

Winter 2005

## Protecting Your Invention When Seeking Venture Capital Financing

By Mark Schonfeld

So you have an invention . . . congratulations! You are almost ready to pitch it to the world and reap your rewards, but then you think: What if I show someone my invention, and he steals my work? How do I protect my invention from theft? The answer depends on the type of invention. Is it a device or a computer program, or simply a "better idea" for a product or business? Many of these can be protected, but your first decision is whether to keep news of your invention private or to 'go public.'

### Public or Private?

Keeping your invention 'private' means that by not disclosing your idea to the public, you are taking the responsibility to keep your work secret. This can be risky because you must keep your work a "trade secret." Trade secret protection may not be enough, because if other persons reproduce your idea on their own, you are out of luck. A famous example of a trade secret is the Coca-Cola formula that has been kept confidential for over a century, with no one reproducing an identical formula. The risk paid off for Coca Cola, but will it for you? This also may make it more difficult to seek venture capital financing because, as discussed below, most venture capitalists are reluctant to sign non-disclosure agreements.

### How Do I Protect My Invention?

The primary 'public' categories for invention protection are copyright, patents and provisional patents. To determine which may be right for you depends on what your work is, its stage of development, and how much you are willing and able to invest.

### Copyrights and Patents

Obtaining a copyright or a patent provides great protection because it

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serves as your announcement to the world as to what your protected work is, it puts others on notice of your ownership rights, and it allows you to sue others for infringement.

Copyrights protect original works of authorship (such as books, music, art and computer software) for a certain period of time. Registration is not necessary for protection, but you generally cannot sue for infringement if your copyright is not registered. The protection period can also be quite long (depending on the creator). After that time has ended, the work becomes "in the public domain," and is free for others to use.

A patent is a property right granted by the U.S. government that protects inventions such as machines, processes, and manufactured items. In exchange for public disclosure, the inventor is protected against others using, selling, creating, or importing anything covered by the patent. The protection period usually lasts 20 years, with some exceptions. After such time, the invention becomes free for public use. Having a patent can be vital since venture capitalists may not be willing to meet with you until you have one. Obtaining a patent, however, can cost anywhere from \$8,000 to \$30,000, depending on complexity, and may not be worth the price if you have not tested the market and your investment funds are low. If this is the case for you, a provisional patent may be just what you need . . . for now.

### Provisional Patents: Good Option?

A provisional patent is obtained by filing a short-form patent application. It essentially "holds" your place in line for eventually obtaining a regular patent, but for much less upfront

money. The provisional patent starts the process for protection while furthering your idea, buying an additional year for market testing before you invest in a regular patent application. It also permits you to say "Patent Pending."

After filing for a provisional patent, you have one year to decide if you want to file a regular patent application. Failure to file within this time period means you will no longer have any patent protection. Another caveat: provisional patents are not examined by the U.S. Patent and Trademark Office. Therefore, if you decide to file a regular patent application, you will have to wait for the full examination period. Finally, do not skimp on the provisional application. It must clearly and exactly describe the invention and the manner and process of using it. A patent attorney should be consulted.

### Non-Disclosure Agreements

Obtaining a Non-Disclosure Agreement (NDA) is absolutely essential if you decide to keep your idea 'privately' protected. An NDA allows inventors to disclose their idea so that they may present it to potential investors, partners, or licensees. It is critical that the NDA adequately cover all of the information that the inventor discloses, how it is disclosed, and how it may be used in the future. If the disclosure of your invention occurs at a meeting, all discussions must be made in confidence, not just on paper that is stamped 'Confidential'. The NDA should also

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# Reducing Health Care Costs: Health Savings Accounts

By Evelyn A. Haralampu

The vast majority of Americans who have private health insurance are covered through an employer. Reports show, however, that the percentage of employees who receive health insurance from their employers has dropped from 70.1% to 64.2% over the period from 1987 to 2002. During that time, the larger the company, the more apt it was to curtail or eliminate healthcare benefits. Various factors are associated with the overall decline in employer-sponsored health coverage, including the rising cost of healthcare benefits; the shift of jobs from manufacturing to the service sector; the increased use of part-time workers, temporary employees, independent contractors and contingent workers; decreased unionization; and periods of higher unemployment.

