vice President and Team Leader, [US Bank](#), (208) 383-7023.

D. Equipment Leases.

Many financial institutions offer leases for expensive equipment such as heavy machinery, trucks, computers, medical equipment, or the like. Under the terms of the lease, the financial institution keeps title to the equipment while you pay off the lease. Most lease arrangements provide an option to purchase the equipment for a certain price either during the term of the lease or at the end of the lease. While you may pay more for the equipment over time, a lease helps give you time to pay for the equipment and can help you preserve cash during the critical growth phase of your company.

Local financial institutions offering equipment leases include:

- [KeyBank](#)
- [Northwest Bank](#)
- [US Bank](#)
- [Wells Fargo](#)
- [Zions Bank](#)

E. Venture Backed Debt.

Some institutions are willing to provide debt financing to your company by taking a security interest in your company's intellectual property and equipment. In many ways, this type of debt

financing is similar to a combination of conventional and equipment lease financing. But because of the higher risk associated with these types of loans, you should expect to pay a higher interest rate than you would by obtaining financing from any local bank. Venture backed debt also usually allows the lender to acquire ownership interests in your company (typically through warrants) at some future date at prices that are below fair market value. Venture backed debt is typically limited to companies whose primary asset is intellectual property with high growth potential, like a high tech company or a biotech company.

While venture backed debt typically comes with a higher interest rate than a bank loan and shorter repayment terms, it can provide offsetting advantages such as no personal guarantees and no financial covenants (e.g., requiring you to keep a minimum working capital ratio) that often come with a bank loan.

Venture backed debt is commonly used when traditional bank financing is not available and the current owners want to avoid ownership dilution by selling additional shares or units of ownership. The financial concept of venture backed debt is to pay a higher interest rate than a bank loan but a lower rate of return than a new shareholder would expect. But you must remember that debt typically comes with a structured repayment schedule, while equity does not. Thus, if you use debt as part of your capital structure, you must make sure that your company can generate the cash flow needed to make the required payments. This is especially true with venture backed debt that comes with a high interest rate.

Regional providers of venture backed debt for start-up and emerging growth companies include:

- [Chris Fenner](#), Managing Director, Pacific Northwest Region, [Vencore Capital](#), (503) 675-3123.
- [Jeff Roberts](#), Vice President, [Comerica Bank](#), (425) 452-2529.
- [Ron Sherman](#), Senior Relationship Manager, [Silicon Valley Bank](#), (503) 574-3706.
- [Bob Van Nortwick](#), Regional Manager, [Square 1 Bank](#), (206) 812-4254.

F. Angel Investors and Venture Capital.

Angel investors may also help provide early stage capital, often as the first source of outside equity following the founder(s)' initial investment. Angel investors are typically wealthy business people who are looking to invest in high risk ventures with the hope of making a substantial return on their investment. In many instances, angel investors are passive investors who invest based upon gut feelings they have about the business and the management team. These people usually have some knowledge of the business and a high level of trust in the management. In other cases, high net worth angel investors have formed groups, where the angels create due diligence teams to help evaluate many different potential investment prospects, then negotiate term sheets for those prospects that "make the cut," then make a decision on whether they want to invest (either individually or as a group or both) and the level of dollars they want to invest.

Venture capital is generally viewed as follow-on financing to the angel round of investment. Furthermore, venture capital firms invest institutional funds (such as state and corporate funds and endowments), versus an angel investor who is investing his or her own money. Venture capital firms will also spread their investments over ten to fifteen companies to create portfolio diversification. Finally, venture capital firms will typically invest in larger dollar amounts than an angel investor (although there are exceptions to this general rule). Venture capital firms are also much more concerned about exit strategies, where they can liquidate their investment and return money to their investors.

The process of obtaining financing from angel investors or venture capital firms comes with several risks and obligations. First, these investors will typically place one or more of their members on your board of directors to gain some control over your company's direction. Second, these outside investors will want to exit their investment in ten years or less so that they can gain liquidity (e.g., by selling your company or taking it public). Thus, if you want to run your company indefinitely as a privately owned or family owned business, you will probably want to avoid these types of investors. Third, if your company routinely misses its financial forecasts upon which their investment is based, angel and venture capital investors may become actively involved in the strategic direction of your company to minimize their losses, such as refusing to invest further in your company, change management of the company, or put pressure on management to sell the company or its assets at what you might consider a distressed price. Fourth, angel investors and venture capital firms will almost always structure their investment so that they will have special rights and privileges beyond those associated with the common shares (e.g., getting paid before the common shareholders in the event of a liquidation event, special voting rights, the ability to sell or transfer shares in certain circumstances, and the ability to control a certain number of seats on the company's board of directors). Fifth, angel investor groups and venture capital firms typically invest in stages, and will link subsequent dollar commitments to the company achieving specific performance benchmarks such as minimum revenues or profitability (often referred to as "milestones"). Thus, if you do raise angel or venture capital money, you should focus your business efforts on achieving the milestones that are needed for subsequent investments (e.g., managing your cash and increasing your sales).

Another aspect of angel and venture capital financing is that the process is very selective, with most angel investors and venture capitalists investing in only a small fraction of the total investment opportunities presented to them. Most venture capital firms also limit their investments to specific industry sectors which are likely to produce extraordinarily high returns, such as the high tech industry. Venture capitalists also typically diversify their risk by investing in a portfolio of companies, with the understanding that a portion of those companies may fail outright or produce negligible returns, but with the hope that a handful of their portfolio companies will produce extraordinarily high returns, resulting in a higher than average return for the entire portfolio. Given the portfolio business model, venture capital firms will rarely continue to invest in a company that materially misses its performance benchmarks, because by doing so, the venture capital firm exposes the entire portfolio to lower than anticipated returns. The portfolio business model also creates a competitive investment process for later round investments, where venture capital firms look to put their remaining limited investment dollars in those portfolio companies that are most likely to hit the home run versus the other portfolio companies that are not.

Before an angel investment group or a venture capital firm will invest in your company, they will conduct due diligence on your company to make sure it has certain legal protections in place (e.g., making sure that your company owns its intellectual property and has measures in place to protect that intellectual property). Additionally, they will look at a whole slew of due diligence items associated with the business aspect of your company, such as the development stage of your product or idea, how you intend to get your product or idea to market, your current sales pipeline, meeting your management team, assessing the accuracy of your internal financial statements and future projections, and the like. The more you have these issues pinned down, the greater your chance of obtaining funding.

