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Ten (or More) Pitfalls in Incorporating a Business

by WHITNEY M. SKALA

The incorporation of a business is not only the beginning of a dream for the client, but it usually is the beginning of a relationship for the attorney. Most businesspeople, it seems, try to grow their business without legal advice until they feel it is time to incorporate. They then retain an attorney, expecting the attorney simply to perform the mechanical step of incorporation. It is risky for the attorney to limit his or her thinking to these simple mechanics, ignoring the many legal issues that often lurk beneath the surface of the otherwise limited scope of the engagement, or to overlook some of these mechanics in an effort to quickly and cheaply conclude the incorporation.

This article does not seek to replace the many incorporation checklists that have been published. Rather, it will examine certain of those checklist items in greater detail, and will add some issues that most checklists fail to address.

HYPOTHETICAL

A and B come to see you, telling you they have a new business idea and a financier (C). They wish to incorporate. They admit they do not know much about incorporating, as they always have worked for other people and have never before started their own business. A friend told them that there is a book explaining how to incorporate, with forms, in their public library; how much will you charge them? They want to call their company "Hammer, Inc.," because they intend to call their product, which is a new automobile security gadget, "The Hammer." C travels a lot to monitor her many investments, but will be at her beach house in the area in a couple of weeks, and will be available then to sign the documents.

PITFALL NO. 1: OVERLOOKING THE OBVIOUS

Sometimes, the smaller the task, the bigger the embarrassment when that task is overlooked. So in abbreviated form, here is a quick list of a few selected items that should not, but frequently do, either fall through the cracks or are completely ignored. For your new client, be certain to:

1. Check the availability of the corporate name. The availability of a corporate name can be determined through the Office of the Secretary of State, and, for a minimal fee, the name can be reserved for 60 days while you conclude the incorporation paperwork. Formerly, name availability could be determined by simply calling the Secretary of State, but now, only those who enroll in the Corporate Pre-Pay Priority Telephone Service are afforded such a privilege (everyone else must determine name availability by writing to the Secretary of State's office). The Pre-Pay service requires an initial agreement, which the attorney or attorney's firm must sign, and a deposit of $100, to be applied against future charges. Once availability has been determined, corporate names may also be reserved through this service. The cost for use of the Pre-Pay service is $4 to check availability and $10 to reserve a name. Alternatively, an attorney may contact a participant in the Corporate Pre-Pay Public Access Service,

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such as an attorney service, through whom the name can be both checked for availability and reserved.

2. Advise the client of the filing fees required by the Secretary of State (and require the client to front those fees). When the client asks counsel to estimate his or her fees for the incorporation, it rarely crosses the client's mind that the state will charge anything more than a minor administrative fee. The second, and related, surprise to the client is that the state charges are due up front, with a check. You might allow the client 30 to 60 days to pay your fees, but the state does not. The fees presently are $900 ($800 is a franchise tax, payable in advance for the first full or partial year, and $100 is a filing fee), plus a $15 charge for filing over-the-counter.

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3. Confirm in the initial interview that all shareholders are California residents. An out-of-state shareholder may complicate your securities law considerations (and also increase your fee) by requiring that you examine the securities laws of the foreign state and that you rely on a federal registration exemption other than the intrastate exemption under 15 USC §77c(a)(11). The parties' respective states of residence can no longer be presumed. So many Californians have moved to other states but still conduct business here, and so many out-of-state residents spend substantial time and pursue business interests in this state, that it is highly likely that one of the potential shareholders will be an out-of-state resident. Do not assume that just because a shareholder-to-be is spoken of as frequently visiting the office, or being in constant contact with the founding group, that the shareholder necessarily lives in California. Clear this up at the outset.

