



# How to Start & Run Your Own Firm

## OPERATIONAL HANDOUT

### Creating and Maintaining a Professional Practice

Starting your own firm is a challenge; structuring it to survive is a formidable task. Architects contemplating starting their own professional practices as well as those who have created their firms recently need to know the practical, professional, ethical, legal, and insurance issues that a new firm faces.

Few architects contemplating creating their own firms have an education or practice experience in the business, legal and insurance issues of practice. Many, in fact, are unsure about considerations such as what constitutes professional integrity and client satisfaction.

Architects who want to make the transition to running their own firms must recognize and analyze the advantages and disadvantages of independent practice before taking the significant step of starting a firm. They must be able to identify the keys to client relations and ethical practice. With sensitivity, business acumen, professional skill, and sufficient planning, the architect starting a firm will be able to pursue personal and professional goals while managing risks routinely and profitably.

### Addressing Initial Concerns

Creating a business takes planning, but *deciding* to create one takes faith. A professional must have faith that the new firm will offer a unique value to the marketplace for professional services. And the professional must have faith both in his or her professional qualifications and business management skills.

**Determining When to Start a Firm** There is no perfect time to start a firm, but there may be a time when starting a firm is appropriate from a business/professional point of view. The entrepreneurial professional must be self-motivated and disciplined, a responsible leader and organizer, capable of making decisions, healthy, and energetic. Reasons often cited for creating a new firm include the following:

- The ability to realize goals and follow interests
- A desire to balance or integrate personal and professional life
- The need for a direct relationship between effort and reward
- Professional drive for greater control over design
- A goal of working with specific colleagues
- A realization that a firm can be a solid preparation for bad times

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Wanting to create a firm is not enough. Writing down a focused business plan that reflects your expectations and including with it a realistic estimate of the first-year revenues and expenses is essential to planning. Formulating an internally consistent statement of goals and conducting an objective analysis of professional and business strengths and weaknesses provide further guidance.

**Funding the Creation and Conduct of a Firm** Start-up capital is crucial for any new firm to cover initial expenses and the cost of funding operations until a sufficient cash flow to sustain operations has been established. No two new firms are exactly alike, but most find it necessary to have enough cash to cover three to six months of operating costs, plus the amount needed to cover organizational expenses. Putting aside at least \$50,000 and establishing a source of contingency funding for future years is realistic.

Organizational expenses to be considered include office space and leasehold improvements, furniture, computer equipment and software, printed materials, marketing materials, and office supplies. Operations expenses will be incurred for such things as salaries, benefits, rent and related occupancy costs, insurance, taxes, travel, copies, internet access and telephone service. A worst-case contingency fund for use in case cash flow disappears is also essential.

Sources for initial capital include personal savings, loans backed by equity in personal real estate; loans from friends and relatives, personal credit cards, governmental loans and commercial bank loans. Banks are reluctant to loan money to new firms since they don't want to be investors. Therefore it is realistic that at least personal assets must cover half of the start-up cost.

Few professionals have an understanding of the underlying issues related to operating a business in a particular profession. The first lesson all must learn is that cash flow is essential to survival.

**Understanding Legal Considerations** It is necessary to figure out the best way to organize your business to protect your personal assets and how to structure a sound financial system so the business can operate at a minimal effort. Paying for expert legal and accounting advice is usually a good investment. State laws and the impact of registration law requirements vary from state to state, so firms must properly organize to be able to practice and collect professional service fees. New firms must identify the best way to be structured for initial operations and growth. And they must understand the legal and taxation requirements for organizing business and financial records.

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## Setting Up a Practice

**Preserving Ethical Conduct to Former Employers** Previous employers can be the undoing of a new firm. Often this is because the employer is unhappy with the way in which a new firm “took” from the old firm. While the taking can involve equipment and supplies, usually the concern is over credit or clients. The founder of a new firm can take credit only for the work that he or she actually did. Be sure to cite a previous employer on every project on which you participated as an employee. And do not steal clients. You cannot interfere with your former employer’s contracts, but you are, of course, free to inform clients that you are planning to start your own practice. Other conditions may apply if you sign a non-compete agreement.