Cost is certainly a major reason for this trend as is evidenced by the rate of employment-sponsored health coverage which falls during periods of rapidly rising premiums and stabilizes when the increase in premiums slows.

In light of these trends, the Medicare Prescription Drug Improvement and Modernization Act of 2003 sought to make health coverage available to a wider group of Americans. It allows employers and individuals to cut their healthcare coverage costs by establishing tax deductible health savings accounts (HSAs) in conjunction with less expensive, high deductible insurance policies.

## Overview

By purchasing high deductible group policies for employees and their dependents who are not entitled to Medicare, employers should be able to reduce significantly the premium costs of employees' health benefit plans. A high deductible health plan for a single individual must have an annual deductible of at least \$1,000, and annual out-of-pocket expenses (i.e. deductibles, co-payments and other amounts, but not premiums) not exceeding \$5,000. For a family, these limits are doubled. HSA balances may be used to pay for uninsured medical expenses.

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## HSA Contribution Limits

Employers or individuals may establish HSAs on a tax-favored basis to pay medical expenses. The maximum, tax deductible annual HSA contribution is the lesser of: (a) 100% of the annual deductible under the high deductible plan, or (b) \$2,500 (for an individual) or \$4,500 (for family coverage). Individuals who are over the age of 55 have slightly higher dollar limits (e.g. for 2005, the limit is \$600 higher). These limits include both the employer and

employee contributions to an HSA. Contributions in excess of the limits are subject to a 6% excise tax unless the excess is distributed or applied to a later year.

## Distributions from HSAs

HSA balances used to pay for uninsured medical expenses are excluded from the individual's gross taxable income. Distributions used for other purposes are generally includible in gross taxable income and subject to a 10% excise tax. However, the excise tax is waived on distributions made after the HSA owner dies, becomes disabled or attains age 65. COBRA premium payments may be paid through HSAs as well as health premiums during the period of an individual's unemployment compensation. Medicare premiums, but not premiums for Medigap policies, may also be paid from HSAs.

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## What's New

### Tax Alert

On January 6, Congress passed a bill that permits taxpayers to claim a tax deduction in the tax year 2004 for donations made for the tsunami disaster relief before January 31, 2005.

### News

New attorneys: **Mark A. Nowak** [Partner, Trusts & Estates Group], **Howard J. Susser** [Partner, Intellectual Property], **C. Elizabeth Brady** [Associate, Business Litigation], **John K. Kelley** [Associate, Corporate], **Anne C. Pareti** [Associate, Intellectual Property]

### Articles

**Where There's a Will, There's A Reality Show**, by Brian D. Bixby, *Massachusetts Lawyers Weekly*, January 10, 2005

**Marriage and Estate Planning, Under Goodridge v. DPH**, by Lisa Madeleine Cukier, *Boston Bar Journal*, November/December 2004

**The Offer Letter: Beware of Creating Contractual Bind**, by Nancy A. Newark, *Boston Business Journal*, November/December 2004

**Avoiding An 'Implied' Employment Contract Or Drafting A Favorable One: A Primer**, by Nancy A. Newark, *New England In-House*, October 2004

### News Quotes

**Lawrence P. Murray** was quoted in **Contract Change is OK Under Statute of Frauds**, by Tony Wright, *Massachusetts Lawyers Weekly*, December 2004

**David P. Rosenblatt** was quoted in **Debunking The Law-Firm 'Danger Zone'**, by John O. Cunningham, *Massachusetts Lawyers Weekly*, October 4, 2004