4. Discuss with the client other, related documentation. When it comes to incorporating, clients invariably sound as though they are price-shopping. As the practitioner focuses on keeping fees to a minimum, the need for other, appropriate documentation, such as a buy-sell or right-of-first-refusal agreement, an employment agreement (with confidentiality and other clauses), and a licensing agreement (pertaining to property that will be used by the corporation but not contributed to the corporation) is often ignored. A detailed discussion of these documents is beyond the scope of this article, but there are excellent sources for forms and attendant explanatory material. See, *e.g.*, California Business Practice Forms Manual (Cal CEB 1992), Business Buy-Sell Agreements (Cal CEB 1991), Organizing Corporations in California (2d ed Cal CEB 1983). And remember to obtain the spouse's signature consenting to documents that purport to govern the disposition of what may be community property.

5. Ask for the name and phone number of the client's accountant. Counsel will need to coordinate certain filings with the accountant anyway, and the absence of an accountant might be a good indication of your client's sophistication (or lack of it).

PITFALL NO. 2: NOT ADDRESSING AND MONITORING THE ETHICAL ISSUES

Whenever there is more than one founder of a corporation, there is a potential conflict-of-interest issue. In some situations, two or more of the founders will ask that you represent them. Other times, one of the founders will retain you, while the other founder(s) either are represented by other counsel, or choose not to be represented at all.

The best way of dealing with ethical problems is with a strong start. Before you begin work on the matter, identify the potential and actual conflicts of interest, and strictly follow the requirements of the applicable Rules of Professional Conduct of the State Bar of California.

Your search through the Rules of Professional Conduct will quickly lead you to Rule 3–310, which sets forth several rules of which the practitioner should be aware when representing multiple parties in forming a corporation. Rule 3–310(B) requires that the practitioner disclose in writing to the client any relationship that the practitioner has or had with the parties, witnesses, or subject matter of the representation.

The term "disclosure" is a defined term. It means "informing the client or former client of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client or former client."

Adequately identifying the "relevant circumstances" and the "actual and reasonably foreseeable adverse consequences" in the situations enumerated in Rule 3–310(B) is challenge enough. Rule 3–310(C) and (E) require "informed written consent" (a term defined in Rule 3–310 (A)(2) as being consent following written "disclosure") of the client (or the former client, as the case may be) in each of the following, more complicated circumstances:

- Accepting representation of more than one client in a matter in which the interests of the clients potentially conflict (Rule 3–310(c)(1));
- Accepting or continuing representation of more than one client in a matter in which the interests of the clients actually conflict (Rule 3–310(c)(2));
- Representing a client in a matter and at the same time in a separate matter accepting as a client a person or entity whose interest in the first matter is adverse to the client in the first matter (Rule 3–310(c)(3)); or
- Accepting employment adverse to the client or former client where, by reason of the representation of the client or former client, the member has obtained confidential information material to the employment (Rule 3–310(E)).

"The best way of dealing with ethical problems is with a strong start."

Although subparagraphs (C) and (E) require client consent while subparagraph (B) does not, each of these subparagraphs incorporates the concept of "disclosure." The more important distinction between (B) and (C) is that they apply to different situations. Subparagraph (C)(1), for example, requires disclosure when the clients' interests "potentially conflict"; some might argue that this standard is so difficult to meet as to require that practitioners refuse multiple representation as a matter of course. In any case, when consent is requested, counsel should also urge in writing that the client seek independent counsel in evaluating whether to consent to multiple representation when there are actual or potential conflicts of interest.

The discussion notes following Rule 3–310 are also instructive as to the conduct expected of counsel. The notes make clear that subparagraph (C) applies to transactional matters, specifically including corporate formation. It identifies as an example of a potential adverse aspect of multiple representation, which requires "disclosure," the provisions of Evid C §962, which states that the attorney-client privilege is not available in a dispute among clients who retained the same attorney as to the subject matter of that dispute.

Moreover, the discussion notes clarify that the requirements of subparagraphs (C)(1) (requiring informed written consent to potential conflicts of interest) and (C)(2) (requiring informed written consent to actual conflicts of interest) are cumulative: that is, when what you identified in your engagement letter as a potential conflict of interest comes to pass, and what once was "potential" has ripened into the "actual," the practitioner must again obtain the informed written consent of the clients.