**Gaining Access to Clients** Facing the decisions necessary to start a firm and establishing the business structure and financial operations are relatively easy. While essential, such steps do not result in success. Fundamentally, firms need clients and for those clients to pay their bills. In many cases the best source of clients is past firms. Former employers are often willing to provide advice and support, including references, and in some cases referrals, if, of course, you left the firm in a professional manner.

**Starting the Business Development Process** It is important that any new firm understands the concepts of marketing and branding. A new firm must communicate its reputation and value immediately. That means organizing your marketing workflow and keeping all marketing materials updated and ready to use. It also means developing the right kind of network. You can capture attention by knowing who the right contacts are for your business, knowing what is “press-worthy,” knowing how to write an effective news release, and understanding media protocol. The more you can get published or be quoted, the greater your value seems to prospective clients. Generating a brand can be helped along with these methods:

- Have an “elevator” speech: be ready to explain your skills and value in the one minute it takes for an elevator to reach the penthouse.
- Be a community presence: get involved in organizations so that others can see your skills.
- Attend events that will put you in touch with your clients rather than with your professional peers.
- Establish relationships with media contacts from the beginning.
- Differentiate yourself and match your strengths to the client’s needs.

## Operating a New Practice

**Meeting Professional Standards and Business Requirements** Keep in mind that owning a firm means constant and consistent attention to both the professional and business details

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of a practice. Creating a rewarding work experience and operating profitably and with stability is only possible if you are skilled at the following:

- Obtaining projects within your skill range
- Negotiating reasonable and fair contracts
- Designing and detailing at an acceptable level of quality
- Producing timely and adequate construction documents
- Working with contractors and installers as a professional
- Maintaining amicable relationships with clients
- Hiring, training and retaining qualified staff

Surviving the time and skill demands of practice is one of the most challenging aspects of starting a firm. The likelihood of survival increases when a new firm establishes practice management systems that are responsive and reasonable. Obviously it is necessary to address issues such as negotiating the scope, time, and compensation for services, the scheduling of design and production, and responding to project delivery variations while all the time emphasizing quality.

**Keeping Track of Finances and Other Risks** Establishing a financial tracking system is imperative. Set up information so invoicing is simple and payments for services and reimbursables can be easily monitored. Regular invoicing is a must; most firms bill biweekly or monthly. Monitoring payments, which should be due immediately upon receipt, is essential. Keeping communications open with the people who pay is probably the best way to prevent a late payment—or a decision to withhold payment—that can disrupt a new firm's critical cash flow.

Design skills alone do not keep a business alive. Recognizing the impact of contract law and tort law on daily operations is basic to any professional practice. This means developing effective risk management attitudes and procedures. While a new firm's biggest risk is that it will not be paid, managing risk includes recognizing professional liability exposures and determining insurance requirements for the business.

## **Surviving as a Business Entity**

Many architects find that surviving the perils of creating their own professional practice does not mean long-term prosperity or professional achievement. Managing a professional practice can be frustrating, time-consuming, and financially draining. It can also be rewarding by allowing an architect to determine the parameters of success, including professional, financial, and emotional accomplishments.

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All firms have to meet acceptable standards of professional performance including creativity, timely services, and adequate documentation. But even a firm with exceptional professional qualifications can have its survival threatened. Unfortunately, when a new professional practice is created, there is no “owner’s manual” that discusses the many details of practice and the ever-changing challenges faced in managing a firm. Essentially each firm has to create its specific “owner’s manual” to guide it through the difficulties of running a business based on providing professional services.

There are many legal and business issues faced by every established firm. These topics include the following:

- Legally pursuing new clients and projects
- Maintaining professional integrity and a reputation of value
- Negotiating reasonable professional service agreements
- Billing and collecting fees and reimbursables
- Establishing productive interprofessional and client relationships
- Structuring for growth and eventual ownership transfer
- Facing professional liability, employment liability, and other business risks
- Evaluating financial performance using standard industry measurements.

Few architects are sufficiently educated in the skills set required for running a firm. Those that pick up skills while working in other firms rarely acquire an adequate understanding of the many legal and risk management issues in running a professional practice. No one provides an “owner’s manual” to a practitioner crafting a new firm, but there are sources of information that can help an owner create the body of knowledge necessary to guide the successful conduct of a practice. One of the most valuable sources is the sharing of practice experience by others who have faced the many challenges to the survival of an architecture firm.

