

Agenda

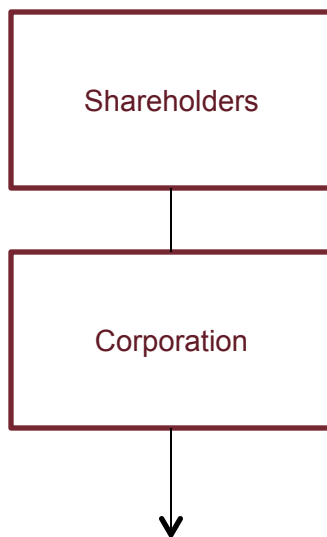
- Choosing entities and limiting liability
- Founder arrangements
- Importance of contracts
 - Non-Disclosure Agreements
- Approaches to intellectual property
- Employment/Consulting Matters
- Regulatory matters
 - Formation and raising capital
- Questions and Answer – but don't wait

Choice of Entity Choices

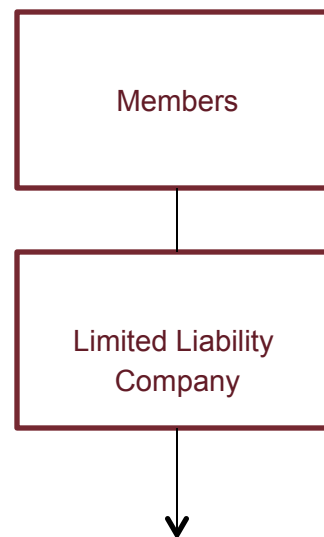
- C Corporation*
 - S Corporation
 - Limited Liability Company*
 - Sole Proprietorship
 - Partnership
 - Limited Partnership
 - Benefit Corporation/ B Corp
- * Denotes most likely entity choice



Corporate Structure v. LLC Structure



Managed by Directors/Officers



Managed by Managers or Members

Choice of Entity

There is no one answer for all companies
“It depends...”



Limit personal liability

- Form an entity
- Adhere to formalities-“piercing the corporate veil”
- Avoid personal guarantees



Personal liability chart

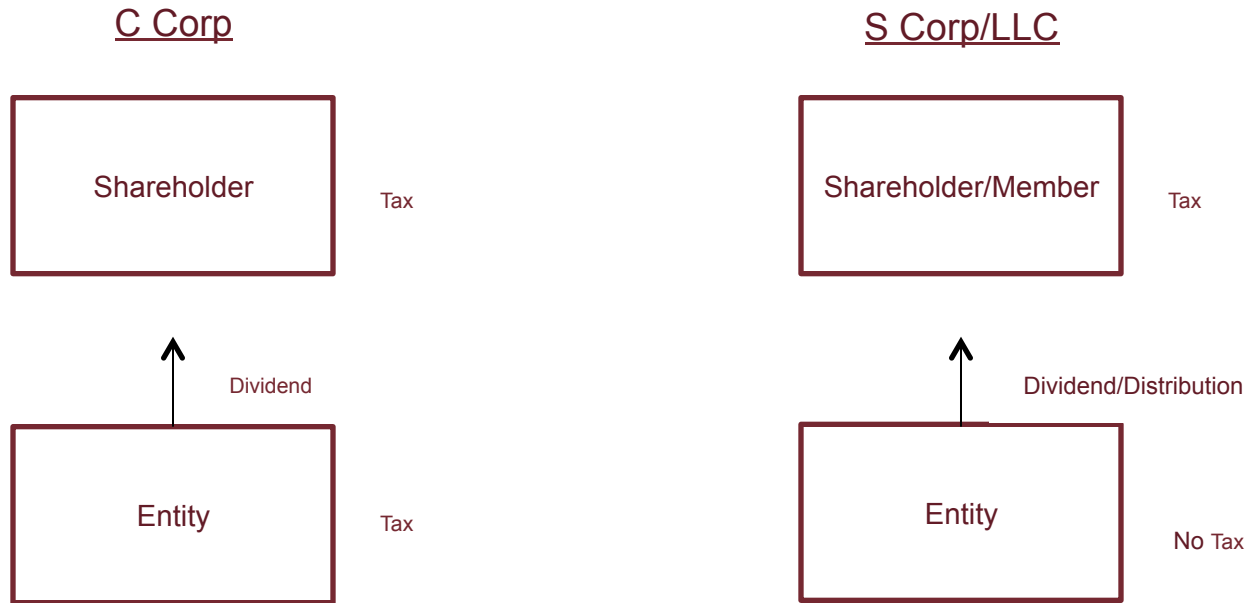
Entity	Limited Liability
Corporation	Favorable
Limited liability company	Favorable
Partnership	Unfavorable
Limited partnership	Mixed
Sole proprietorship	Unfavorable