While there are many risks associated with angel and venture capital investments, there are also many benefits, the most significant of which is the business savvy and financial expertise that comes with angel and venture capital investors. Remember, they are not investing in your company to run it into the ground. Rather, they are interested in growing your company so that they can later sell their ownership interests for extraordinarily high returns.

Local angel investment groups include:

- [Kevin Learned](#), President, [Boise Angel Alliance](#).
- [Nathan McDonald](#), Boise/Idaho Chapter President, [Keiretsu Forum](#).

Local venture capital firms include:

- [Carl Ledbetter](#), Managing Director, [Pelion Venture Partners](#), (801) 365-0262.
- [Len Jordan](#), General Partner, [Frazier Technology Ventures](#), (206) 621-0055.

G. Private Equity.

Private equity is typically available for later stage companies that have fully developed management teams, are generating revenues and at least modest profitability. Private buy out equity firms typically look for underperforming companies, companies that have assets with a high liquidation value, companies that need greater access to capital to grow the company, companies looking to spin off a division of a larger company, or companies that can be merged with other existing companies to provide economies of scale or new market segments. Many private buy out equity firms employ a strategy of buying such companies or divisions for purposes of growing or fixing them, and then selling them several years later for a significant gain.

Private equity firms invest in a variety of industries and do not limit themselves to the high return industries like venture capital firms traditionally do. Private equity firms also typically invest in more mature companies, i.e., at a later stage in a company's life cycle, than do angel investors and venture capital firms.

Local private equity firms include:

- [Whitt Barnard](#), Managing Director, [Sawtooth Capital](#), (208) 892-3226.

- [Stephen Babson](#), Managing Director, [Endeavour Capital](#), (503) 223-2721.

H. Mezzanine Debt Financing.

Mezzanine debt is typically defined as the tier of capital which by the nature of its terms is junior to bank loans but senior to preferred stock and common stockholders, i.e., it has liquidation preferences over equity owners in the event of a bankruptcy. Mezzanine financing is often used to fund acquisitions of established businesses or to provide capital to a company in need of immediate cash to sustain its business operations or to pay for large, one time capital expenditures. This type of funding usually comes with a high fixed rate of interest (to account for the increased risk associated with subordinated position) and an equity kicker, which allows the mezzanine financier to acquire an equity stake in the company (typically through warrants or a conversion-into-stock feature) at some future date at prices that are below the then-prevailing fair market value.

- [Justin Smith](#), Vice President and Team Leader ,US Bank, (208) 383-7023.

5. INVESTMENT AND ACQUISITION VALUATION ISSUES.

Valuing a business is very complicated, the details of which can and have filled thousands of pages of text. This manual will give you a high level overview of how valuation experts and professional investors typically value a business for either investment or acquisition purposes.

The most accepted and time proven methodology for valuing a business is a three-pronged analysis. The first prong attempts to forecast your company's future free cash flows and then discount those free cash flows to a present value using a discount rate (income approach). Future free cash flows represent the amount of funds that could be removed from the business without affecting its ability to operate, sometimes referred to as its dividend paying capacity. The discount rate is dependent upon the risk associated with your company. The higher the risk, the higher the discount rate and the lower the valuation. The concept is simple. The higher the risk, the higher the return that a prospective investor will demand.

The second prong used in valuing a company is determining the value of comparable companies (market approach). Finding comparables for privately held companies is challenging for a variety of reasons. While information on publicly traded companies is freely available, those companies are usually much larger and more mature and may have business units that are not comparable to the company being valued. And finding values for comparable privately held companies is difficult because of the secrecy typically associated with their financial statements and any sales to private investors. That being said, most valuation experts have access to proprietary databases that provide reliable information about privately held companies. Finally, many start-ups are entering new markets, making it nearly impossible to find comparable companies.

The third prong in valuing a business is valuing the company's assets (asset approach). This is typically done by determining the cost to replace the company's tangible assets in like-kind condition. This prong is usually the least reliable in determining a company's value, especially

for a company whose primary asset is intellectual property, but must be considered when determining a company's value.

Finally, a business valuation expert will place the weight they feel is appropriate on each of the three prongs to come up with an ultimate opinion on the value of the company. When appropriate, the appraiser must also consider things such as a discount for lack of control for a minority ownership interest to reflect that owner's lack of control over the company's direction and operations. Additionally, the valuation expert must consider a lack of marketability discount to reflect the limited pool of buyers for a minority interest in a privately held company.

Intangible assets that may be acquired or created by a start-up company can also add complexity to the valuation of the entity. Intangible assets include such things as trademarks, trade names, brand names, logos, patents, technical documentation, literary works and copyrights, proprietary computer software, software copyrights, automated databases, industrial designs, trade secrets, engineering drawings, customer lists, customer contracts, customer relationships, license agreements, franchise agreements, noncompete agreements, trained and assembled workforce, employment agreements, leasehold interests, and goodwill. All three approaches, the income approach, market approach, and asset approach, may be used to value intangible assets.

Some professional investors will use less complicated valuation methods known as "rules of thumb." For example, some investors will determine a company's value for investment or acquisition purposes by calculating the company's earnings before interest, taxes, depreciation, and amortization (EBITDA). By performing this calculation, they are trying to determine how much cash your company will generate, regardless of how it is capitalized with either debt or equity (i.e., before the deduction of (i) interest expense related to the company's leverage and (ii) all non-cash items such as depreciation and amortization). After they calculate the company's historical and projected EBITDA positions, they will typically assign a multiple to the calculated EBITDA to derive a value at the time of investment or acquisition. These multiples are usually lower for service related companies and retail operations, higher for non-tech manufacturing operations, and much higher for a company that is selling a high tech product like software. The multiple assigned to your company will depend on a variety of risks and other factors associated with your company and industry.

Valuing start-up and emerging growth companies is more complicated, mainly because most companies are not profitable in the start-up phase. This lack of profitability often dictates the need for angel or venture capital investment. Most angel investors and venture capitalists will try to project what they anticipate your company's EBITDA to be in future years and, in doing so, will evaluate the strength of your management team, your core intellectual property, the market for your product or idea, the plan to get your product or idea to market, customer references, and your existing sales pipeline. Professional investors will also apply a significant discount rate (again, the higher the discount rate the lower your company's valuation) to any EBITDA projections for a start-up company because of the increased risk associated with an unproven business model. Because of the challenges associated with projecting a company's EBITDA and the appropriate discount rate, some angel and venture capital investors will use even simpler rules of thumb, such as pegging an investment price to a multiple of the company's past twelve (12) months trailing revenue. Angel investors and venture capital firms will also place significant weight on other similar investment opportunities when deciding (i) how much

they are willing to invest in your company and (ii) at what assigned value. You must remember that they are considering a number of opportunities and they will only invest in your company if they believe their dollar investment is likely to produce a greater return than investing in another company they are considering.