**Establishing Operational Methodologies** Firms operate differently depending on the conditions of their markets. The differences are most prominent in firms that directly provide services, to the ultimate client and those that provide services through interprofessional arrangements. Most firms do not want to be “lower tier” providers of services where they are separated from decision makers and from direct payment for services. Some, however, see the interprofessional relationship as shielding them from the many problems of working directly with clients and from disputes and claims.

Regardless of the client base, all firms must emphasize quality. Services must be consistent with client expectations—whether the client or another professional or construction firm is the ultimate user—and professional values. Quality produces a reputation that is essential

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for competitiveness. While the implementation, review, and control of quality may be delegated throughout a firm, it is both the right and responsibility of the firm owner to establish the level that must be achieved. An emphasis on an appropriate level of quality must be applied in design, in documentation, in construction, and in service.

**Legal Considerations in Running a Firm** A professional practice is a business and its owners must understand the legal ramifications of running a business. It makes sense for a firm to seek professional advice on any action that involves setting up an organizational structure or modifying the legal basis of the practice. Assistance is necessary on legal options and the firm's decision-making structure, on the initial contributions of capital and methods for the distribution of profits and losses, and on any changes in ownership such as a departure of an owner or a modification of the firm's structure because of retirement, death, disability, or a decision to dissolve the firm.

**Marketing and Management Issues** It is up to the firm's ownership to provide leadership in both management and marketing. Owners provide the inspiration, direction, and motivation for the firm and organize individuals and groups effectively to pursue the vision that guides the firm. A professional practice must be managed so that it produces a profit. The profit must be sufficient to ensure firm continuity and provide a return to its owners at whatever level they deem appropriate for their effort and risk, and that they are capable of producing. In most markets, prospective clients buy from owners, who are responsible for fulfilling client expectations regarding the execution of projects. Satisfied clients generate future revenues.

**Billing and Collecting Fees and Reimbursables** Capital needs and sources are important for the creation of a firm. Owners must understand issues of cash flow and cash projections. Capital is necessary for growth that cannot be funded from profitable operations. Capital is vital to support the increasing need for more sophisticated technology. Additional capital needs are frequently met with bank loans in the form of lines of credit. For these and for other loans such as in the financing of equipment, owners usually assume the responsibility and risk on a personal as well as business basis.

The core of financial management is knowing costs, revenues, and their proper balance. While the easiest way to increase the profit margin is to reduce overhead—and low overhead can be a competitive advantage—a firm without a clear understanding of its overhead factors may cut overhead in a way that jeopardizes the future of the firm. But while knowing the financial ratios by which a firm can analyze and control its operations is vital, it is critical to understand the cash cycle.

Firms that understand the need for cash find ways of making sure it flows properly. Most successful firms operate on somebody else's money. They immediately get a retainer that is usually applied to final payment. Providing services is a business arrangement—getting

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money up front is a prudent business practice. Firms that extend credit rather than receive cash for services endanger their operations. Many firms invoice monthly with payment due within 10 days of receipt. Others bill even more often. Most make it clear that payment is due when specified services are rendered. Because a firm is selling its professional expertise, they suspend services if payment is not received.

Often, as their only bargaining chip, firms hold their instruments of service or their responsiveness to required statements or certifications. Some personalize the payment process by demanding payment in person whenever a meeting is scheduled. While every firm faces situations where it may “write off” part of a fee, some have not simply allowed a client to breach its agreement to pay. In some cases, firms have gone as far as issuing a 1099 to a client for unpaid fees forcing the client to pay taxes on the amount of the earned but unpaid fee for the consultant’s services.

There are many ways to set up billing and collection systems, and there is sufficient advice on how to use communications or the control of services to pursue payment. Even simple accounting systems can include reminders to contact delinquent clients, but often, personal contact and intervention by the owner is required. Every firm should have in its “owner’s manual” procedures to make sure the cash keeps flowing.

**Contract Negotiation** Good contracts and careful negotiation are important to reduce vulnerability. Contracts are guides to the management of services. They include clear provisions addressing scope, compensation and risk. In negotiating contracts, architects manage their exposures and establish the financial success of their own practices. Although there can be significant differences in both the content of contracts and the negotiation techniques used in developing agreements with clients and other design professionals, all have to be carefully crafted and consistently used to direct performance. As firm owners become more experienced, they increase their ability to identify the value of appropriate contract language on professional satisfaction and prosperity.