Tax – Why you should care!

- Double Taxation (C Corporation)
 - Corporate
 - Individual
- Significance
 - Material cash distributions/dividends
 - Sale of the Company



Illustration of Double Tax



Example of Double Tax on Sale of Assets

	<u>C Corp</u>	<u>S Corp/LLC</u>
Income	\$100	\$100
Corporate Tax	\$ 21	\$ 0
After-Tax Entity Income	\$ 79	\$100
Individual Tax -	\$ 16	\$ 20
Individual After-Tax Cash	\$ 63	\$ 80

Assumed Tax Rates

21% corporate

20% capital gain

Point: Single Layer of tax is better – LLC's, S Corporations



More reasons to care about tax

- Section 1202 – Qualified Small Business (benefit for C Corporations)
 - **100%** exclusion from capital gains
 - 5 year minimum holding period
 - Excluded businesses: professional service businesses; real estate companies; financial services businesses
 - Maximum: \$10 million exclusion per shareholder
 - Grants as income
 - Impact on personal tax returns

Other Considerations in Deciding Entity

- Investor Favorable (C-Corporations)
- Availability of Losses (LLC/S Corps)
- IPO Favorable (C-Corporations)
- Ease of use (e.g., option pools) (corporations)
- Relative ease of switching from LLC to C-Corporations



Bottom Line of Entity Choice



- No simple answer
- “Life-style company” or significant dividends/distributions—consider S Corporation or LLC
- Venture-capital oriented
 - Lean toward a C Corporation
- If model is build/sell after 5 years, consider C Corp
- If not sure, start at LLC and convert to C Corp

Limit corporate liability

- Contractual limitations
 - Cap liability
 - Limit liability for consequential damages
- Insurance

Name of Entity

- Check availability
- Quick trademark search
- Quick “Google” search

Caution: The name of the entity can be changed – don’t overthink it!!!

*What’s in a
Name?*

State of Formation

- Taxation
- Predictability
- Cost
- Attractive to capital
- In general
 - (a) “Fancy capital structure” or “Venture capital”-
Delaware
 - (b) Otherwise-PA

Founders Rules of Engagement – Agreement with the Entity and Among Owners

- Formation
 - Certificate of Formation/Incorporation
 - Bylaws
 - Shareholder Agreement or Operating Agreement
- Restricted Equity Agreement
- Employment/Consulting Agreement

Founder Employment/Consulting Arrangements

- Role of Founder going forward
- Compensation
- Intellectual Property Assignments—critical (discussed below)
- Restrictive Covenants (discussed below)
- Severance

Founder Equity Arrangements— How much?

