

Start Ups and Emerging Companies – 101: Employee – Contractor Considerations

Stock Options

Stock options are a great way to retain employees and incentivize employees to be productive. Stock options are a contractual right to purchase [stock](#). The stock is issued to the employees pursuant to an Option Plan adopted by the company. Generally, the employees are given the right to purchase the stock at a specific price. If the stock price increases in the future, the employee may "exercise" his or her right to purchase the stock and profit from the increase. If the stock does not increase in price, the employee may elect not to "exercise" the stock option.

There are two types of stock options: Incentive Stock Options (ISOs) and Non-Qualified Stock Options (NSOs).

Summary of Incentive Stock Options (ISOs)

- May only be issued to employees
- Must be issued at fair market value
- Taxed to the employee when the employee sells the stock
- Any increase in the price of the stock is taxed as capital gain
- Must be exercised, if at all, within 3 months of termination from employment
- Must be held for one year
- Not transferrable

Summary of Non-Qualified Stock Options (NSOs)

- May be issued to anyone (not just employees)
- Must be issued at fair market value
- Taxed to the holder when exercised (not when sold)
- Any increase in the price of the stock is taxed as ordinary income

Employment Invention Agreements

Employees are deemed to be "at will" employees in California (absent an employment agreement to the contrary), and may be terminated without cause. Accordingly, employment agreements may not be necessary for staff.

An employment agreement is generally advisable for the



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founders, key employees and management personnel. The employment agreement will cover, for example, termination for cause vs. at will, salary and bonus payments, benefits, stock grants and options, and confidentiality provisions.

The employment agreement or separate invention agreement should require the founder, key employee or manager to both disclose and assign to the company any intellectual property (owned or created by such individual) that is relevant to the company's business. The purpose of this disclosure and assignment is to ensure that the company is the owner of the intellectual property that is critical to the business of the company. In most cases, the value of the company relates to the "big idea" that the company is bringing to market. Without a documented assignment of this "big idea" to the company, it is questionable whether the "big idea" is owned by the company, or the founders that originated the concept.

Independent Contractor Agreements

The start up may decide to hire individuals or vendors to perform discrete assignments for the company, rather than to hire such individuals as employees of the company. It is advisable that such arrangements be documented in an independent contractor or vendor agreement.

Typically, the independent contractor or vendor agreement will contain the scope of work, price and schedule for performance. In addition, it is generally advisable for the company to include provisions which permit the company to terminate the relationship for convenience. Also, if the scope of work involves the company's trade secrets or requires the disclosure of sensitive materials, the agreement should include a confidentiality provision, and clarify that any work product generated by the contractor is owned by the company (i.e. "work made for hire"). It is also important to obtain a license from the contractor to any underlying intellectual property that would be necessary for the company to fully utilize the work product generated by the contractor.

For more information, please contact:

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