## **Managing Risks and Profitability**

When a new firm is created, its creator decides to take on the risks of a new venture. Risks do not disappear when a firm has survived its initial period. Often the need to address a firm’s exposure to loss intensifies. Managing risks leads to the management of profitability. Avoiding risks can mean avoiding the opportunity for success but ignoring risks can mean financial failure.

Risk taking moves the firm forward. Firms need to explore new opportunities—new clients, new project types, new technologies—that may expose the firm and its owners to risks that

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are discomfoting. The continuation of a firm involves a specific “risk attitude” that should be based on the owner’s understanding of the many exposures a professional practice faces. Capitalizing on opportunities require making choices and those choices have attendant risks.

Survival also depends on preventing or resolving disputes. All firms have them eventually. They can range from a claim from a dissatisfied client or an injured project user to allegations by disgruntled employees. Facing the realities of professional liability, employment liability, and other professional and business risks takes knowledge and commitment. Too often firms fail after a successful start because they did not identify, evaluate, and manage their exposures. As a firm develops, insurance coverage becomes vital to protecting the investment in the firm and the personal assets of its owners. Working with an experienced independent insurance broker who understands the needs of a professional practice is a prudent way of addressing many of the risks to a continuing practice.

A new firm is exciting, exhausting, and exacting. Architects who want to run their own professional practices must not only have the ability to design but also the ability to manage business and personal challenges.

In an ever-changing competitive environment no professional service firm can ever claim final success. Owning a professional practice is a journey—the business form is the vehicle. And the “owner’s manual” must be developed by every operator.

## Firm Formation and Legal Issues

*PLEASE NOTE: The material in this paper is designed to inform readers generally about various legal and professional practice topics. Readers are cautioned to use this paper as an informational guide only. Determinations concerning particular legal matters or the application of the law to particular factual situations should not be made solely upon information contained in this paper. Consult your attorney or other appropriate professional advisor before applying or acting upon anything contained in or suggested by this paper.*

### BASIC BUSINESS STRUCTURES

#### Sole Proprietorship

- The business is owned by one person, but with any number of employees.
- The owner has complete control over, and responsibility for all management decisions; is personally liable for all business debts; is personally liable for his/her own wrongful acts or omissions, as well as for those of employees, if made in the course of their employment.
- The owner is taxed personally on the net income of the business.

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- The business dies when the owner dies.

## General Partnership

- “An association of two or more people to carry on a business for profit as co-owners.”
- The partnership may be established through either oral or written agreement.
- Generally, each partner has an equal input into management decisions.
- Each partner is personally responsible for his/her own wrongful acts or omissions, as well as for those of all other partners and employees, if made in the course of their employment.
- Partners can agree to indemnify one another with respect to partnership liabilities.
- Each partner is personally taxed on his/her share of net partnership income, but the partnership must also file an informational tax return.
- The partnership dissolves upon the withdrawal, retirement or death of any partner, unless the partnership agreement provides otherwise.

## Joint Venture

- A joint venture is essentially a partnership, except that it generally anticipates and intends a limited scope and duration of business activities.

## Limited Partnership

- A limited partnership has characteristics of both a general partnership and a corporation.
- General partners manage the entity and are responsible for it, much like partners in a general partnership.
- Limited partners are like shareholders in a corporation: they contribute capital and share in profits, but losses are limited to the amount invested and they do not participate in management of the entity.

## Limited Liability Partnerships or Companies

- Subject to the specific laws of each state, these hybrids are essentially partnerships operating as corporations. A hybrid between a partnership and a corporation.
- An alternative to S Corp status, allowing limited liability with no double taxation. An S Corp may only have 75 shareholders, so this is particularly attractive to firms which might have, but for size, chosen S Corp status. An LLC can be organized to be very flexible in terms of structure and operations to suit individual needs or desires.

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- The “limited liability” refers to the ability to insulate “innocent principals” from the negligence of other principals. They rarely limit the business risks of the firm nor do they limit the professional liability risks of the negligent principal.