- Lessons Learned
 - Keep in mind the inevitable dilution
 - Keep it simple (i.e., Avoid fancy formulas)
 - Err on the side of incenting those who are providing value going forward
 - Even splits are not usually the right answer
 - Beware of the dreaded “50/50”
 - Shot-gun
 - Third party director
 - Arbitration

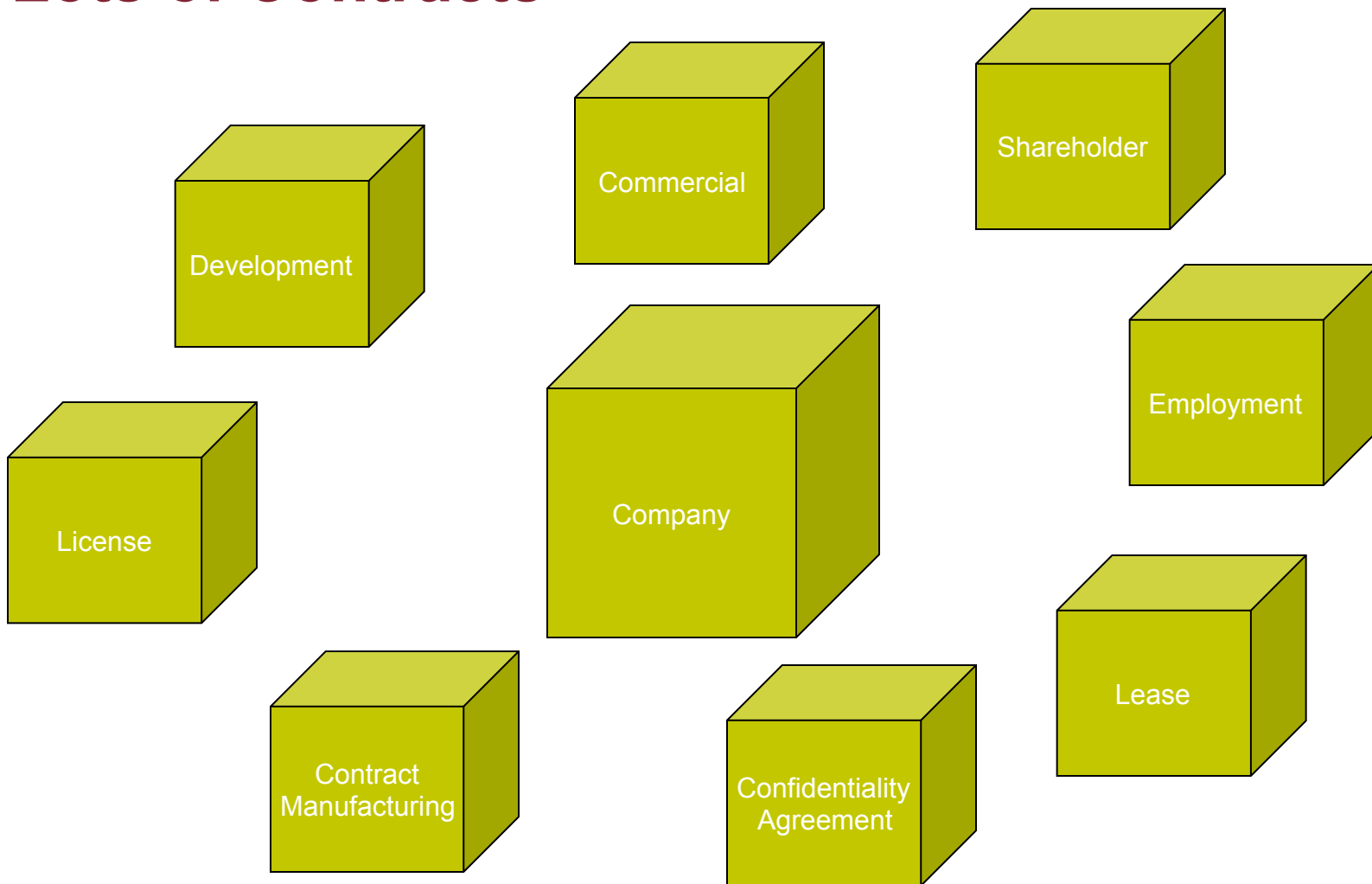
Founder Arrangements

- Vesting Arrangements
 - Amount of vested stock
 - Length of time of vesting
 - Buy-back arrangements
 - Effect of termination and/or sale of company
- Decision-Making/Management
 - Who decides who decides?
 - Directors/Managers
 - Officers
- Restrictions on Transfer
 - Absolute prohibition or Company consent
 - Rights of first refusal

Contracts - What not to do!



