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JUNE 2017

Letter from the Editors

Dear Readers,

I was recently reminded of the twin issues of Artificial Intelligence (AI) and cyber security when I re-watched the classic movie *War Games*. As many of you are aware, arguably the two hottest sectors in the VC world today are Artificial Intelligence (AI) and cyber security. We seem to have hit an inflection point where AI (also known as machine learning) seems to be making almost every business model more efficient. Further, anyone who spends time in front of a computer is well aware of the daily hacking and phishing threats. No wonder the quest for creating new machine learning applications and new cyber security risk management tools is happening at a torrid pace.

What was amazing about watching *War Games* is that a movie made in 1983 was so prescient about the benefits and pitfalls of AI and cyber security. For those who haven't seen it (and if you haven't, you should), the movie follows a young Mathew Broderick as an earnest teenage computer hacker who finds a "back door" into the NORAD computer systems that provide war game scenarios and also control the launch and defense of America's nuclear weapons. A hacking session by our hero and a security flaw almost turns into an Armageddon-like nightmare. But with human guile and wisdom, our hero is ultimately able to provide the guidance to the AI computer system to save the world from nuclear destruction (all while winning the girl's affection and showing the so-called "grown-ups" how to act better). Pretty good stuff. But what we learn from this movie is that while machine learning will enable us to perform many tasks more efficiently, our computers still need human guidance and oversight. How we adapt to the use of these incredible tools we are creating will shape our lives in the future.

The current edition of *TechConnect* includes an article relating to investing in hot secondary securities and an article on some of the pitfalls in our "gig economy" under New York law when hiring independent contractors. We also highlight a very cool young company called Kinnos, which is raising the standard of infectious disease decontamination to protect healthcare workers, patients, and the general public.

As always, we welcome your questions and inquiries, and we invite all of you to visit our website for emerging companies and entrepreneurs @www.mintzedge.com

Sincerely yours,

Dan + Sam

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Seniority Matters

BY DANIEL DEWOLF

There is little doubt that activity in the trading of secondary shares of private companies remains robust. Private companies are staying private longer and there seems to be an unlimited demand to buy into the newest "Unicorn" anointed each week. As the market for secondary shares stays strong, valuations seem not to matter much to most buyers. Additionally, many buyers seem to pay little attention to whether they are buying senior preferred stock at the top of the stack, as compared to junior securities, or common stock sold by many former employees. But as we all know, things that can't go on forever, don't. And, as Warren Buffet once famously said: only when the tide goes out do you discover who has been swimming naked.

At some point a number of these Unicorns will become Unicorpses. We have seen this multiple times in various sectors where once high flying companies run out of money. And, when these companies are forced to sell (often in order to survive), where a stockholder stands in the stack is of critical importance.

In a sale of a company, after the payment of deal expenses and any carve out for management, the senior preferred stockholders receive their money back first. After holders of the senior preferred get paid, then holders of the junior preferred are paid. Lastly, the residual proceeds, if any, are paid to the common shareholders. In many sale situations, particularly if a sale is the only alternative to survival, the common shareholder walks away with zero. The closer you are to the top of the stack, the more likely you will at least receive your money back. The closer you are to common, the greater the chance you will receive back less than your basis.

In an era where investors are making wild bets on companies that often lack meaningful profit margins or even meaningful revenues, and are doing so relatively blindly without receiving the normal financial information generally available to investors in the public markets, it really does matter that you are as close to the top of the equity stack as possible. For when the market turns just a little bit south, as it inevitably will, you really don't want to be the one swimming naked.

The Gig Economy, Independent Contractors, and New York Law

BY KAITLIN FOX

The gig economy (on-demand work) is a disruptive factor in many industries, including the housing market (Airbnb, Homeaway), transportation services (Uber, Lyft, Juno, Via), delivery services (Postmates, Caviar, Instacart), and beauty services (Glamsquad, The Glam App). Time Magazine conducted a study which revealed that more than 90 million U.S. adults have participated in the gig economy, with at least 45 million U.S. adults earning income as a provider of such goods or services.