For more information on business valuations contact:

- [Peter Butler](#), CFA, ASA, [Valtrend](#), (208) 371-7267.
- [Meg Carlson](#), CBI, [C&H Group](#), (208) 853-0991.
- [Paul Hyde](#), EA, MCBA, BVAL, ASA, MAI, [Hyde Valuations, Inc.](#), (208) 722-7272.
- [Keith Pinkerton](#), CFA, ASA, [Coles Reinstein, PLLC](#), (208) 344-2527.

6. LEASING VS. OWNING YOUR BUSINESS FACILITIES.

Most start-ups will initially lease space for a variety of reasons, most commonly to avoid the large cash outlay typically associated with any purchase of real estate. Banks are also less willing to lend money to start-ups to purchase real estate because the value of the real estate is dependent upon the rents that can be achieved by leasing the property. Thus, if your company fails, the real estate's value is diminished because another tenant must be found to lease the facility. A bank's willingness to lend money for any real estate acquisition depends on the value of the collateral, i.e., the real estate securing the loan.

Whether you purchase or lease, you will face a host of legal issues. For example, if you purchase real estate for your company's facilities, you must ensure that you obtain clear title. You will also want to know what liens, encumbrances, and restrictions are imposed against the property. For example, you will want to make sure the property is properly zoned for your company's intended use or obtain any necessary variances. You will also want to make sure there are no boundary disputes or easements that would require you to alter the physical structures on your property or hinder future anticipated expansions of your business facility. Finally, if customer access to your facility is imperative, you will want to make sure that your facility has adequate ingress and egress to any neighboring roadways. Purchasing real estate also comes with a variety of transactional costs, such as escrow closing costs, title reports, and title insurance.

If you lease your business facilities, key terms you will want to negotiate, in addition to the obvious rental rate, include: the term of the lease, tenant improvement allowances, how any rental rate increases will be determined over the term of the lease, renewal terms, termination provisions, your ability to assign the lease or sublease the property, whether you will be required to personally guarantee the lease, exclusivity clauses to keep out competitors in a multi-tenant complex, and who is responsible for real estate taxes, insurance, maintenance, repairs, utilities, and other items.

Local real estate developer Mark Rivers (of BoDo fame) opened the WaterCooler in 2008, a business development center that leases office space for qualifying small and emerging businesses; has an idea studio for workshops, classes and programs; and offices for [Idaho TechConnect](#) and [Boise State University's Centre for Creativity & Innovation](#).

Boise State University also operates the [Boise State Technology and Entrepreneurial Center \("TECenter"\)](#) in Nampa, Idaho. The TECenter serves as an incubator with office space and other resources for qualifying start-up and emerging stage technology companies.

For more information on purchasing or leasing commercial office space in Ada County, contact:

- [Bill Beck](#), Principal, [Tenant Advisor Commercial Real Estate](#), (208) 333-7050.

For more information on purchasing or leasing industrial space in the Treasure Valley, contact:

- [Devin Pierce](#) or [Scott Raeber](#), Brokerage Services, [Thornton, Oliver Keller](#), (208) 378-4600

For more information on the [WaterCooler](#), contact:

- [Tara Flume](#) at (208) 794-7508.

For more information on Boise State's TECenter, contact:

- [Denise Dunlap](#), TECenter Director, [Boise State Technology and Entrepreneurial Center](#), (208) 562-3600.

7. LICENSES AND PERMITS.

Some businesses require a [license](#) or permit from a government agency. For instance, a contractor in Idaho that engages in public works projects must have a public works license. Additionally, any company that discharges hazardous waste must obtain the proper environmental permits to do so. Most government agencies are very good at providing you with the details of what information you must provide to them to obtain the proper licenses and permits for your company. For example, the State of Idaho has published several [Internet resources](#) that provides a detailed listing of the various governmental agencies that issue the necessary licenses and permits for your business. Likewise, the Idaho Small Business Development Center has posted a [handy electronic questionnaire on the Internet that will give you information on the various licenses and permits needed for your business, contact information, and Internet links to the various governmental agencies who issue such licenses and permits](#).

8. CONTRACTS WITH YOUR SUPPLIERS AND CUSTOMERS.

Contracts with your suppliers and customers are a reality of doing business and involve a host of legal issues. For instance, there are laws that may impact your ability to disclaim warranties if not done properly, laws that may require you to make certain language stand out from other boilerplate (preventing you from burying one sided terms in a lengthy contract), and things that

may be incorporated into your contract if it does not address certain issues. Contracts can limit your liability in certain circumstances, but only if done properly. Contracts can also be used to clarify what will happen in the event of termination or default by one of the parties, rather than leaving those issues to chance and application of unknown law. Contracts should be used to minimize your company's legal risks and to define the parameters of your relationship with your suppliers and customers. Some laws also require certain contracts to be in writing to be enforceable.

9. PROTECTING YOUR COMPANY'S INTELLECTUAL PROPERTY ASSETS.

A. Patents, Copyrights, Trademarks, and Assignments of Intellectual Property.

When you form your company, you must identify the intellectual property assets that are critical to your company's survival. Then you should take measures to protect your company's rights to those intellectual property assets. For instance, if the founders of your company are contributing intellectual property, you will probably want to have the founders assign that intellectual property to the company. Likewise, if your company has created a novel piece of equipment to manufacture your product or if you are selling a unique product that can be subsequently manufactured by others through reverse engineering, you may want to consider obtaining a patent. If you have a distinctive mark that you use in your business to distinguish your products and services from your competition, you may want to consider a trademark to prevent others from infringing upon your mark. Things that can be trademarked include: letters and words, logos, pictures, a combination of words and a logo, slogans, colors, product shapes, and sounds. If your company is selling software, you should consider software patents, copyright protection, or selling your software pursuant to a carefully drafted license agreement.