Lots of Contracts



Beware of Oral Contracts

- Oral contracts are enforceable – with limited exceptions (Statute of Frauds). Exceptions include:
- Promises to marry
 - Suretyships/guarantees
 - Sale of land
 - Agreements that can't be performed within 1 year
 - Contracts for the sale of goods valued in excess of \$500 (note: course of conduct exception)

Beware of Oral Contracts (cont.)

Examples of contracts that are not exceptions: 

- Employment Agreements and the terms
- Equity arrangements (promises to give equity)
- Investment agreements
- Short-term debt instruments
- Licenses or promises to license

Importance of Clarity for Start-ups

Start-ups cannot afford ambiguity

- They need the performance (e.g., employment)
- They can't afford litigation
 - Legal fees
 - Distraction
- Ambiguity during dispute
 - Cloud on title
 - What are the rules
- Potential liability



Formation- Clarity of Obligations

Who is doing what and when? →

- Employment Agreements – Role and compensation
- Vesting of options – When and how much?
- Lease – What premises and when? Who is constructing the premises and when?
- Convertible debt – When will it convert into equity, how much equity and into what equity?
- License – What technology is being licensed? Improvements?

DON'T LEAVE THIS TO THE LAWYERS!!!

Failure of performance

- Remedies
 - Termination (out-license)
 - Damages (e.g., failure to manufacture)
 - Injunctive relief/specific performance (e.g., reseller)



Dispute Resolution (continued)

- Where does the fight occur?
 - Venue
 - Forum
 - Arbitration v. Court
 - 1 arbitrator v. 3 arbitrators
- Governing Law
- Who pays for the fight?
- What happens during the fight?



Non-Disclosure Agreements (cont.)

Key concerns for start-up company: →

- Importance of having NDA's
- Definition of Confidential Information
- Term of Confidentiality (note: trade secrets)
- Remedies/cost of enforcement
- Alleged possession/use of third party Confidential information – Bilateral



Non-Disclosure Agreements (cont.)

Key lessons for start-up company:

- Don't rely on confidentiality agreement
- Stage disclosure
- Obtain NDA's (Remember third parties)
- Beware of NDA's for third party information
- Pay attention to the term of the agreement
- Consider remedies (collection of legal fees, etc.)



The Big Three Intellectual Property Questions

1. Does the start-up own its intellectual property?
2. Does the start-up infringe on a third party's intellectual property?
3. What is the start-up doing to protect its intellectual property?

Why bother?



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Roadblocks

- Previous intellectual property assignments
 - Agreements
 - Policies
- Non-competition/non-solicitation
- Confidentiality agreements
- Fiduciary duties



Intellectual Property Assignments

Why are they necessary?

- Current
- Prospective

Employee v. Independent Contractor

Post-employment

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Intellectual Property Protection

- Patents
 - Copyrights
 - Trade secrets
 - Trademarks
-
- Keys: **Develop a Plan**