## **Corporation**

- A corporation is a legal entity separate and distinct from its owners and managers.
- Once properly established, the corporation is responsible for its own debts and obligations.
- Shareholders (owners) are not personally liable for the corporation's debts. They stand to lose their investment, but not more.
- A corporation may exist in perpetuity, regardless of the comings and goings of the shareholders and the management.
- Owners (shareholders) must approve of all fundamental changes in the corporation. They elect a Board of Directors. The Board of Directors is ultimately responsible for the management of the corporation. They elect the Officers.
- The Officers conduct the day-to-day affairs of the corporation.
- If the corporation earns a net profit, it generally must pay it out to shareholders proportionally as a *dividend* on each share. The corporation is taxed on its profit and then shareholders are taxed on their dividend income. This “double” tax may be avoided by electing “S Corp.” status, if possible, where income can be passed directly to shareholders, where it is taxed once and only once.
- A professional corporation is like a regular business corporation, except that all shareholders must be licensed to practice the profession that the corporation will practice.

## **BASIC CONTRACT LAW**

A contract is “a promise that the law will enforce.”

**ELEMENTS** REQUIRED TO MAKE A CONTRACT ARE:

- **Mutual assent**
  - Mutual assent is manifest through an offer and acceptance.

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- Offers must be accepted exactly as offered. If modified terms are proposed, that becomes a counteroffer.
- Unless otherwise specified, an offer may be withdrawn any time prior to acceptance.
- **Consideration**
  - Consideration is “the price, motive or benefit that induces the parties to contract” and is a bargained-for exchange of something of legal value. Commercial value is normally irrelevant with respect to valid consideration. For example, one dollar is legal consideration for the sale of a house.
  - Some contracts may be “under seal.” In Massachusetts, for example, a contract “under seal” is presumed to have proper consideration. Such contracts in Massachusetts also have a 20-year statute of limitations (vs. the normal 6 years).
- **Legal capacity to contract**
  - A person is incapable if:
    - Under age (18 or 21, depending on the state),
    - Drunk (or unable to understand the action being taken),
    - Mentally ill,
    - Under legal guardianship.
  - Corporations may not be empowered or licensed to sign contracts for specific types of work or services.
- **A legally permissible objective**
  - A contract that requires one or both parties to perform one or more illegal acts is unenforceable.

**“Statute of Frauds”** requires that some contracts be in writing to be enforceable. For example, a contract for sale of an interest in real estate must be in writing or it is voidable at the option of the party to be charged. Similarly, states may require that other specific types of contracts be in writing. California, for instance, requires that all contracts for architectural services be in writing.

**Modifications** to contracts require new consideration.

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**Breach of contract** occurs when there is substantial failure by a party to perform contractually defined duties or obligations, thereby causing the other party to suffer loss or injury.

- *Defenses* include:
  - Failure to comply with the statute of frauds,
  - Duress,
  - Mistake,
  - Unconscionability,
  - Misrepresentation,
  - Impossibility,
  - Impracticability,
  - Statute of limitations.
- *Remedies* include:
  - A monetary award,
  - Specific performance of the contract requirements,
  - An injunction (a court order for a party to stop, or refrain from stopping, some activity).

All parties are under a legal duty to **mitigate** their damages in the event of breach of contract by the other party.

Contracts may be **assigned**. An assignment transfers one party's rights under a contract to a third party (not originally a contracting party). Generally, an assignment does not discharge the original party's obligations under the contract. It is rare that a professional service contract is permitted to be assigned by the professional since the client's expressed desire is to have the professional perform the services. In addition, client contracts may prevent the right of the design professional to payment to be assigned to another party.

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The ***Uniform Commercial Code*** (UCC) is a model law governing commercial transactions. It has been enacted virtually intact in all states except Louisiana. Article 2 covers the sale, by a merchant, of goods worth \$500 or more. Construction contracts involve both services and sale of goods, but because services predominate, the UCC does not apply to most general construction contracts.

***Warranties*** are a type of contract. They are assurances of the quality or performance of a product or work, or of the duration of satisfactory performance. Professional service contracts are based on the standard of care for the professional services and not on the warranty of results or any guarantee of services.