B. Trade Secrets.

A trade secret is legally defined as information, including a formula, pattern, compilation, program, computer program, device, method, technique, or process, that derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use. But the trade secret laws will only protect your trade secret if you have taken reasonable measures to maintain the secrecy of the trade secret. Theft of trade secrets most commonly happens when an employee uses his or her former employer's trade secrets at his or her new job. That being said, you should take reasonable measures to prevent both employees and third parties from accessing the secrecy of your trade secrets, unless they truly need to know about them. And in that circumstance, you should implement carefully drafted non-disclosure and confidentiality agreements wherein your employees and third parties agree to keep your trade secrets confidential.

C. Non-Disclosure Agreements (NDAs) and Confidentiality Agreements.

An NDA is a contract that allows two or more parties to share confidential materials or information through an agreement that requires all parties to protect the confidentiality of the materials or information shared under the terms of the NDA. NDAs are typically used when two or more parties are considering doing business together and need to understand the proprietary aspects of the other company before deciding to do business with one another. NDAs are also often used with employees, independent contractors, and temporary employees at the time of hire, or otherwise incorporated into employee handbooks, employment agreements, or stand alone agreements as a means of protecting the company's confidential information and trade secrets. Some courts allow for broader protections of confidential information under an enforceable NDA or confidentiality agreement than they do under the trade secret laws because of the restricted legal definition of a trade secret.

D. Employment Policies and Agreements to Protect Your Intellectual Property.

i. Trade secrets and non-competition agreements.

The most common misnomer in business is that intellectual property only applies to the technology industry. That is not true. In addition to the obvious intellectual property assets such as a software code or the design of a computer chip, intellectual property rights can also attach to a customer list, customer and employee relationships, a supplier list, and a non-obvious manufacturing process. These types of assets can be protected through trade secret protection policies and carefully drafted non-competition and non-solicitation agreements. To protect a trade secret, such as a customer list, you must take reasonable measures to protect the secrecy of that information. Likewise, non-competition agreements and non-solicitation agreements will only be enforced if they serve a legitimate business purpose and are narrowly limited in their duration, geographical scope, and prohibited activities. Employees are also much more likely to be receptive to non-competition and non-solicitation agreements at the outset of the employment relationship than they are if they are forced upon them during the employment relationship. Failing to put trade secret protection policies, non-competition, and non-solicitation agreements in place may also jeopardize your ability to raise outside financing, as many investors are unwilling to invest in a company whose intellectual property can walk out the door with its employees the next day.

ii. Assignment of intellectual property developed by employees.

Many statutes and court decisions will grant you ownership protection to things developed by your employees during the course and scope of their employment. However, to avoid disputes over ownership of intellectual property assets, you should consider having your employees execute agreements that define ownership of intellectual property assets that are designed, developed, or acquired by your employees. As mentioned previously, the same applies to founders who contribute intellectual property as part of their capital contribution to the company.

iii. Assignment of intellectual property developed by independent contractors and temporary employees.

The use of independent contractors or temporary workers who are employed by someone other than you may impact your company's ability to protect its intellectual property. As mentioned previously, many statutes and court decisions will grant you ownership protection to things developed by your employees during the course and scope of their employment. But absent an agreement providing otherwise, independent contractors and temporary workers can obtain intellectual property rights for things they develop for you. This is especially true with copyrights, where the law begins with a presumption that the creator or author of a work is the owner of any copyright that attaches to that work.

10. EMPLOYMENT ISSUES.

A. Employee Handbooks.

A carefully drafted employee handbook can head off a host of legal employment issues. As will be explained further below, you can avoid liability for certain sexual harassment claims by implementing a sexual harassment policy that requires your employees notify you of any inappropriate conduct so that you have an opportunity to correct the problem before the employee resorts to legal action. Employment handbooks are also a good place to remind employees that Idaho is an at-will state, meaning employees who are not under contract for a certain time period can be terminated for any reason so long as that reason does not violate public policy (e.g., you cannot terminate an employee because he or she filed a workers' compensation claim, nor may you terminate an employee because he or she made a sexual harassment complaint). Employees should also be reminded in the handbook of their duties to protect your company's confidential information and trade secrets and that anything they develop during the course and scope of their employment is considered the company's intellectual property. Finally, employment handbooks are the best place to explain your expectations of your employees, your employment policies (e.g., drug testing, computer monitoring, Internet policies), and the employment benefits available to your employees. But for any employment policy to be enforceable, you must ensure it complies with the applicable law, e.g., the Idaho Private Employers Alcohol and Drug-free Workplace Act. You should also utilize employee consent forms, whereby your employees: acknowledge receipt of the handbook; consent to at-will employment status; agree to comply with all provisions of the handbook, including their duties to protect your confidential information and trade secrets; and agree to do all things necessary to transfer ownership rights for any intellectual property they develop, or that they are hired to develop, for your company.

B. Hiring and Firing Employees.

Hiring and firing employees is happenstance for any company. [But there are a host of laws that define what you can and cannot do as part of the hiring process.](#) Likewise, while Idaho is an at-will employment state, you may not terminate your employees in violation of public policy (e.g., for filing a worker's compensation claim), nor may you take an adverse employment action against your employees in violation of the federal or state discrimination laws (see below).

Well documented terminations and well conducted exit interviews are of tremendous value when litigation arises as a result of an employee's termination. Well conducted exit interviews can also be of tremendous value in protecting your company's trade secrets and learning whether your soon-to-be former employee is going to honor their confidentiality, non-competition, and non-solicitation agreements. Finally, severance agreements that attempt to release certain employment claims are only enforceable if they contain very specific language required by the applicable laws.

C. Federal and State Employment Laws.

i. Tax withholdings, unemployment taxes, and state registrations.

[Federal laws](#) require you to withhold federal income tax and FICA (Social Security and Medicare) from your employees' wages. If you have employees in Idaho, you are also required to withhold state income tax from your employees' wages. Other states with income taxes have similar withholding laws.

[Federal law](#) requires you to pay a federal unemployment tax at the applicable rate. [Idaho law](#), and laws in most other states, require you to pay state unemployment taxes. [To obtain your Employer Identification Number \("EIN"\) which you will need for tax purposes, to open a bank account, and register with the appropriate state agencies, click on the following link.](#)

Any company that has employees in Idaho is required to register with the Idaho State Tax Commission, the Idaho Department of Labor, and the Idaho Industrial Commission. The Idaho Small Business Development Center has also posted a [handy electronic questionnaire on the Internet that will give you contact information and Internet links to all of the various governmental agencies that may regulate your business.](#)

ii. Minimum wage and overtime.