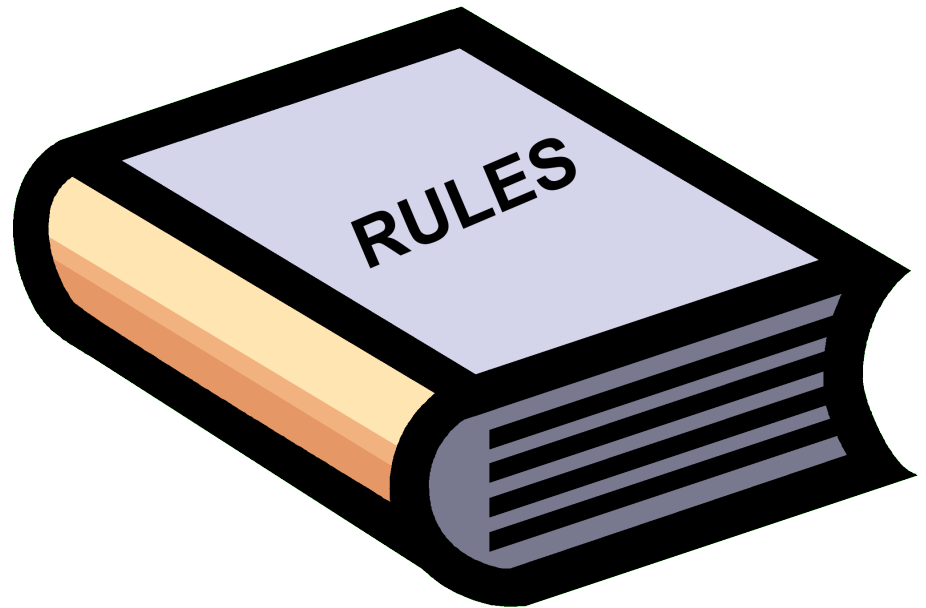
Employment/Consulting Arrangements

- Importance of writing
- Term or at-will
- Intellectual Property Assignments—critical
- Restrictive Covenants
 - Confidentiality – no limitation
 - Non-compete
 - Non-solicit (employees and customers)



Non-Competition Obligations

- Length of time
- Substantive scope
- Geographic scope
- Consideration
- Reasonableness



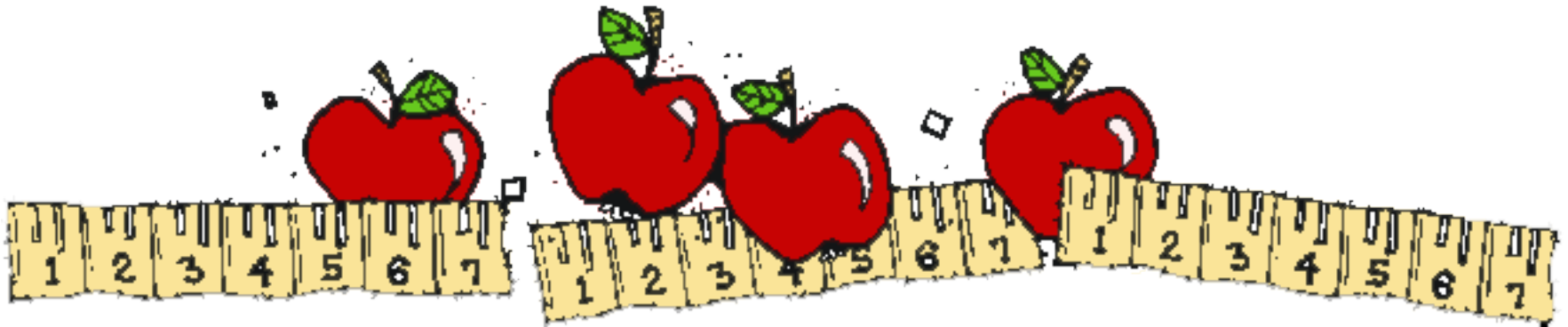
Equity Arrangements - Vesting

- Amount of stock subject to vesting
- Vesting arrangements
 - Time – Based
 - Performance - Based
- Buy-back arrangements
 - Unvested stock
 - Vested stock
- Effect of termination and/or sale of company

Consider Regulatory Implications of Business

- Federal, State and Local
- Licenses and permits (consider Uber)
 - These can be assets if handled correctly

Know the Rules



Sales of securities are regulated

- Different levels
 - Federal
 - States
- Exemptions from registration are available, BUT there are requirements
 - Limitations on means of sale – general solicitations
 - Limitations on purchasers (accredited v. non-accredited)
- Filing for Federal and State

Caution on raising capital:

- Talk to a lawyer before:
 - Advertising in any manner (including websites)
 - Taking any money from third parties