Creating a business in the gig economy is advantageous for startups because when they are able to classify their workers as independent contractors, the startups can avoid paying benefits, such as sick days, health insurance, pensions, and vacation time. The startups also will not be mandated to pay payroll taxes, unemployment insurance, workers' compensation, and disability. Startups, however, need to carefully classify their workers as misclassification can lead to investigations, penalties, and lawsuits, which are becoming increasingly common. Additionally, misclassifying workers can eventually require a restructuring of a startup's business model.

Startups in New York need to be especially careful because New York is aggressive in investigating and identifying independent contractor misclassification. In July 2016, Governor Andrew Cuomo signed an executive order that established a permanent joint task force to fight worker exploitation and employee misclassification. If a company misclassifies its workers, it will be subject to huge penalties: fines by the IRS, U.S. Department of Labor, and state agencies can exceed millions. Startups can be penalized for (1) failing to pay overtime and minimum wage, (2) failing to withhold state or federal payroll taxes, (3) failing to comply with I-9 requirements, (4) failing to pay fees to the state unemployment insurance funds, (5) violating worker's compensation laws, and (6) not providing benefits.

There are basic benefits that employees receive that independent contractors typically don't have the luxury of receiving, including being paid in a reasonable time. That, however, changed in New York City when Mayor de Blasio signed the Freelance Isn't Free Act (FIFA) in November 2016. One of the biggest aspects of FIFA is that an independent contractor can be awarded double damages for failure to be paid for services on a timely basis. Under FIFA, startups and independent contractors need to have a written agreement with specific terms, including a list of services to be provided, the rate and method of compensation, the value of services to be provided, and a payment for services date (or, if no date is specified, it is mandated to be within 30 days of completion of services).

The New York State Department of Labor defined factors that will help companies determine if their workers are employees or independent contractors. The factors include whether workers are free from supervision, direction, and control. Unfortunately, there is no "magic combination" for ensuring the factors will weigh in favor of the workers being classified as independent contractors.

The amount of supervision, direction, and control varies from company to company – and even within a company – and is one of the reasons there is no exact test. For example, on the one hand, Uber sets the fee per mile that drivers can earn and Uber can disable drivers' access to the software for getting low customer ratings. On the other hand, however, drivers can turn the application on and off whenever it is convenient for them. In an ongoing lawsuit between Swift Transportation Company and its workers, the workers insist they are employees partly because Swift controlled every aspect of their schedules, including where and how the workers delivered their cargo and which routes the workers had to use.

Whether workers provide their own tools and/or if they are reimbursed for business expenses should also be taken into account in the determination. Many gig economy startups run on an app, so owning a smart phone is required to participate. While Uber insists its drivers are independent contractors, Uber works with cell phone providers to offer discounts on its drivers' monthly phone bills that can be extended to their immediate families. That is a benefit that is often offered to employees at companies where using a phone is necessary to perform the work. This is another example of how grey the classification of workers can be.

The relationship between startup and worker is not defined by what they call their relationship; it can only be defined by evaluating the level of supervision, direction, and control exercised by the startup. While there is no perfect classification structure, startups have likely misclassified employees as independent contractors if there is (1) more than minimal training for their workers,

(2) a requirement that their workers perform contract work only for them, and (3) excessive control over how their workers perform the services.

If you are a startup in New York and are using or want to use independent contractors, you should contact your legal counsel to ensure you are in compliance with the laws.

Innovator Profile: Kinnos, Inc.

Kinnos Inc. is a New York-based company that is raising the standard of infectious disease decontamination to protect healthcare workers, patients, and the general public. Their first product, Highlight®, is an additive for disinfectants that eliminates human error and allows even untrained end-users, such as healthcare workers, housekeeping staff, and biosafety personnel, to immediately use disinfectants effectively.