The federal [Fair Labor Standard Act \(FLSA\)](#) applies to all enterprises that are engaged in interstate commerce, all enterprises whose annual revenues exceed \$500,000, hospitals, businesses providing medical or nursing care for residents, and schools and preschools. Thus, almost all companies are subject to the FLSA. The FLSA requires non-exempt hourly employees to be paid at least the prevailing [state or federal minimum wage](#), whichever is higher. The FLSA also requires non-exempt employees to be paid overtime if they work more than 40 hours in the defined work week. Employees that are exempt from the FLSA's minimum wage and overtime requirements include executive, administrative, professional, outside sales, and computer employees. [Regulations promulgated by the Department of Labor \(DOL\)](#) provide guidance on which employees qualify as exempt executive, administrative, professional, outside sales, and computer employees. The FLSA does not require pay for holidays, vacations, or sick days. Your employees are only entitled to pay for holidays, vacations, or sick days if you agree to pay them for those days.

iii. State wage laws.

Most states have enacted laws that require wages to be paid by a certain date and impose penalties for non-payment or late payments of wages. For instance, the [Idaho Wage Act](#) requires payment of triple wages as a penalty in certain circumstances.

iv. Immigration.

[Federal law](#) requires you to confirm for each individual you employ: (1) their identity, and (2) their ability to work in the United States. You must do so by [completing an I-9 form](#) for each employee you hire. The [I-9 form](#) is posted on Homeland Security's website. The U.S. Citizenship and Immigration Services has posted a [webpage](#) that lists the acceptable documents that an employee must provide to you to prove their identity and their ability to work in the United States. Employers who hire or continue to employ individuals knowing that they are not authorized to be employed in the United States may face civil and criminal penalties.

v. Federal anti-discrimination laws.

The federal anti-discrimination laws may apply to your company, depending on the number of individuals you employ. In sum, you cannot terminate, demote, treat differently, refuse to hire, or pay differently someone based upon age, race, color, gender, religion, national origin, or based upon a disability that does not prevent your employee or potential employee from performing the essential functions of their job with or without a reasonable accommodation.

(a) Title VII of the Civil Rights Act of 1964 (Title VII).

This [federal statute](#) applies to employers with 15 or more employees and prohibits employment discrimination on the basis of race, color, religion, sex, and national origin. This statute also governs [sexual harassment](#) and pregnancy discrimination claims. Sexual harassment covers two basic areas: (1) actions taken by a superior that require a subordinate to engage in sexual favors as a condition of granting a raise, promotion, or other job benefit or punishes the subordinate for refusing to comply; and (2) hostile work environment claims. To succeed on a hostile work environment claim, the employee must establish: (1) that he/she was subjected to sexual advances, requests for sexual favors, or other verbal or physical conduct of a sexual nature; (2) that this conduct was unwelcome; and (3) that the conduct was sufficiently severe or pervasive as to alter the conditions of the victim's employment and create an abusive working environment.

You can avoid liability for hostile work environment claims by implementing a policy that requires employees to report any unwelcome conduct to your attention, thus giving you an opportunity to investigate the claim to determine if it has merit and, if so, take reasonable measures to put an end to the unlawful conduct.

[The Pregnancy Discrimination Act](#) is an amendment to Title VII and prohibits discrimination on the basis of pregnancy, childbirth, or related medical conditions. Thus, you cannot refuse to hire a woman because of her pregnancy-related condition so long as she is able to perform the essential functions of the job. If an employee is temporarily unable to perform her job due to

pregnancy, you must treat her the same as any other temporarily disabled employee. For example, if your company provides modified tasks, alternative assignments, disability leave or leave without pay for other disabled employees, you must do the same for a pregnant employee who is temporarily unable to perform her job due to the pregnancy. Likewise, if your company holds open jobs for employees on sick or disability leave, you must do the same for a pregnancy-related absence. As for employee benefits, any health insurance benefits that you provide to your employees must cover expenses for pregnancy-related conditions on the same basis as costs for other medical conditions. Further, if your company provides any benefits to workers on leave, you must provide the same benefits to your employees on leave for pregnancy-related conditions.

(b) Age Discrimination in Employment Act of 1987 (ADEA).

[The ADEA](#) applies to employers with 20 or more employees and prohibits employment discrimination against individuals who are 40 years of age or older.

(c) Title I of the Americans with Disability Act of 1990 (ADA).

[The ADA](#) applies to employers with 15 or more employees and prohibits employment discrimination against qualified individuals with disabilities. An individual with a disability is a person who: (1) has a physical or mental impairment that substantially limits one or more major life activities; (2) has a record of such an impairment; or (3) is regarded as having such an impairment. A qualified employee or applicant with a disability is an individual who, with or without reasonable accommodation, can perform the essential functions of the job in question. [Reasonable accommodation](#) may include, but is not limited to: (1) making existing facilities used by employees readily accessible to and usable by persons with disabilities; (2) job restructuring, modifying work schedules, reassignment to a vacant position; or (3) acquiring or modifying equipment or devices, adjusting or modifying examinations, training materials, or policies, and providing qualified readers or interpreters. You are not required to make a reasonable accommodation to the known disability of a qualified applicant or employee if it would impose an “undue hardship” on the operations of your business. Undue hardship is defined as an action requiring significant difficulty or expense when considered in light of your company’s size, financial resources, and the nature and structure of your operation. You are not required to lower quality or production standards to make an accommodation.

In layman’s terms, the ADA applies to a person who has a disability that substantially limits one or more major life activities (e.g., sitting, standing, sleeping). Thus, the ADA in some circumstances can cover people with physical disabilities such as epilepsy, diabetes, HIV infection, or severe forms of arthritis, hypertension, or carpal tunnel syndrome. In other circumstances, the ADA can cover people with mental impairments such as major depression, bipolar (manic-depressive) disorder, and mental retardation.

Even if an employee or applicant does not have a disability that substantially limits a major life activity, the ADA prohibits you from acting on myths, fears, or stereotypes about a person’s medical condition. For example, the ADA prohibits you from denying a job to someone who has

a history of cancer because of a fear that the condition will recur and cause the employee to miss a lot of work.

To qualify for ADA protection, the disabled employee or applicant must prove that he or she can meet the job-related requirements (e.g., education, training, or skill requirements) and that he or she is able to perform the job's essential functions (i.e., its fundamental duties) with or without a reasonable accommodation.