### Recent Client Updates

**Misclassification of Workers as "Independent Contractors" May be a Crime**, *B&L Employment Solutions Update*, January, 2005

**Preventing the Health Privacy Rules from Jeopardizing Your Estate**, *B&L Client Update*, by Evelyn A. Haralampu, January 2005

**Review Your Deferred Compensation Plans to Avoid Penalty Taxation**, *B&L Client Update*, by Evelyn A. Haralampu, November 2004

**B Shares In Retirement Plans: Getting An F of Fees**, *B&L Client Update*, by Evelyn A. Haralampu, October 2004

# The Massachusetts Wage Act - Proceed with Caution!

By Mark F. Murphy and Michael P. Murphy

The Massachusetts Wage Act governs the frequency and timing of the payment of wages. Its purpose is twofold – to ensure that employers promptly pay their employees and to prevent employees from squandering large lump-sum payments of wages. The statutes that comprise the Wage Act are complex and generally regarded as not well written. To further complicate matters, many of the issues raised by the Wage Act have not been resolved by the courts. In addition to the uncertainties inherent in the Wage Act are certain provisions which, if violated, result in serious consequences, among which are treble damages and attorney's fees to the employee who establishes the failure to pay wages, and personal liability for officers and agents of the employer.

Generally, the Wage Act requires the payment of wages within six (6) calendar days of the termination of either a weekly or bi-weekly pay period, although certain categories of employees such as executive, administrative and professional employees may be paid bi-weekly or semi-monthly. These categories of employees can also elect to be paid monthly. The Wage Act also requires that a discharged employee be paid in full on the date of termination (*i.e.* not at the next regular payroll). Employers should also remember that an employee's agreement to defer payment of earned compensation for other than tax planning purposes is prohibited by the Wage Act. In order to avoid running afoul of the Wage Act, an employer should at a minimum understand the following three important issues:

- Who is an employee;
- Who is an employer; and
- What is a "wage."

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### Who is an Employee?

The Wage Act governs the payment of wages to "employees." Courts have found that the Wage Act does not apply to independent contractors. Beyond that, however, there has been a great deal of confusion over what is meant by an employee. Some lower courts have ruled that certain highly paid individuals or executives are not employees for purposes of the Wage Act. These courts have apparently relied on the paternalistic origins of the Wage Act to conclude that only low paid employees require the protection of the Wage Act. The problem with these decisions is that there is almost no textual basis for the courts to have reached this conclusion. In fact, just the opposite is true. The statute, on its face, provides in part that executives are protected by the Wage Act. Moreover, more recent rulings have underscored this common sense definition of "employee" and have found that all employees at any level, including executives, are subject to the protection of the Wage Act. Although appeals courts have yet to resolve the confusion in the lower courts, these more recent cases are grounded in the text of the statute and employers should therefore assume that all of its employees are protected by the Wage Act.

### Who is an Employer?

In a highly unusual provision, the Wage Act allows employees who have established that they have not been paid wages to "pierce the corporate veil" and recover damages from "the president and treasurer of a corporation and any officers or agents having the management of such corporation." Unfortunately, there is little case law

upon which an individual can determine who will be included within the meaning of the phrase "officers or agents having the management of such corporation." At least one lower court found without much discussion that the general manager of an employer that failed to pay wages was personally liable to the employee. Given this uncertainty, employers and individual managers should be particularly vigilant about ensuring that employees are timely paid all of the wages that they have earned. To do otherwise would be to risk incurring personal liability.

### What is a Wage?

For purposes of the Wage Act, compensation that is protected generally includes base pay, vacation pay, holiday pay and commissions that have been definitely determined and that are due and payable. There is still a great deal of uncertainty in the law, however, as to what exactly falls within these protected categories of wages. For example, as yet, there is no clear definitive boundary between what is a bonus and what is a commission. Consequently, employers should proceed with caution and consider bonuses, stock options, incentive plans and other similar forms of compensation as likely to be included within the protection of the Wage Act. Employers should ensure that their employees are promptly paid all compensation once earned and payable to the employees.

