THE LAW FOR FOUNDERS

CANADIAN EDITION

A Guide to PROTECTING YOUR STARTUP

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DEDICATION

Dedicated to my father, David Wires, a (retired) litigation lawyer who paved the law path for me and made this book possible.

"There is, in my view, no doubt that Mr. Wires and his firm have performed heroically. Over seven years, Mr. Wires did battle with one of the most powerful American regulatory agencies [the Federal Trade Commission], an agency with virtually unlimited legal resources and ably represented by the largest law firms in Canada, first BLG and now Gowlings. He eventually succeeded "against almost insurmountable odds" in setting aside the ex parte orders, getting a damages inquiry on the plaintiffs' undertaking, and having the 2002 action stayed – and did all of this without being paid by his clients. This is surely a testament not only to the fortitude of the senior defence counsel, David Wires, but to his commitment, indeed passion, for justice."

- Justice Belobaba on David Wires in United States of America v. Yemec, 2009 CanLII 61418 (ON SC).

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INTRODUCTION

This book is for founders, not lawyers.

If you are a founder, or an aspiring founder, this book is to help you wade through the trenches with practical legal tips and information for building and protecting your business.

Consider this book as a legal guide to implementing your business idea and understanding the legal framework around your business. Using case examples and examples from my own practice the book covers core legal issues every start-up should consider.

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Entrepreneurship is alive and well in Canada. More and more Canadians are capitalizing on their dreams of operating their own businesses. The success of organizations like Victoria Lennox's Start-up Canada are a testament to the growing popularity of becoming an entrepreneur.

Somewhere along the line, entrepreneurship not only became an option in university programs, but it actually became "cool". As college students started making money online and building business empires like Facebook and Google, fewer hockey players were born in Canada. Now more than ever, teenagers and young adults are aspiring to become founders.

In the early 2000's, as tech entrepreneurship grew, so did the support systems for founders. From educational institutions building a host of incubator and accelerator programs to crowdfunding sites like Kickstarter giving a funding boost to new ventures and products.

However, one support network that lags is the legal services industry. Start-ups are lean and lawyers are expensive. This leads to a legal knowledge gap for founders and often a failure to fully consider how the law impacts a founder's business.

Many founders fray from meeting with a lawyer until they view it as absolutely necessary or there is some existential crisis. I see it frequently, where founders wish they met with a lawyer sooner to understand the implications of decisions they made, agreements they signed or risks they took. Decisions which, unwittingly, can materially impact the success of a business.

Starting in 2011, I practiced corporate litigation. I came to realize that many businesses fail or face setbacks as a result of not having completed important legal processes early on. From not entering contracts with third parties and founder disputes tearing a business apart, to government regulators seizing assets and shutting businesses down. In some cases, it was hard to watch.

With an interest in tech, I decided I would pursue a career helping founders build businesses, rather than tear them down. So, in 2013 I started my own corporate law firm and for the last 11 years I've enjoyed working with founders. Their personalities are positive and optimistic, unlike many lawyers (especially litigation lawyers).

Yet, founders often face a blind spot for the law. I realized that part of the lawyer's role becomes not just giving advice and drafting contracts, but educating clients on the legal issues and legal framework around the decisions they make. As I found myself educating clients on common topics, I decided to sit one night and map out a table of contents with all the things a founder will wish they knew about the law when they started.

And so, my motivation in writing this book became filling the legal knowledge gap for Canadian founders. To enable founders to make more calculated decisions about their business and operate from a position of confidence and strength. With the knowledgebase from this book, you will make more informed decisions about protecting your business and stick-handling legal challenges you will undoubtably face.

There are known risks and unknown risks that lurk in the future for every founder. This book intends to shift some of the unknown risks, the ones you might not have even contemplated, and make them known risks for you to navigate on the way to success.

Enjoy.

CHAPTER 1: LIFT OFF

We've all experienced that spark—the brilliant business idea that consumes our thoughts. Maybe it's a new app, a custom GPT, a SaaS platform or a unique online store. It's an exciting feeling. The idea becomes your passion, keeping you up at night as you envision its potential.