(d) Equal Pay Act of 1963 (EPA).

This federal statute applies to almost all employers and prohibits wage discrimination between men and women in substantially equal jobs within the same establishment. The jobs need not be identical, but they must be substantially equal. It is job content, not job titles, that determines whether jobs are substantially equal. Pay differentials are permitted when they are based on seniority, merit, quantity or quality of production, or a factor other than sex.

(e) Retaliation.

It is also [unlawful to retaliate](#) against an individual for opposing employment practices that discriminate in pay or for making a discrimination charge, testifying, or participating in any way in an investigation, proceeding, or litigation under Title VII, ADEA, ADA or the Equal Pay Act. Further, to prevail on a retaliation claim, your employee does not have to prove the merits of the underlying action (e.g., that he or she was sexually harassed), rather they need only prove that they in good faith engaged in a protected activity (e.g., made a good faith complaint of sexual harassment). Retaliation includes terminations and any other employment action that is considered an adverse employment action, e.g., a demotion, a reduction in pay or benefits, a refusal to promote, and, according to some courts, giving the employee the cold shoulder and stripping them of any meaningful duties.

vi. Idaho anti-discrimination laws.

(a) The Idaho Human Rights Act (IHRA).

The [IHRA](#) applies to any company or person who hires five or more employees whose services are to be partially or wholly performed in the state of Idaho. The IHRA also applies to any person or company who, as contractor or subcontractor, is furnishing material or performing work for the state of Idaho. The IHRA prohibits discrimination on the basis of race, color, religion, sex, national origin, disability, or age similar to the corresponding federal laws, i.e., Title VII, the ADA, and the ADEA.

(b) Discriminatory wage rates based upon sex.

This [state law](#) applies to almost all Idaho employers and prohibits wage discrimination on the basis of sex similar to the corresponding federal law, i.e., the EPA.

vii. The Family and Medical Leave Act of 1993 (FMLA).

Employees are eligible to take [FMLA](#) leave if they have worked for you for at least 12 months, and have worked for you at least 1,250 hours over the previous 12 months, and work at a location where you employ at least 50 employees within a 75 mile radius. Thus, if you employ less than 50 employees (temporary workers are counted against the 50) or, more technically, if you do not employ 50 or more employees within a 75 mile radius, the FMLA does not apply to your company.

If the FMLA does apply to your company, you must grant an eligible employee up to a total of 12 workweeks of unpaid leave during any 12-month period for one or more of the following reasons: (1) birth of a child and to care for the newborn child, (2) placement of a child with the employee for adoption or foster care, (3) care for a family member (child, spouse, or parent) with a serious health condition, (4) the employee is unable to perform the functions of his or her job because of the employee's own serious health condition. In 2008, the FMLA was amended to allow 12 workweeks of FMLA leave for any "qualifying exigency" because of a spouse, son, daughter, or parent being on active duty or having been notified of an impending call or order to active duty in the Armed Forces. The 2008 amendments also permit a "spouse, son, daughter, parent, or next of kin" to take up to 26 workweeks of FMLA leave to care for a "member of the Armed Forces, including a member of the National Guard or Reserves, who is undergoing medical treatment, recuperation, or therapy, is otherwise in outpatient status, or is otherwise on the temporary disability retired list, for a serious injury or illness."

Under some circumstances, employees may take FMLA leave intermittently, which means taking leave in blocks of time, or by reducing their normal weekly or daily work schedule. If the FMLA applies to your company, you may require an employee to provide a medical certification confirming that a serious health condition exists, attend a medical examination at your expense to confirm the serious health condition, and require your employee to provide periodic reports during FMLA leave regarding the employee's status and intent to return to work. Under the FMLA you can require your employees (or an employee can elect) to use accrued paid leave, such as vacation or sick leave, for some or all of the FMLA leave period. When paid leave is substituted for unpaid FMLA leave, it may be counted against the 12-week FMLA leave entitlement, but only if you properly notified the employee of the designation when the leave begins. An employee's entitlement to FMLA can be extended beyond 12 workweeks if you fail to properly notify your employee that their leave will be counted against available FMLA leave.

If your employee was receiving group health benefits when leave began, you must maintain them at the same level and in the same manner during periods of FMLA leave as if the employee had continued to work. Further, upon return from FMLA leave, an employee must be restored to the employee's original job, or to an equivalent job with equivalent pay, benefits, and other terms and conditions of employment. However, under specified and limited circumstances where restoration to employment will cause substantial and grievous economic injury to your company, you may refuse to reinstate certain highly-paid "key" employees (an employee who is among the highest paid 10% of employees within 75 miles of the work site) after they have used all of their FMLA leave (assuming the appropriate health coverages were maintained during the FMLA leave). To do so, you must comply with certain specific requirements of the FMLA. In addition, you are not required to continue FMLA benefits or reinstate any employee who would have been

laid off or terminated for a legitimate business reason had they continued to work for you during the FMLA leave period as, for example, due to a general layoff. But you may not terminate an employee for taking FMLA leave. Rather, there must be a legitimate business reason justifying the layoff or termination.

Employees who are unable to return to work after exhausting their 12 weeks of FMLA leave in the designated “12 month period” no longer have FMLA protections for leave or job restoration (note that some employees may be entitled to 26 weeks of FMLA leave to attend to an injured soldier).

viii. Uniformed Services Employment and Reemployment Rights Act (USERRA).

In most circumstances, [USERRA](#) requires your company to grant leave to an employee called into military service. Following the completion of such military service, USERRA, with few exceptions, requires you to reinstate that employee into his or her prior position, a similarly situated position, or the position they would have attained if he or she were not called into service.

USERRA generally requires your employees to provide advance notice of military-related leave. Additionally, USERRA’s reinstatement obligations generally require your employees to re-apply with your company within a certain time period following their discharge from military service. The time period for re-application is dependent upon the length of military service and whether the employee is hospitalized or recovering from a service-related injury or illness.

USERRA also requires you to make reasonable accommodations for those employees who re-apply and were injured in military service, similar to the provisions of the ADA. And if the injured soldier is not able to perform the essential functions of their former position or a similarly situated position with a reasonable accommodation, then you are obligated to reinstate them into a position for which they are qualified, with or without a reasonable accommodation, that is the “nearest approximation” to their former job in terms of seniority, status, and pay.