Clearly, the provisions of the Wage Act are not simple and applying the facts of a particular case can be complicated. If there are specific questions concerning an issue potentially involving the Wage Act, please do not hesitate to contact an attorney in the Employment Group of Burns & Levinson LLP. ■■

### Protecting Your Invention

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ensure that the third party may not use the information in any way other than how you intend. Lastly, the agreement should also include the inventor's right to seek an injunction if the other party violates the agreement. What makes this approach risky, though, is seeking venture capital financing is that most VC firms will not sign an NDA, meaning your universe of potential funding sources will be severely limited. An attorney should assist you in preparing an NDA. ■■

## Protecting Your Home: Homestead Act Update

By Michael F. Dowley

Since the mid-nineteenth century, the Massachusetts Homestead Act has protected the principal residences of Massachusetts residents from the grasp of creditors. This protection from creditors is not absolute or automatic, but it is simple to claim and Massachusetts residents should avail themselves of the protections that the statute provides. The protection is available to both single and married homeowners, with or without children, for property which is the principal residence of the owner. Effective October 26, 2004, the protection was increased from \$300,000.00 to \$500,000.00, so there is even more motivation to file. Once you have filed, \$500,000.00 of the equity of your home is protected from attachments, levy on execution and sale by your future creditors.

If you have already filed a Declaration of Homestead prior to October 26, 2004, your existing homestead protection was automatically increased to \$500,000.00 on that date, but the added protection only applies to debts incurred after that date.

To obtain homestead protection for a property, you must record a document called a "Declaration of Homestead" in the registry of deeds for the county or district in which your principal residence is situated. If you and all co-owners of the property are under age sixty-two (62) and none is disabled, you may establish an estate of homestead in

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the maximum amount of \$500,000.00. However, if all owners are sixty-two (62) years of age or older, or disabled, each such owner may record a homestead declaration and they will each independently obtain the \$500,000.00 protection from creditors (*i.e.*, a married couple each of whom is sixty-two (62) years of age or older can obtain \$1,000,000.00 in protection).

To establish entitlement to homestead protection on the basis of disability, you are required to attach proof of the mental or physical disability to the homestead declaration. The Homestead Act defines a disabled person as an individual who has any medically determinable physical or mental impairment that would meet the disability requirement for supplemental Social Security.

The protections provided under the Homestead Act are not an absolute bar to actions brought by all creditors. Federal, state and local tax liens, mortgages used to purchase the property, executions issued by the Probate Court to enforce spousal or child support judgments, debts incurred prior to recording the homestead, and most forms of commercial debt incurred after recording the homestead are exempt.

For more information on establishing homestead protection, please contact a real estate attorney at Burns & Levinson LLP. ■■

## Focus

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## Reducing Health Care Costs: Health Savings Account *continued from page 2*

Other healthcare premiums may not be paid from HSAs.

### Death of HSA Holder

On the death of the account holder, an HSA balance may be paid to a beneficiary. If the beneficiary is the account holder's surviving spouse, that spouse can continue the HSA. For non-spouse beneficiaries, however, the account ceases to be an HSA and is subject to income tax on the account holder's death.

### Transfers of HSAs in Divorce

HSAs may be transferred without taxation in connection with a divorce. The account is treated as the HSA of the recipient spouse.

### Employer Sponsored HSAs

An employer sponsoring and contributing to HSAs must provide comparable contributions to employees with comparable coverage. Comparable coverage may be measured either by the amount

or by a percentage of the deductible.

### Going Forward

As the insurance industry develops high deductible health insurance products to combine with HSAs, employers will have one more choice to consider when designing employees' health benefits. As employers look to save money on their healthcare programs, HSAs and high deductible policies should be considered as options. ■■