Maybe you are bold enough to go one step further, beyond just an idea, to forming a start-up. For many, the start-up decision is about more than a great idea. It's about exercising your creativity and taking joy in building something. It's a decision to escape the 9-5 employment grind and a path to escaping what Tim Ferriss calls the "deferred-life" where people work, slave, save and retire. It's about taking initiative and giving purpose to your day.

I understand the thrill, having launched businesses myself and witnessed my clients' enthusiasm over the years. Yet, I've also seen the sobering moments when doubt creeps in—concerns about viability, money, lawsuits and even your own perseverance.

If your business fails, whether or not you sought legal advice may seem inconsequential. But as success grows, so does the likelihood of legal challenges. Nothing attracts greater legal risk and the threat of lawsuits than a business that sees success.

I've seen it all. Co-founders who walked away popping back up claiming ownership of shares, intellectual property, domain names and other assets. Contractors claiming they were promised equity or a share of profits. Employees claiming they were wrongfully terminated. Regulators wanting to investigate the safety of your product, or compliance with privacy laws. Customers claiming defective products. Investors demanding larger dividends. Competitors trying to cut you off from a supplier or claiming you breached their intellectual property rights. Foreign entities stealing your technology or copyrighted works. Past employees taking your client lists or trade secrets. I could go on and on.

I joke with clients that if your business fails, or you lose the passion and abandon the idea, it may not matter whether you understood the legal framework and mitigated legal risks. But if you believe you are on a path to success, you will wish you stopped for a moment and carefully thought about protecting your business and its assets from the get-go.

In a fast-paced start-up, the opportunity to mitigate legal risks, before they come to fruition, passes by quickly. This book aims to help you take a pause, look at the horizon and pre-emptively address legal issues.

Founders typically aim for one of three outcomes: a profitable exit, building retirement capital, or creating a legacy (i.e. passing a business on to the next generation). To achieve one of those aims, you must not only succeed in business, but also in protecting your start-up from legal risks.

To set your business on a solid path, we'll initially focus on choosing a business name and domain name, with examples of how things can go horribly wrong from the get-go.

From there, the book covers seven main topics:

1. Corporations, since corporations are the main vehicle used by Canadian founders.

2. Negotiating founder and shareholder agreements.
3. Raising capital from investors and issuing shares.
4. Protecting intellectual property rights.
5. Hiring contractors and employees.
6. Special considerations for web-based businesses, like SaaS and e-Commerce companies.
7. Selling your business.

Let’s go.

CHOOSING A BUSINESS NAME: WHY GETTING IT RIGHT IS IMPORTANT

Your trading name is an asset. From a business perspective, many entrepreneurs put a lot of stock in the name. Some believe, that from a branding perspective, your name can make or break your business. Good names are easy to understand yet unique and memorable.

The problem, of course, is that there are not many names left to choose from that are short, catchy, and descriptive which stand out at the same time. This makes finding the right name an often long and tedious project.

While the laws governing trademark and trade name disputes are much more nuanced, the number one rule is simple - don't be a copycat. From a legal perspective, choosing the wrong name can be devastating. Choosing a name that is too similar to an existing name or trademark opens your new business up to the threat of a lawsuit before you even leave the gate.

While the law differs based on jurisdiction, the general rule of thumb is to not pick a name that creates confusion in the marketplace between you and an existing business or trademark.

To avoid selecting a similar name, the first step is the good old Google test. Do a quick Google search to see if existing businesses are listed in Google search results. Google is a good preliminary indicator for whether a name might be confusingly similar to existing businesses or brands. It also helps ensure that when you start competing for that keyword on search results, acceptable results show up. That said, not all businesses have websites and not all businesses have a public facing component to them, so the Google test is by no means determinative.

If you plan on building a business that sells internationally, it's a good idea to consider search results in those jurisdictions as well. Perhaps more importantly, ensure your name does not have a different meaning in other jurisdictions. For example, "Pee Cola" (which means very good cola in Ghana) might be a difficult sell in Canada.

Next, using a tool like ChatGPT is another great way to do a preliminary search for confusingly similar names. As an example, I prompted ChatGPT with:

Prompt:

I want to start a business called "Wires Law", search the Web and see if there are confusingly similar names that already exist.

ChatGPT:

The name "Wires Law" is already in use by an established corporate commercial law firm founded by John Wires. This firm provides legal services to entrepreneurs and businesses across Canada, with a focus on technology, SaaS, and e-commerce clients.