The discussion further cautions that "[t]here are some matters in which the conflicts are such that written consent may not suffice for non-disciplinary purposes," citing, among other cases, *Woods v Superior Court* (1983) 149 CA3d 931, 197 CR 185 (counsel to family-owned corporation disqualified from representing husband in divorce action, where family corporation is primary focus of dispute of marital dissolution). Clearly, the representation of multiple clients requires that the practitioner be aware of the standard of conduct required by the Rules and by the cases thereunder.

Other ethical rules are also relevant to corporate formation, even when the practitioner represents only one client. For example, the practitioner should be aware of ethical rules concerning the source of payment of fees (Rule 3–310(F)) and for investing in the client's venture (Rule 3–300).

Throughout the engagement, the practitioner should keep in mind the following passage from *Tomblin v Hill* (1929) 206 C 689, 694, 275 P 941, which almost always appears on the first page of motions to disqualify and other challenges to the role the practitioner has assumed:

> It is better to remain on safe and secure professional ground, to the end that the ancient and honored profession of the law and its representatives may not be brought into disrepute. Courts have consistently held the members of the profession to the strictest account in matters affecting the relation of attorney and client.

PITFALL NO. 3: FAILING TO DISCUSS THE HISTORY OF THE BUSINESS IDEA AND THE BACKGROUND OF THE FOUNDERS

For many clients who seek to incorporate, the incorporation decision may signify an abrupt change in their career path. After years of working for someone else, for example, the client may finally have found the right internal emotion or external circumstances to warrant starting his or her own company. And although loyalty to the former employer may have waned, the client's legal liabilities might still continue. The practitioner must interview the founders to determine whether the business venture is in danger of committing such acts (punishable by injunction or worse) as would constitute unfair competition, misappropriation of trade se-

crets, or a violation of a noncompetition or other employment agreement covenant.

Perhaps one of the first facts the practitioner must establish is whether the founders are still employed by their soon-to-be former firms. An employee may be liable for establishing and operating a business while employed elsewhere. The leading California case in this area is *Bancroft-Whitney Co. v Glen* (1966) 64 C2d 327, 346 n10, 49 CR 825, which provides this summary of the law:

> Comment e of §393 of the Restatement Second of Agency provides that an agent can make arrangements to compete with his principal even before the termination of the agency, but that he cannot properly use confidential information peculiar to his employer's business and acquired therein. "Thus, before the end of his employment, he can properly purchase a rival business and upon termination of employment immediately compete. He is not, however, entitled to solicit customers for such rival business before the end of his employment nor can he properly do other similar acts in direct competition with the employer's business. The limits of proper conduct with reference to securing the services of fellow employees are not well marked. An employee is subject to liability if, before or after leaving the employment, he causes fellow employees to break their contracts with the employer. On the other hand, it is normally permissible for employees of a firm, or for some of its partners, to agree among themselves while still employed, that they will engage in competition with the firm at the end of the period specified in their employment contracts. However, a court may find that it is a breach of duty for a number of the key officers or employees to agree to leave their employment simultaneously and without giving the employer an opportunity to hire and train replacements."
>
> The illustration given by the Restatement is as follows: "A is employed by P as manager for a year. Before the end of the year, A decides to go into business for himself; in anticipation of this and without P's knowledge, he contracts with the best of P's employees to work for him at the end of the year. At the end of the year, A engages in a competing business and employs the persons with whom he has previously contracted. A has committed a breach of his duty of loyalty to P."

Preparing written announcements of future employment or the establishment of a new company, leasing necessary premises, or forming a corporation have each been permitted. See *Motorola, Inc. v Fairchild Camera & Instrument Corp.* (D Ariz 1973) 366 F Supp 1173; *Sarkes Tarzian, Inc. v Audio Devices, Inc.* (SD Cal 1958) 166 F Supp 250; *Southern Cal. Disinfecting Co. v Lomkin* (1960) 183 CA2d 431, 7 CR 43. In each of these cases, however, the employees were terminable at will by their respective employers.