Under USERRA, you are not obligated to pay your employees for absences due to military service. However, USERRA leave may impact your obligations with regard to employee benefits, such as health care coverage and retirement benefits.

USERRA can also impact the at-will status of your employees, by prohibiting the termination of a returning employee without cause in certain circumstances. Additionally, USERRA prohibits you from taking an adverse action against an employee (e.g., demoting or firing them) because of their past, present, or future military obligations.

D. Record Keeping Requirements.

State and federal employment laws require you to keep employment records for different time periods. The records you are required to keep include personnel files; job application forms; job advertisements; documentation on hiring, promotions, demotions, transfers, layoffs, or terminations; payroll information; job descriptions; employee handbooks; requests for reasonable

accommodations; and employee evaluations. Federal and Idaho state wage laws require you to keep: personal information, including employee's name, home address, occupation, sex, and date of birth; hour and day when workweek begins; total hours worked each workday and each workweek; total daily or weekly straight time earnings; regular hourly pay rate; total overtime pay for each workweek; deductions from wages; total wages paid each pay period; and date of payment of wages and pay period covered. The longest period of time you are required to keep these records under both federal and Idaho employment laws is three years, unless you know that litigation is imminent, whereupon you have a duty to preserve all documents, including electronically stored information, until the litigation is fully and finally resolved. The law also requires you to keep your employee's personnel records confidential.

The [IRS](#) requires you to keep all employment tax records for at least 4 years after the date that the tax becomes due or is paid, whichever is later.

E. Employees vs. Independent Contractors and Temporary Employees.

With all of the nuances of the various employment laws, you may think it is easier to classify everyone who works for you as an independent contractor rather than an employee. Not so fast! [The IRS may penalize you for improperly classifying an employee as an independent contractor](#), including requiring you to pay employment taxes for that worker. For tax purposes, the IRS is more concerned with the control you exert over your workers than how you classify them. And the more control you exert over your workers, the more likely the IRS will classify them as employees. According to the IRS, you have the right to control or direct the result of the work done by an independent contractor, but not the means or methods of accomplishing the work.

Misclassifying an employee as an independent contractor can also lead to a plethora of legal actions, including claims for unemployment insurance, stock options, overtime pay, retirement benefits, profit sharing contributions, disability payments, medical insurance benefits, workers' compensation benefits, or any other benefits that you have contractually agreed to provide to your employees or that you are otherwise legally obligated to provide to your employees. These same type of claims may arise with temporary workers (e.g., workers hired from temp agencies) whom your company has engaged for prolonged periods of time ("perma-temp employees").

Classifying a worker as an independent contractor versus an employee may also jeopardize your right to claim ownership to the intellectual property (e.g. computer source code) created by that independent contractor.

F. HR Consultants.

Most emerging and start-up companies do not have a full-time HR Manager, largely because of the cost to hire a full-time HR Manager. In many cases, this is a wise decision because your company's focus should be on what is most important, getting your product and services to market and generating revenues. You should, however, hire a good HR consultant to help you navigate many of the day-to-day HR tasks that come with running any company, like payroll, overtime, hiring and firing employees, implementing prudent employment policies to minimize

your legal exposure for employment related claims, training supervisors on appropriate employment practices, and managing and coordinating your employee benefit programs.

If you need HR consulting services, contact:

- [Tresa Ball](#), President, [HR Precision](#) (208) 846-7778.

For more information on managing and coordinating your employee benefit programs, contact:

- [Susie Brocke](#), Principal, [Myriad Benefits](#) (208) 343-6107.

11. INSURANCE.

Insurance should be a critical component of your risk strategy. The last thing you want to happen during the start-up phase of your company is litigation. Litigation will cause your company grief in a number of ways. First, you and your employees will be required to assist your attorney in defending the case. Second, you will have to pay your attorney to defend your company. Third, investors are very unlikely to invest new money into your company because of the uncertainty associated with litigation. Insurance can help you mitigate some of those litigation risks by providing you with coverage for any judgment entered against your company, and will cover the costs of the litigation, i.e., pay for your costs and attorney fees (assuming the claim is covered under your insurance policy and assuming the judgment does not exceed your insurance policy limits).

But because insurance policies are written to cover only certain types of claims (they typically do not cover things such as intellectual property disputes or intentional acts), it is critical that you establish a close relationship with your insurance broker so he or she understands the risks associated with your business and places the appropriate coverages for your company. Likewise, when a contract obligates you to maintain certain insurance coverages or obligates you to include other parties as additional insureds, you should immediately notify your broker so they can verify that you have those coverages in place.

Things you should inquire about with your broker when purchasing any type of insurance include: (1) what is your self-retention or deductible (e.g., how much do you have to pay before the insurance company pays your attorney fees or a covered loss); (2) do costs and attorney fees reduce the limits available to pay any settlement/judgment; (3) do you have any control over settlement (if you have concerns about an adverse implication of a settlement); (4) do you have any control over the selection of the attorney that will defend you if you are sued for a covered claim; (5) who is an insured under the policy, i.e., does the policy cover only the company, both the company and certain individuals, or companies with which you have a contractual relationship; (6) what are the effective dates of your policy periods, i.e., do your current policies pick up claims associated with events that happened outside of the policy period or do they simply pick up claims that are filed during the policy period; (7) are the limits of coverage adequate; and (8) what is the financial strength of the insurance company issuing the policy.

The most common types of insurance coverages purchased by small start-up companies include the following:

- General liability – provides defense and indemnification for bodily injury and/or property damage arising from your operations, products, or work performed.
- Property – covers your building or business personal property for physical loss. Equipment breakdown coverage can be added to cover mechanical breakdown of equipment maintained on your business premises. You should consider this coverage or a similar coverage even if you are leasing your business space.
- Fidelity/employee dishonesty – covers claims of theft by your employees, e.g., embezzlement by an employee.
- Automobile – to cover vehicles owned or non-owned by your company.
- [Workers' compensation](#) – provides coverage for workers' compensation claims and is mandatory for all employers employing individuals in Idaho.

A Business Owners Policy (BOP) can bundle many of the aforementioned coverages into one policy that is suitable for most small businesses at a discounted premium.

