

Tips for raising venture capital: employment issues

By Jeff Lehrer

Your business is growing and you're ready to take on your first hire – or are you? As you position your company for financing or an exit, keep in mind that employment issues are among the factors investors and potential acquirors will be examining. Here are six action steps to consider as you build your team.

1. Put employment terms in writing

Once you've decided to bring on a new hire, be clear about the terms of employment and, most importantly, be sure to memorialize these terms of employment in writing. For example, consider the potential impact of confusion regarding vacation policy, including how vacation time is accumulated, whether unused time rolls over to the next year and who is keeping track of employees' accumulated vacation time. A clearly written contract will help you avoid situations in which an employee comes back asking for what was promised, or what was never promised, whether it is more equity or more money.

[Refer to our article](#) to read more about the similarities and differences between employment offer letters and employment agreements; to learn more about employment agreements for your first executives, [check out our article](#).

2. Non-competes and prior employers

During the interview process, be thorough. Be sure to inquire whether the candidate has signed a non-compete agreement with a previous employer – a lack of diligence here may not just be an immediate hassle, but may lead to unpleasant surprises that affect your company's potential for financing or a smooth exit. On a related note, keep in mind that employees must not keep or use confidential information from their prior employers.

Refer to our article on non-competes and non-solicits [here](#).

3. Employee classification issues

Know your state's overtime rules. Be sure to correctly identify non-exempt employees who must be paid overtime rates. Be aware of the need to pay overtime premiums, record non-exempt employee time accurately and prevent non-exempt employees from working unnecessarily excessive hours.

In addition, consider the risks associated with classifying someone as an independent contractor, including a greater need for such documentations as an assignment of inventions or confidentiality agreement. If you misclassify someone as an independent contractor when, in reality, he or she should have been classified as an employee, your company may face claims for stock options, benefits, worker's compensation or withholding.

Refer to our articles for more information on the [basics of employee classification](#), including the meaning of exempt vs. non-exempt employees as well as [differences between contractors, employees and consultants](#).

4. Compensation and wage and hour issues

Be sure to pay your employees, even when cash is tight. Failure to do so may lead to potentially huge wage-and-hour claims, with penalties to the company and potential additional liability for officers and directors. In addition, be careful when navigating the very complicated Section 409A-related rules in connection with deferred compensation arrangements, which have the potential to result in penalties to both service providers and the company.

Refer to our [article](#) for situations when an individual officer or director may have liability for unpaid wages and/or severance payments.

Learn more about [paying founders](#) and [paying interns](#).

5. Failure to properly address poor performance

If you have mediocre or poor performers in your company, be sure to document their performance honestly and diligently. Avoid giving unduly generous evaluations or merit raises to these performers, as this may lead to liability issues further down the line.

When terminating an employee, document each step along the way, and ensure compliance with company policy for everyone.

Refer to our [article](#) to read more about employee terminations and [separation agreements](#).

6. Compliance issues

More and more laws apply as your business grows. Creating and abiding by an employee handbook, along with involving a Human Resources representative or employment law counsel, can help you navigate compliance issues as your labor force grows.

Be sure to comply with or engage in risk avoidance with regard to applicable employment statutes. Special attention should be given to prohibiting discrimination and requiring leave and reasonable accommodation for disabled employees and applicants. Even small companies with fewer employees than necessary for federal law coverage may be sued under county anti-discrimination ordinances for wrongful discharge if they are fired for discriminatory reasons. Further, make sure that you are withholding an appropriate amount of state and federal taxes as well as providing proper worker's compensation insurance.

As a matter of legal compliance as well as good corporate housekeeping, be sure to retain records related to employment decisions. For example, failing to retain applications of unsuccessful candidates is a frequent violation, and this issue has become more complex as companies increasingly search for job candidates online. In addition, when promoting employees into management roles, ensure that you provide proper training regarding managing people and the applicable legal rules.

Each of the issues above is an area in which investors will want to assess the risk and liability that the company may have. When investors see a company with too much risk or liability, they may either reduce the valuation or, worse yet, not invest at all. By addressing these employment issues at the outset, you can reduce the risk that an investor or an acquirer gets cold feet.



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