The background of the founders and the details of the intended business strategy might also reveal that the founders may be contemplating actionable behavior after they leave their respective employers and begin business. The privilege of business competition (including against one's former firm) was defined in *Katz v Kapper* (1935) 7 CA2d 1, 4, 44 P2d 1060, as follows:

> Competition in business, though carried to the extent of ruining a rival, is not ordinarily actionable, but every trader is left to conduct his business in his own way, so long as the methods he employs do not involve wrongful conduct such as fraud, misrepresentation, intimidation, coercion, obstruction, or molestation of the rival or his servants or workmen, or the procurement of the violation of contractual relations. If disturbance or loss comes as the result of competition, or the exercise of like rights by others, as where a merchant undersells or oversells his neighbor, it is *damnum absque injuria.*

"Although covenants not to compete generally do not appear to be enforceable, they might be enforceable when their purpose is to prohibit the unauthorized use or disclosure of trade secrets."

The customers of the former employer seem always to be targeted by the founders, in hopes of luring these accounts away from the former employer. However, when the means are unjustified, intentional interference with the contractual relations of a competitor (*e.g.*, the former employer of your clients) is actionable, whether the goal of the interference is to induce the breach of an existing contract, or simply to induce the third party not to enter into or continue a business relationship with the competitor. *Masoni v Board of Trade of San Francisco* (1953) 119 CA2d 738.

The identity and details of these customers may be proprietary to the former employer. The details of the product or way of doing business may also be proprietary. California has adopted the Uniform Trade Secrets Act, codified at CC §§3426–3426.11. Civil Code §3426.1(d) defines a "trade secret" as "information, including a formula, pattern, compilation, program, device, method, technique, or process, that (1) [d]erives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclo-

sure or use; and (2) [i]s the subject of efforts that are reasonable under the circumstances to maintain its secrecy." Actual or threatened misappropriation may be enjoined, and exemplary damages are available when misappropriation of the trade secret is willful and malicious. CC §§3426.2(a), (c), 3246.3(c).

The practitioner should ask whether the employees have employment contracts with their employers. Although covenants not to compete generally do not appear to be enforceable, they might be enforceable when their purpose is to prohibit the unauthorized use or disclosure of trade secrets. See Competitive Business Practices §3.34 (Cal CEB 2d ed 1991). In any event, if the employee executes a termination agreement, the terms of that agreement may modify the common law by limiting the rights of the former employee more than the law of the marketplace otherwise would. See *Loral Corp. v Moyes* (1985) 174 CA3d 268, 219 CR 836.

PITFALL NO. 4: FAILING TO REVIEW WITH THE CLIENT OTHER ENTITY STRUCTURES

On September 30, 1994, the Beverly-Killea Limited Liability Company Act (Stats 1994, chs 1200, §27), now codified at Corp C §§17000–17705, became effective. In authorizing the formation of limited liability companies, California became one of the last states to permit this form of entity.

The practitioner now has a new form of entity to recommend. The limited liability company is commonly hailed as allowing its members the limited liability enjoyed by corporate shareholders and the tax benefits enjoyed by partners in a partnership.

The chart opposite compares partnerships, corporations, and limited liability companies, with regard to several selected issues.

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PITFALL NO. 5: FAILING TO DISTINGUISH BETWEEN CORPORATE NAME AVAILABILITY AND THE RIGHT TO USE A NAME IN COMMERCE

Clients seem to place great emphasis on their choice of a name for their corporation, sometimes to the point that the practitioner might wonder whether the corporate name selection was both the beginning and the end of the client's business planning. When the practitioner cautions that the corporate name availability must be determined before going further, the client understandably might conclude that by incorporating under a certain name, that name therefore enjoys far-ranging protection from competitive or similar use.