Other types of coverages you may want to consider include:

- Directors and officers liability (D&O) – covers directors and officers from claims filed against them for mismanagement of the business without proper regard for the rights of others.
- Errors and omissions (E&O)/professional liability – if your business provides professional services such as giving advice, making recommendations, designing things, providing physical care or representing the needs of others, you could be sued by customers, clients, or patients claiming your failure to perform your job properly has harmed them in some way. E&O and professional liability covers these types of claims.
- Employment practices liability insurance (EPLI) – EPLI can provide coverage for a host of employment claims, such as sexual harassment, discrimination, wrongful termination, breach of employment contract, wrongful infliction of emotional distress, and mismanagement of employee benefit plans.
- Employee benefits liability – because of recent court decisions that have expanded the scope of fiduciary responsibilities for employee benefit plan trustees, you may want to consider this type of coverage to protect you from any claims by your employees that relate to negligent administration and management of the benefit plan.
- Computer operations interruption – covers business income lost and extra expenses incurred as a result of many different computer-related problems.

- Electronic data loss – covers the cost to replace or restore electronic data destroyed or damaged as the result of a cause of loss named in the policy.
- Key person life insurance – can provide liquidity to help repurchase a deceased founder’s ownership interest and/or provide funds to recruit and retain a replacement.

For more information on insurance products that are appropriate for start-up and emerging growth companies, contact:

- [Joe Anderson, Bell-Anderson Insurance](#), (208) 514-1762
- [Nate Kim](#), President, [Blaine Christensen Insurance Agency](#), (208) 336-7711.

12. EMPLOYEE BENEFITS.

Any owner of a start-up company is a risk taker. Most other people, including almost all of your employees, are not. Most people want security from the unknown. [Employee benefits](#) such as health insurance and a retirement plan often provide the security blanket needed to attract quality employees. Other benefits, such as vested profit sharing plans, paid leaves of absence, and stock option plans, can be useful tools to retain employees.

But adding employee benefit plans can also impose additional legal duties on you as the owner, such as: fiduciary duties that arise under laws such as the [Employee Retirement Income Security Act \(ERISA\)](#); obligations to make your company’s group health care benefits available to former employees and their qualified beneficiaries in certain circumstances under the [Consolidated Omnibus Budget Reconciliation Act \(COBRA\)](#); and a prohibition of discrimination against an employee or their dependent family member based on any health factor they may have, including prior medical conditions, previous claims experience, and genetic information under the [Health Insurance Portability and Accountability Act \(HIPAA\)](#). Failure to follow these laws can result in severe penalties to your company and may expose you to personal liability in certain circumstances.

These are some of the financial benefits you can provide to your employees:

- Paid holidays, vacation, and sick days – this applies to your hourly workers who are not exempt from the FLSA.
- Medical insurance – employee contributions for premiums, high deductibles, or employer buy downs are often good ways to hedge against the rapidly rising expense of medical insurance.
- Dental and vision insurance.
- [401\(k\) Plans](#) or [other retirement plans](#) such as [Payroll Deduction IRA Plans](#), [SEP Retirement Plans](#), and [Simple IRA Plans](#) – there are many different plans available. You should ask your financial advisor about the investments available

to the plan, the costs associated with the plan, and the tax benefits of one plan versus another.

- Flex plans or health savings accounts – these allow employees to set aside a portion of their pre-tax wages to pay for health care expenses, such as medical bills that are not paid by a medical, dental, or vision insurance carrier (e.g., the employee has not yet met their deductible); flex plans can also allow employees to use pre-tax wages to pay for dependent care services such as day care.
- Employee Assistance Program (EAP) – provides counseling services and other services to employees to assist them with personal issues that may adversely affect their work performance (alcohol or drug addiction, financial problems, divorce, or other significant life events).
- Disability insurance – provides compensation for an employee who becomes disabled and is unable to perform the essential functions of their job.
- Life insurance.
- [Stock option plans](#) – this gives your employees a share in the upside potential of your company. But please take note that there are many tax issues implicated with any stock option plan. Thus, if you are not careful in how you implement your stock option plan, your employees could incur significant adverse tax consequences creating horrendous cash flow problems for your employees when their tax obligations come due.
- [Employee stock ownership plan \(ESOP\)](#) – this is a defined contribution plan used to buy and hold your company's stock in a retirement plan such as a 401(k) plan.
- Non-qualified deferred compensation plans – these plans can provide key employees with the ability to contribute portions of their salary into a tax-deferred plan. These plans can also be used by employers to incentivize key employees to remain with the company by having your company make contributions to the plan, with benefits to be paid in the future to the employee under a vesting schedule. These types of plans have many tax consequences to both the employer and the employee, and should only be implemented with careful advice from your tax advisor.

Many small companies also try and distinguish themselves from the competition by allowing employees to work from home, bringing their pets to work, providing access to health clubs, providing friendly and technologically sophisticated work spaces, or allowing employees to take paid time off for community service activities.

For more information on health, dental, vision, disability, life insurance, health savings accounts, and flex benefit plans for small and emerging growth companies, contact:

- [Susie Brocke](#), Principal, [Myriad Benefits](#), (208) 343-6107.

13. OTHER RESOURCES.

While this manual is focused on starting up a company from a legal and financial perspective, there are a host of other providers and sources available to assist you with the nuts and bolts of putting your company together. These providers and sources include:

- [Boise Metro Chamber of Commerce Small Business Success Center](#)
- [Idaho Small Business Administration](#)
- [Idaho Small Business Development Center](#)
- [Idaho TechConnect](#), Idaho Ideas for Idaho Businesses
- [Micro Enterprise Training & Assistance \(META\)](#)
- [Score](#), Counselors to America's Small Business
- [TechHelp](#), Solutions for Manufacturers
- [Zions Bank Business Resource Center](#), [Karen Appelgren](#), Assistant Director, (208) 501-7449.
- "[Business Start-up Guide](#)," by Idaho Small Business Development Center
- "[Idaho Small Business Solutions](#)," by Idaho Small Business Development Center
- "[Business Resources for the State of Idaho](#)," by Idaho Department of Commerce
- "[Tax Guide for Small Business](#)," by the IRS
- "[OSHA Handbook for Small Businesses](#)," by U.S. Department of Labor, Occupational Safety and Health Administration

14. CONCLUDING REMARKS.

The prospect for your company's success is dependent upon the employees and professionals you hire. Moffatt Thomas is committed to adding value to your start-up by creating a network of professionals that are dedicated to creating the infrastructure of your business while allowing you to focus on what is truly important for your business: getting your idea to market and generating revenues.

For further information on how Moffatt Thomas can assist your start-up company, please contact [Clay Gill](#), Attorney, [Moffatt Thomas](#) (208) 385-5478.