You could even go one step further and do:

Prompt:

Is there a trademark registered in Canada for "Wires Law"? Search the web, including the Canadian Intellectual Property Office website to find out.

ChatGPT:

> The trademark "WIRES LAW" is registered in Canada under Application Number 2041784, as detailed on the Trademark Elite website. The mark is categorized under Class 045 for personal and legal services.

If your name passes the Google and ChatGPT test, use a domain registrar (like GoDaddy) to see if a suitable domain name is not only available, but also not easy to confuse with different domain extensions. For example, if my father wasn't the one who owned http://wires.law as a domain name, I'd consider suing, given I own the "Wires Law" trademark and the .law domain extensions are intended for legal related businesses.

The next step is the CIPO test. CIPO is short for the Canadian Intellectual Property Office, a government entity. CIPO has a public database on their website with a list of all registered trademarks. You can search the database for free to see if the same or confusingly similar names appear in search results.

To highlight the importance of the CIPO search, when I type in "Wires Law" to the search bar, it comes up with more than 10 pages of search results. While there may not be trademarks that have the exact name, it might show other marks that use "Wires" in the title that I may want to consider if I was registering a new business.

Keep in mind that just because there is not an exact match does not give you a free pass to use the name. Speak with a lawyer or trademark agent for an opinion on whether it can be registered given the particular laws, rules and regulations in your jurisdiction. Your lawyer will be impressed, and you'll save him or her time, if you arrive having already done the above searches.

The NUANS Name Search

The final step, at least for Canadian federal and Ontario corporations or businesses is a NUANS name search. A NUANS name search report lists similar existing business names and trademarks registered in Industry Canada's database. The federal and most provincial governments require all new businesses to complete a NUANS name search report as part of registering a new business.

While the search report is intended to show all similar business names and trademarks registered federally and in certain provinces, the search process is subject to a number of flaws. For various reasons, there may still be similar names in existence that are not disclosed in the NUANS report. This makes the Google, ChatGPT, GoDaddy and CIPO searches that much more important.

While it is your job to ensure that the new name does not create confusion with existing names, the Federal government registration agents will often review your NUANS report to determine whether you can register the name. In some cases, the agent will ask you for more information and research about an existing business, asking that you provide evidence as to why a name displayed in the report is not confusingly similar to your chosen name.

That is, in assessing possible confusion, "Corporations Canada looks at all circumstances, including a comparison of the goods, services and operating area of your proposed business with those of existing businesses. While name approval from Corporations Canada does not guarantee that you are not violating the rights of another firm or individual, it reduces your risks."

In Ontario, the registrar often provides less scrutiny, and unless there is a business with the exact same name, typically the Ontario registrar does not question, review or scrutinize the name registration.

In either case, whether forming a Canadian federal or provincial corporation, the fact that the registrar permitted you to proceed with the name should not be seen as an indication you have chosen a name for which you cannot be sued. The NUANS report only shows names and trademarks registered in Canada and does not consider foreign jurisdictions you may want to enter at some stage.

Again, your own due diligence (searching for names outside of the NUANS process) is important to try to ensure you are not choosing a name that is confusingly similar to an existing business.

Distinctiveness

The *Canada Business Corporations Act*, for federal companies, also requires your name to be distinctive from other businesses that carry on the same or similar activities. Your name will not be distinctive if it merely describes your business activities. For example, the name "Coffee Bean Roaster Inc." lacks distinctiveness since it just describes the activities of all coffee roasters.

You can achieve distinctiveness in several ways. One of the most common is to add an element to an otherwise indistinct name. "Jonny W’s Coffee Roasting Inc." for example, is distinctive. New words also give a name distinctiveness. They can be a combination of two dictionary words such as "Infotech" or something completely new. Unusual highly distinctive names are given greater protection because they are unique and more obvious when a competitor chooses to compete with a similar name. Unique names will also likely be easier to trademark.

Consequences of Creating Confusion with Other Names or Trademarks

If your name is too close to an existing corporate name or trademark the owner of that name may commence legal action to force you to stop using your name and even to pay damages for its unlawful use.