The truth is that incorporation and a fictitious name filing (discussed below) do indeed establish some rights in the name, but those rights are limited, and the availability of state and federal trademark registration should be considered to determine competing usage and to maximize the corporation's rights in its name.

In California, trade name registration is addressed in Bus & P C §§14411–14418. Under Bus & P C §14411, a fictitious name filing creates a rebuttable presumption (affecting the burden of producing evidence) of exclusive trade name rights in the county of filing, if the registrant is first to file and is actually using the name in a trade or business. Note, however, that a fictitious business name statement, where one is required, need only be filed in the county in which the corporation's principal place of business is located. Unless the fictitious business name is also filed in other counties in which the corporation is doing business, the presumption of §14411 will not be available in those other counties.

Similarly, under Bus & P C §14415, the filing of articles of incorporation by a domestic corporation or the obtaining of a certificate of qualification by a foreign corporation creates a rebuttable presumption (affecting the burden of producing evidence) of exclusive trade name rights in the state, if the corporation is first to file or obtain a certificate under the name and is actually using the name in a trade or business.

When one party has filed a fictitious business name in its county, and a second party has incorporated the same or a confusingly similar name, the benefit of the presumption created by Bus & P C §§14411 and 14415 shall be awarded, for purposes of the county at issue, to the party that first filed the fictitious business statement or the articles of incorporation, respectively.

Neither of these statutes addresses the rights, if any, of such parties with respect to a partnership's tradename. Moreover, the only protection afforded is simply the benefit of a rebuttable presumption. By contrast, a registrant for state trademark protection in California obtains a certificate of registration, which is prima facie evidence of ownership of such mark. Bus & P C §14241. Additionally, any out-of-state usage by a California corporation lacks the statutory protections of Bus & P C §14415. For several hundred dollars, the availability of a name may be researched at the state and federal level, determining, to the extent possible under available databases, whether a name has been registered or even is in common-law usage.

One final note: As hinted at in Bus & P C §14415, corporations that seek to enforce their trade name and trademark rights in a foreign state, without having first qualified to do business in that foreign state, may face significant procedural hurdles in so doing. See Gibson, Trademark Protection and Practice §8.03[4][b] (Mathew Bender 1994).

If the intended corporate name is an integral element of the business plan, the best practice is to conduct a trademark search simultaneously with the corporate name availability determination. Then, provided that the name is available and is free from competing uses, the practitioner should discuss with the client the importance of all steps available to protect the corporation's name in the marketplace.

PITFALL NO. 6: FAILING TO PLAN AROUND THE CORPORATE OPPORTUNITIES DOCTRINE

Often, the founding shareholders (who usually become the initial directors and senior officers) come together over a business venture because of their preexisting business involvement in the field. One or more of the founders may already own and operate a related business, or may frequently invest in or consult to related businesses. When the new business gains stability and begins to grow, it may be natural for its products or services to evolve or diversify in such a way as to grow closer, in subject matter or mission, to the outside business interests of one of the founders.

Such a scenario may create unanticipated problems for that founder under the "corporate opportunities" doctrine. This doctrine is a law school staple and can be stated easily: A director or officer, acting on his own behalf, may not take advantage of a corporate opportunity without offering that opportunity, on the same terms and conditions as the opportunity was offered to the officer or director, to the corporation. The doctrine is rooted in the fiduciary duty owed by officers and directors to the corporation. See 18B Am Jur 2d Corporations §§1770–1787 (2d ed Bancroft-Whitney 1985). Without grounds establishing a fiduciary duty, a mere shareholder would not appear to be subject to the cor-

porate opportunities doctrine (although other doctrines may limit or prohibit the competitive acts of shareholders, such as, for example, the prohibition against misappropriating trade secrets).

Surprisingly, rarely is anything done by counsel to anticipate this problem, and to document, at the time of corporate formation, the intentions of the parties. In fact, if anything, counsel is encouraged by standard form documentation to overlook this issue. For example, most corporate attorneys can recite what has become the boilerplate Article II of the articles of incorporation:

The business of the corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business, or the practice of a profession permitted to be incorporated by the California Corporations Code.