The company began in 2014 in response to the Ebola crisis in West Africa, where healthcare workers were being infected at high rates. The three co-founders, Jason Kang, Katherine Jin, and Kevin Tyan, were juniors at Columbia University when the school held a design challenge to develop low cost solutions for the outbreak. A major problem during the Ebola crisis was improper decontamination – despite disinfectants like bleach demonstrating efficacy against Ebola and other pathogens in the laboratory, they often are not used effectively in practice.

The problem is that current disinfectants are transparent, making it difficult to see where they have been applied. They bead up and roll off waterproof surfaces, leaving gaps in coverage, and they provide no indication when a pathogen has been killed, with end-users not waiting long enough to allow the disinfectant to inactivate the pathogen. Such human error and a lack of compliance means that surfaces are often not fully decontaminated, leading to infection. Improper decontamination goes beyond just Ebola, spanning from norovirus outbreaks in nursing homes to bacterial infections in hospitals. According to the Center for Disease Control and Prevention, one out of every 25 patients will contract a healthcare-associated infection, leading to 75,000 deaths and over $28 billion dollars lost in the U.S. healthcare system annually.

Highlight® is a patent-pending point-of-use additive that directly addresses these issues by colorizing the disinfectant, creating a film and adhering to waterproof surfaces, and fading in color to provide visual feedback of when decontamination is complete (video here). Highlight® empowers healthcare workers, patients, and the general public to be confident in their safety by enforcing real-time quality control and real-time compliance. The color-fading is synchronized with the contact time of a disinfectant to kill a pathogen, so healthcare workers can intuitively see that a surface has been fully disinfected based on the color change. Because it's just an additive for existing disinfectants, it can be readily implemented without the need for new equipment, training, or changes in protocol.

In February 2017, Kinnos announced the closing of a $1 million seed round funding. The seed financing was led by Georgica Advisors, with participation from New York Angels, VentureWell, and other strategic angel investors. The funds will be utilized to build out the Highlight® product platform and allow it to be implemented in multiple healthcare settings.

"Although we first started working on Highlight® in response to the Ebola crisis in West Africa, it has become increasingly clear that infection prevention is a top priority for medical organizations around the world," said Kang, CEO of Kinnos.

Highlight® is used by the Fire Department of New York's HazMat unit, was one of only 12 grantees of the USAID Fighting Ebola Challenge out of over 2,000 international applications, and has been field-tested in Liberia, Guinea, and Haiti for the Ebola and cholera outbreaks. Ongoing trials and planned pilots include work with organizations such as International Medical Corps, Doctors Without Borders, NewYork - Presbyterian Hospital, and Cleveland VA Medical Center. Kinnos has been featured by the Wall Street Journal, Scientific American, PBS NewsHour, and as one of *Forbes*' "30 Under 30" in Healthcare.

Industry Update: SEC's Piwowar Warns 'SAFE' Investments Carry Risks

BY TOM ZANKI

Originally published in *Law360* (May 9, 2017, 6:38 PM EDT)

U.S. Securities and Exchange Commission member Michael Piwowar on Tuesday urged investors to be wary of the pitfalls of so-called SAFE investments — a sophisticated financing instrument for startup companies — that are increasingly being marketed to the broader retail investing public.

Piwowar said that SAFE investments — which stands for "simple agreement for future equity" — have been used in some equity crowdfunding offerings that are sold to mostly retail investors even though such investors are likely not well acquainted with this kind of investment.

A SAFE is an agreement in which the company promises to give an investor a future equity stake in that company assuming certain triggering events occur, such as a future financing round or an initial public offering. SAFE investments have been used in recent years to provide startup financing for venture-backed companies, which tend to be supported by sophisticated investors.

Speaking to state regulators, Piwowar noted that an investor only receives an equity stake in a SAFE offering if specific terms of that security are met. Plus, terms vary from offering to offering, he said.

"In short, despite its name, a so-called SAFE is neither "simple" nor "safe,'" Piwowar said in a conference with the National Securities Administrators Association in Washington, D.C.