One of the types of damages a plaintiff may claim is an accounting of profits. That is, they may seek to recover any profits you made as a result of using the name, along with handing over all marketing materials. This can be devastating for a new company.

Apple's Name Battles

One example of a company running into name issues involves Apple. Apple Corps was established in 1968 and owned several businesses, including a record label. In 1978, when Apple Inc. (formerly Apple Computer, Inc.) was founded, Apple Corps sued the new tech company for trademark infringement due to the similarity of their names and logos. The parties reached a settlement in 1981, with Apple Inc. agreeing to pay an undisclosed sum and to not enter the music business.

However, with the launch of iTunes and the iPod in the early 2000s, Apple Inc. found itself once again embroiled in a legal dispute with Apple Corps. Apple Corps claimed that Apple Inc. had breached the 1981 agreement by entering the music business. In 2006, the courts ruled in favor of Apple Inc., stating that the company had not violated the agreement by producing and selling music-playing devices and software. The judge clarified that the agreement only prevented Apple Inc. from operating a record label or releasing music under the Apple name.

In 2007, the two companies announced another settlement, with Apple Inc. now owning all Apple-related trademarks and licensing some of them back to Apple Corps. The terms of the financial agreement were never disclosed, but the resolution allowed both companies to continue using their respective names and logos without further legal issues.

Given not all companies have the same resources as Apple, this case highlights the importance of thoroughly researching and choosing a unique business name to avoid potential trademark infringement lawsuits and confusion in the market. However, the difficulty in Apple's case was not even knowing that one day, they would enter the music space with their now famous iPod and Apple Music. If you know you have plans to expand your business into different industries, it is worth considering those other industries as part of your naming process, and whether that expansion will impact the calculation as to whether your name is confusingly similar to an existing business name or trademark.

Legal Element

All corporations in Canada are required to add Limited, Incorporated or Corporation, or contractions such as Ltd., Inc. or Corp. to allow people you do business with to identify your business as a corporation.

Section 2 of Ontario's *Business Names Act* prohibits an individual or corporation from carrying on business under any name other than their legal name unless the name is registered under the *Act*. For example, neither John Wires nor John Wires Inc. would be permitted to carry on business as "Wires Plumbing" unless they registered "Wires Plumbing" as a business name under the Act. Failing to register a business name can result in fines and a prohibition from commencing a lawsuit.

CHOOSING A DOMAIN NAME AND NOT GETTING SUED

Choosing a business name that has a suitable domain name was becoming increasingly difficult. There was some relief in 2013 when the Internet Corporation of Assigned Names and Numbers ("ICANN") announced a series of new top-level domains (TLD's). TLD's are the extensions that specify a website type and location; .com or .ca for example.

2014 saw another 1400 TLD's become available; from .venture, .inc, .ltd and .llp to .enterprises, .law and .lawyer. While the new domain name expansion will help businesses find a suitable domain name, there will be growth in name and domain name disputes along with other hurdles for business owners.

It is important to tread cautiously and know the domain name dispute rules to ensure you do not find yourself on the wrong end of a domain name dispute. Contrary to popular belief "cybersquatting" where someone buys and holds domains of an existing business and trademark with the sole intention of selling them for a profit can be unlawful.

For example, The *Anti-cybersquatting Consumer Protection Act* (*ACPA*) was enacted in 1999 in the United States. The *ACPA* specifically addresses the issue of "cybersquatting" and provides legal recourse to trademark owners against individuals or entities who, with a bad faith intent, register, traffic in, or use a domain name that is identical or confusingly similar to a distinctive or famous trademark. The *ACPA* allows trademark owners to seek legal remedies including injunctions, damages, and the transfer or cancellation of domain names that infringe upon their trademarks.

The ACPA has been an important tool used by big brands in the fight against the misuse of trademarks in domain names.

Not just as a result of the *ACPA* but even in Canada, where someone registers a domain name that is confusingly similar to a trademark of an existing business, the trademark holder may have legal remedies. This is particularly the case where it is clear that, (i) the domain holder only registered or acquired the domain to fool people into thinking that the registrant is associated with that business, an act called passing off; or (ii) the domain holder bought the domain for the purpose of selling it to a person who has a legitimate business interest in the name.