The ostensible purpose of such a broadly stated provision is to forever remove from the client's concern the need to revisit the articles of incorporation to determine whether a business venture is authorized by the articles (thus bumping into another corporate doctrine, that of the ultra vires act). Amending the articles of incorporation can require assistance of counsel and the payment of fees to the Secretary of State. Corporate actions outside the scope of the articles of incorporation may be subject to attack by dissenting shareholders and directors.

However, for the officer or director who wants to preserve his or her rights to participate in a business related to that of the corporation, a narrowly worded statement of the scope of business of the corporation may be desirable. This is common practice in the drafting of partnership agreements, and language can be borrowed from the practitioner's partnership form files, to simply state the business of the corporation that truly is intended. The minutes of the first meeting of the directors likewise can state the limited scope of business of the corporation, although such a resolution may not carry the permanence of a narrowly worded section of the articles of incorporation. A super-majority provision in the articles of incorporation may be used to further reinforce the scope of business section. It is better to force the founders to work through this issue in advance than to argue over it later, against the fact-specific legal framework of the corporate opportunity doctrine.

PITFALL NO. 7: FAILURE TO FILE A FICTITIOUS BUSINESS NAME STATEMENT

Although the failure of a corporation to properly file a fictitious business name statement may not strike the practitioner or the client as a near-fatal oversight, it is a matter that is frequently overlooked and may cause embarrassing results. As the client rushes the attorney to conclude the incorporating documents, deliberately keeping him or her on a "need to know" basis, the attorney sometimes fails to discover that the corporation will do business under a name other than its corporate name.

Business and Professions Code §17900(a)(3) states that, in the case of a corporation, a "fictitious business name" is "any name other than the corporate name stated in its articles of incorporation." A fictitious business name is "filed" by (1) the completion of the form prescribed by Bus & P C §17913(a), a simple form available from most attorney services and title companies; (2) the filing of that form with the clerk of the county in which the registrant has its principal place of business, as required by Bus & P C §17915, and (3) the publication of that notice, pursuant to Bus & P C §17917 and Govt C §6064, once a week for four successive weeks.

The penalty for failure to comply with this requirement is set out in Bus & P C §17918, as follows:

> No person transacting business under a fictitious business name contrary to the provisions of this chapter, or his assignee, may maintain any action upon or on account of any contract made, or transaction had, in the fictitious business name in any court of this state until the fictitious business name statement has been executed, filed and published as required by this chapter.

Case law has interpreted this provision as requiring only that the corporation comply by the time of trial. See, *e.g.*, *Kadota Fig Ass'n v Case-Swayne Co.* (1946) 73 CA2d 796. Nevertheless, trial counsel must catch the failure to file the fictitious business name statement at least four weeks (the time required for publication) before trial to allow time for publication. The client may not think kindly of the transactional attorney whose oversight resulted in a defense judgment at trial.

PITFALL NO. 8: FAILING TO INSIST THAT CAPITALIZATION ACTUALLY OCCUR

Sometimes, corporations are capitalized with minimal consideration. This may or may not be advisable

from the standpoint of establishing the "corporate veil." More common, however, in cases of minimal consideration, is that the consideration is never paid in at all.

Such a situation will almost certainly threaten the existence of the corporate veil, one of the primary purposes of incorporating. Additionally, any representations that the founders may have made to lenders, in whose favor the founders may have pledged their stock, that the stock is "fully paid," will be false, if not fraudulent.

The practitioner in such situations should insist on specific confirmation, either from the client or the corporation's banker, that the cash contributions have indeed been deposited into the name of the corporation.

PITFALL NO. 9: FAILING TO TRANSFER NON-CASH CAPITAL CONTRIBUTIONS TO THE CORPORATION

Founding shareholders often capitalize their new venture, in whole or in part, with contributions of something other than cash. These items, whether real or personal property, must be put into the ownership of the corporation to establish the corporation's right to use them (and to defend, or claim damages for their impairment, in court) and to deem the stock issued in consideration thereof to be "fully paid."