## BASIC TORT LAW

***Negligence*** is a tort

*Elements* are:

- Existence of a duty (look to the contract and licensing laws in particular),
- Substandard performance in response to that duty (generally, measured by whether or not the performance met the professional standard of care: as well as could reasonably be expected of other similarly situated professionals),
- Damages,
- Proof that the substandard performance was the actual and legal (proximate) cause of the damages.

*Defenses* include:

- Statute of limitations/statute of repose.
- Immunity.

*Remedies* for damages caused by negligence include:

- Compensatory damages (to compensate for the loss),
- Consequential damages (for costs resulting indirectly from the negligent acts or omissions),
- Punitive damages (to punish past wrongful behavior and to deter such behavior in the future).

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## ***Intentional Torts***

*Intentional misrepresentation* occurs when someone:

- States a material fact (not an opinion),
- That he/she knows is false,
- To induce another party to rely on such false statement,
- The other party actually does rely on the statement, to his/her detriment.

*Defamation* occurs when written or spoken language tends to hold another up to scorn and ridicule in the eyes of a substantial number of respectable people in the community.

- If written: libel.
- If spoken: slander.

## ***Interference with Contractual and Business Relationships***

### ***Strict liability***

Liability without fault and generally applies only to abnormally dangerous or hazardous activities.

### ***Vicarious Liability***

- This occurs when one person or entity is held legally responsible for the acts or omissions of another person or entity because of the relationship between them: e.g., employer/employee.
- The party held responsible may be entitled to *indemnity* from the other party. Indemnity is the right to be held harmless.

### ***Joint and Several Liability***

- When two or more individuals or entities:
- Act in concert to injure another, or
- Act independently, but their actions cause a single, indivisible injury, they are *joint tortfeasors*.
- The injured party is entitled to recover the full amount of its damages from either or *both* joint tortfeasors, in any ratio, up to the total amount due.

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- If one joint tortfeasor pays more than its fair share of the damages, it may be entitled to *contribution* from the other joint tortfeasor.

## BASIC INTELLECTUAL PROPERTY LAW

### **Copyrights**

- Last for the life of the creator/author plus 70 years. For “works made for hire,” 95 years from first publication or 120 years from creation, whichever is shorter.
- Do not protect the *idea*, but rather the *form of expression* of the idea.
- The five exclusive rights of copyright holder are to:
  - Reproduce the copyrighted work,
  - Create derivative works based on the copyrighted work,
  - Distribute copies of the work to the public,
  - Perform the work for the public,
  - Display the copyrighted work.
- The author obtains copyright protection as soon as an idea is set forth in a tangible medium. A copyright notice should be placed on works before they are published (i.e., released to the public).
- Notice is no longer required for a copyright to be valid, but does constitute notice of a copyright. It should contain:
  - The word “copyright,” the abbreviation “Copr.” or the symbol ©.
  - The year the work was first published,
  - The name of the copyright holder.
- A copyright may be registered with the Register of Copyrights at the US Copyright Office, Washington, DC. Registration is a pre-requisite to suit for infringement.
- A “work made for hire” is one produced within the scope of one’s employment. The employer, not the employee (creator), owns the copyright.
- Penalties for infringement may include: lost profits, attorneys’ fees, and, perhaps, an injunction prohibiting further use.

### **Trademarks**

- A word, name, symbol, device, or any combination thereof which manufacturers and service providers use to identify their goods and services and distinguish them from

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others.

- Once registered, the trademark owner has nationwide protection.
- Distinguish from a trade name, which is the name selected for a business or corporation. In time, after use, a trade name may become a trademark (e.g., Xerox is both the trade name and the trademark of the corporation).

## Patents

- A grant from the US Government to an inventor giving the exclusive right to make, use, or sell an invention in the United States, for 14 or 17 years, depending on the type of patent.
- Protects the ownership of the basic idea underlying the invention.
- Architectural designs are generally not patentable, though construction methods or devices may be.

## Trade Secrets

- Most businesses have information that they do not want to make known to the public.
- If the information has business value and the business takes precautions to keep the information secret, it is a trade secret.
- Generally must involve a substantial element of secrecy, such that it would be very difficult to discover without the use of improper means.
- Trade secrets are generally treated as the personal property of the owner. Thus, a business may attribute value to its trade secrets.