What a Gongshow

One example is the Canadian hockey apparel company Gongshow Gear and the disputed domain www.gongshow.com. The domain had lawfully belonged, for more than 10 years, to a blogger whose last name was Gong. In November 2012, the domain was sold in a closed auction, however Gongshow Gear was not invited to bid. Instead, the new purchaser of the domain, an individual located in Dubai, tried to flip the domain and sell it to Gongshow Gear for $18,000.

Instead of paying for the domain, Gongshow filed a complaint with ICANN, the international body that regulates website addresses and won the domain without paying a cent. To do so, Gongshow Gear had to prove three main items under the ICANN rules at the time:

1. That the domain was confusingly similar to Gongshow's trademark;
2. That the current owner of the name does not have a legitimate interest in it (i.e. he or she is cybersquatting); and

3. The owner is using the domain in bad faith.

Gongshow, who had been building their brand in Canada and around the world for the previous 11 years was successful on each point.

While there may be separate causes of action that parties may be able to bring in various courts around the world, often the most effective route is an arbitration proceeding, which may be available depending on the type of TLD domain (for example, a .com or a .ca domain). For a .com domain, dispute resolution may be available under the Uniform Domain-Name Dispute Resolution Policy (UDRP) an arm of ICANN. The Canadian Internet Registration Authority ("CIRA") has its own Domain Name Dispute Resolution Policy for .ca domains. Both ICANN and CIRA use a private dispute resolution setting where disputes are usually carried out in writing and resolved by one or more arbitrators.

Who Registered and Owns your Domain Name?

It is also important to ensure you know who is registering the domain name and who has ownership of it. Only as recently as 2011 did the Ontario Courts confirm that domain names are property in the eyes of the law (*Tucows v. Renner*). As property, domain names can be owned by any legal entity. An interesting issue arises under most hosting providers terms of use as to who owns or who can claim ownership of the domain name.

With many start-ups, the domain name is registered in the personal name of one of the co-founders. This can cause a number of problems, particularly where there is a co-founder dispute and the registrant of the domain leaves the business.

Take the Ontario dispute in *Mold.ca Inc. v. Moldservices.ca* argued by my friend John Simpson. In that case, two co-founders ran a mold inspection and removal business, with co-founder 1 being responsible for start-up costs and managing the business and co-founder 2 being responsible for operations, including the registration of the website. Co-founder 2 purchased a number of domain names for the business, using the company credit card, but putting his own name down as the registrant.

When co-founder 2 left the business about a year later, he took the registrations and passwords with him. Unfortunately for co-founder 1, the CIRA dispute resolution proceedings, to have the domain names transferred from co-founder 2, to the company were unsuccessful on the grounds there was no evidence the domain names had been registered in bad faith by co-founder 2, or that they were being used illegitimately.

While the domains were ultimately recovered by the operating company in (expensive) court proceedings, the lesson learnt is to consider if the operating company should be the entity that actually owns (and registers) the domains and website, and not an individual associated with the business, who one day may part ways. If the company is not the registrant, careful thought should be given to who owns it, and what rights the company has to use the domain name.

ABOUT THE AUTHOR

John Wires is a Canadian corporate lawyer. In 2013 he opened his own corporate law firm (Wires Law) offering legal services to founders, investors, and businesses across Canada.

John advises companies, founders and shareholders of software enterprises, app developers, e-commerce retailers and platforms, consulting firms and digital media companies. John's clients and their executives answer to boards of directors and shareholders, hire and fire employees, negotiate and sign contracts, invent new products, license technologies, raise capital and deal with a host of legal issues every day.

John helps clients reduce legal risks in their daily decision making and in the agreements they enter. His services range from setting up and protecting businesses to closing M&A transactions for clients selling their businesses. As a former website builder, John has a passion for technology always playing with the latest tech to see how it can integrate into the practice of law.

John was an advisor to the National Crowdfunding Association ("NCFA"), a not-for-profit working hard to promote crowdfunding as a means for Canadian businesses to access capital. He has been covered in the Globe and Mail, Toronto Star, CBC News, TechVibes and the Canadian Bar Association's National Magazine on Crowdfunding in Canada. He has also been a guest lecturer at Ryerson University and Communitech. He is a former NCAA Division I and OHL hockey player.