As a preliminary point, the discussion with the client of transferring property into the corporation should include an examination of whether the property will be granted to the corporation, or simply leased or licensed. A transfer of less than a complete interest may retain in the transferor the concurrent right to use the property or the reversionary right in the event of nonuse or dissolution by the corporation.

For most forms of personal property, the documentation of a transfer of ownership of that property will simply require a bill of sale. Counsel also should consider whether compliance with the bulk sales laws is necessary. The bulk sales law is found in Com C §§6101–6111. The transfer of assets from an existing concern to a newly formed corporation generally will be subject to public notice and payment of certain creditors when:

- The transfer of assets is not in the ordinary course of the transferor's business and constitutes more than half of the transferor's inventory and equipment;
- The transferor's principal business is the sale of inventory from stock, including a business that manufactures what it sells, or the principal business is that of restaurant owner; and
- On the date of the bulk sale agreement, the transferor is located in California or is located in a jurisdiction outside the United States but has its major U.S. executive office in California.

If the transfer falls within these criteria and therefore is subject to the bulk sales provisions, the transfer nevertheless may qualify for an exemption if the transfer of assets is to a new organization that is organized to take over and continue the business of transferor. However, the new corporation must assume in full all debts that were incurred in the transferor's business before the date of the bulk sale. Notice of such assumption of debts must be published within 30 days after the date of the bulk sale.

If the new corporation does not want to take the risk of assuming debts that the transferring shareholders might fail to disclose or might quantify inaccurately, counsel for the new corporation should strongly consider advising the corporation to go through the time and expense of the bulk sales procedure.

Rights in intellectual property, such as copyrights, patents, and trademarks, should be transferred, if necessary, to the corporation. Not all such property is assignable, however, under all circumstances. A federally registered trademark or service mark, for example, may be assigned only in connection with the transfer of the goodwill of the business in which the mark is used, or with that part of the goodwill connected with the use of and symbolized by the mark. 15 USC §1060. California law is similar in this regard. See Bus & P C §14260. This limitation is grounded in the fundamental nature of a trademark, which is that a trademark is not a property right, but only a right that is appurtenant to a business in which the mark is used. *Greenlon, Inc. v Greenlawn, Inc.* (SD Ohio 1982) 542 F Supp 890.

Some assets, such as a liquor license, require third party approval before the transfer. Likewise, real property leases may not be assignable without the consent of the landlord. Still other assets may be transferrable, such as real property, but may be encumbered by debt instruments that permit acceleration of the indebtedness on transfer. Only by requiring that the client catalog the assets to be transferred can the practitioner hope to complete all necessary transfers and avoid legal issues that could impede the corporation's use of the assets.

PITFALL NO. 10: CONCLUDING YOUR PITFALL REVIEW AT PITFALL NO. 9

Corporate formation, simply as a mechanical task, is not the most difficult endeavor the practitioner will encounter. But to the practitioner whose expectations

of himself or herself match the hopes and dreams of the client, there are many additional issues of which counsel should be aware and topics about which counsel should be knowledgeable. To bring this article to a close, the following is a list of some selected issues and subjects for the attorney to study and bear in mind:

(1) Securities issuance issues, including determining when it is necessary or advisable to register on the federal level;

(2) The taxation under IRC §351 of non-cash capital contributions;

(3) The benefits and mechanics of issuing preferred stock;

(4) The availability of trusts as shareholders in S corporations (Rev & T C §§23800–23811) and the existence of previously drafted trusts that are designed to hold all of a founder's interests, including the stock of the new corporation;

(5) The advisability of incorporation under the laws of other states, such as Nevada or Delaware;

(6) Drafting pricing mechanisms in buy-sell agreements;

(7) Determining the proper amount of initial capitalization;

(8) Properly insuring the assets and activities of the corporation; and

(9) Reviewing the obligations of the corporation to its employees.