Piwowar said the SEC's Office of Investor Education and Advocacy will release an investor bulletin this week describing SAFE instruments. SAFEs have been compared to convertible note offerings except they don't involve debt, pay no interest or dividends, and do not offer voting rights.

The idea behind SAFEs developed in Silicon Valley as a way for venture capitalists to quickly buy future stakes in hot companies without burdening the startup with intense negotiations that equity offerings typically entail. Piwowar said the details of SAFEs, from trigger events to conversion terms, are designed to help startups secure future capital from sophisticated venture investors.

Equity crowdfunding, by contrast, is intended to enable mom-and-pop-type enterprises to raise capital from small investors — often social media followers and other fans of a particular business — who may not be as savvy as Silicon Valley institutions.

Plus, with crowdfunding, Piwowar noted that intermediaries are responsible for educating investors and explaining risks associated with the securities being sold. But explaining SAFEs can be difficult for those intermediaries, the Republican commissioner suggested.

"Intermediaries face a real challenge in educating potential investors about this high-risk, complex and nonstandard security when the security itself is entitled 'SAFE,'" Piwowar said. "Companies and their intermediaries should think carefully about how they name or describe their securities. Securities marketed as 'safe' or 'simple' ought to be just that."

SAFEs are considered risky largely because they provide no assurance of return, unlike a convertible bond that pays the holder interest. An academic study published last year by the Virginia Law Review Online described a SAFE as essentially "a contractual derivative instrument that amounts to a deferred equity investment" whose value can only be realized in the event of a future financing round, sale or IPO.

Piwowar, who filled in as acting chairman before new chairman Jay Clayton was confirmed last week, began several initiatives aimed at easing capital raising during his interim tenure earlier this year. The commissioner said Tuesday he directed SEC staff to begin work on amending certain rules designed to assure auditor independence but, according to Piwowar, don't achieve their purpose and instead create "unnecessary compliance issues" for entities like mutual funds.

Piwowar targeted the "loan provision" rule that deems an auditor not to be independent if that auditor has received a loan from its audit-client. The rule also includes lending relationships between auditors and entities holding more than 10 percent of the audit-client's securities.

Piwowar said that threshold is triggered even in situations where a lender may not be able to assert any influence over the shares it owns, such as instances where the lender holds securities as a custodian or an omnibus account holder for its customers without beneficial ownership.

"More critically, these situations may not have any effect on an auditor's objectivity and impartiality, because the lender does not have significant influence over the audit client," Piwowar said. "Yet these compliance challenges threaten to disrupt the operation of the asset management industry, which is relied upon to manage and invest trillions of dollars of investors' retirement savings."

June 15: Boston Tech Jam 2017
June 22: Xconomy IMPACT: Innovation That Matters
June 27: Boston Innovators Group: Voice Computing (#BIGVoice)
July 17: TechCrunch Sessions: Robotics
July 22: The Women in Tech Summit – Boston 2017

San Francisco
June 5-7: Spark Summit 2017
June 6: TechCrunch Sessions: Justice
June 12: HBaseCon West 2017
June 12-14: Pure Accelerate 2017
June 21: San Francisco Internapalooza
June 27-28: VR Connects Conference
June 29: Female Founders Conference 2017
July 11-12: Mobile Beat 2017
July 25-26: Wearable Technologies Conference 2017

San Diego
June 14: Re-BUILD Roadshow 2017 – San Diego
June 17: Geek Girl Tech Conference 2017
June 19-22: Registration of Interest: Midlands Engine market visit to BIO 2017
June 19-23: San Diego Startup Week 2017
June 29: AITP-SD's 8th Annual Cloud Computing Conference

Washington, DC
June 8: Startupalooza DC + Capital Raising Workshop
June 12-15: Gartner Security and Risk Management Summit
June 13: Women and Innovation – the Perfect Match
June 28-30: .NEXT 2017
July 9-13: Microsoft Inspire
July 17-19: AnDevCon
July 25-26: Startup Spectacular 2017

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