

Legal Issues from Startup Through Series A

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Part 1

Formation & Founders' Matters



1: Incorporation

- **Choice of entity**
 - **Why does this matter?**
 - **Taxation issues**
 - **Transfer of ownership**
 - **Capital requirements/exits**



1: Incorporation, cont.

- **Corporation**
 - Limited liability for stockholders
 - Ease of transfer of ownership
 - 2 levels of taxation
- **Limited liability company**
 - Limited liability for members
 - Flow-through taxation (1 level)
 - Conversion likely required prior to venture financing
- **S-corporation alternative**
 - Requirements: corporation meeting IRS tests
 - 75 or fewer stockholders
 - Individuals/estates - no non-resident aliens
 - One class of stock as to liquidation
 - Results: Flow-through taxation (1 level)

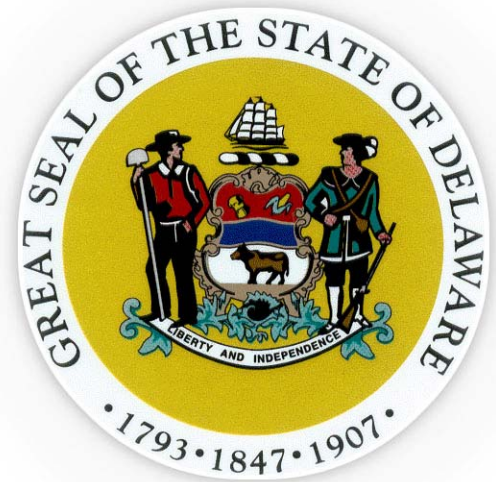
Basic decision:

Corporation vs. Limited Liability Company



1: Incorporation, cont.

- **State of Domicile = Delaware**
 - Developed case law
 - Business-like attitude
 - Sophisticated Business Courts
 - Ease of governance



1: Corporate Governance

Stockholders

- Owners of the Corporation
- Do not participate in the general management of the company
- Elect directors and approve other extraordinary events (e.g., sale, merger, charter amendments)

Directors

- Elected by the stockholders
- Have a fiduciary duty to the Corporation and the stockholders
- Oversee management of the Corporation; approval required of most major decisions

Officers

- Manage the day-to-day running of the company
- Appointed by the Directors



1: Founders as Stockholders

- Allocation of ownership
- Vesting and acceleration
 - Founder expectations
 - VC expectations
 - “Pigs get *Fat*...”
- Assignment of IP
- Right of First Refusal
- Drag Along?



1: Founders as Directors

- **Board of Directors**
 - **Preference for odd numbers**
 - **Independent (from Founders) Director**
 - **Industry expertise and/or network**
 - **Indemnification: Charter, contract and insurance**



1: Founders as Officers

- **Allocation of responsibility**
- **Corporate officers**
 - **President*, Treasurer, Secretary***
- **Operating officers**
 - **Chief Executive Officer**
 - **Chief Technology Officer**
 - **Chief Financial Officer**



1: Founders as Investors

- **Debt vs. Equity**
- **Sweat Equity vs. Cash**
 - **Sweat equity = common stock**
 - **Cash = preferred stock**
- **Terms**



Part 2

Building the Team



2: Personnel

■ Employees and Consultants

- Importance of agreements
 - Offer letter
 - Employee IP agreements
 - Consulting agreements
- Protect IP and confidential information
 - Non-disclosure
 - Non-solicitation
 - Non-compete
- Document the parties' expectations

■ Board of Advisors

- Outside Directors vs. Advisors
- Compensation typically = equity



2: Equity Compensation

- **Importance of a plan**
 - Budget equity awards for next 12-18 months
- **Key terms: award size, vesting, acceleration**
 - Typically 10-25% “reserved”
 - “Standard” vesting: 4 year period, 1 year cliff
 - Acceleration: single trigger, double trigger
- **Pricing?**



Part 3

Building the IP Portfolio



3: IP Portfolio

- **What is intellectual property?**
 - Intangible creations of the mind protected by legal rights. Namely:
 - Trade Secrets, Copyrights, Patents and Trademarks
- **Why does it matter?**
 - Create barriers to entry
 - Creates competitive advantage, resulting in better access to capital

Intellectual property is the core of all technology companies. It is often the only valuable asset a young company owns and the only thing that can protect against larger competitors.



3: IP Portfolio

- **Typical sources of IP**
- **Assignment**
 - **Founders**
 - **Employees**
 - **Consultants**
- **In-License**



3: Trade Secrets

- **Business or technical information**
- **Derives actual or potential value from:**
 - Not being generally known
 - Not being readily ascertainable
- **Includes: formulas, patterns, programs, methods, techniques, compilations. Examples:**
 - Project launch dates for new products
 - Marketing plans
 - Computer programs
 - Negotiated price lists in a contract
 - Customer lists



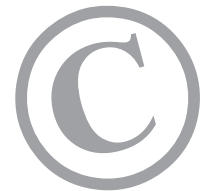
3: Trade Secrets, Cont.

- **Indefinite (so long as secrecy is maintained & steps taken to preserve secrecy)**
- **Affirmative steps**
 - **Identify; put employees on notice**
 - **Confidentiality agreements**
 - **Restricted access (secure facility; computer passwords; etc.)**
 - **Exit interviews**



3: Copyrights

- **Original** works of authorship
- **Fixed** in a **tangible medium** of expression
- Perceived, reproduced or otherwise communicated
- Directly or with use of a machine
- Includes:
 - Text (books, magazines, brochures, software code)
 - Performing arts
 - Visual arts
 - Sound recordings
- **But Not:** idea, concept, process, lists



3: Copyrights, Cont.

- **Exclusive rights to do or authorize:**
 - **Reproduction**
 - **Prepare derivative works**
 - **Distribute or sell copies**
 - **Perform or display (as appropriate to the work)**
- **Accrues from point fixed in tangible medium**
- **Registration**



3: Patents

- **Patentable Subject Matter: Any new and useful . . .**
 - **Process**
 - **Article of Manufacture**
 - **Composition of matter**
 - **Machine**
 - **Improvements**
- **Requirements:**
 - **Useful, novel, non-obvious**
- **Patent grants the right to exclude others from making, using, selling the claimed invention**



3: Trademarks

- **Word, name, symbol or device that is used to identify and distinguish the goods or services of one person from the goods or services of others**
- **Identifies goods or services coming from a particular source**
- **Prevents unfair competition or business practices**



3: Trademarks, Cont.

- **Examples:**

- **Word**
- **Logo**
- **Sound**
- **Color**



- **Rights arise from use in commerce (right to prevent others from using same or confusingly similar mark)**
- **Register with federal government**

Part 4

Beg, Borrow and Steal *“Friends & Family Round”*



4: Sources of Equity Capital

- **Seed Funding (“FFF”)**
 - High Net Worth Individuals
 - Less sophisticated on terms and value
 - Search for “bell cows”
 - Less “value-added”
 - Terms offered by company rather than investors
- **Other sources of Equity Capital**
 - Angel Funds
 - Corporate Investment



4: Friends and Family Rounds

- **Debt**
 - Key terms: interest rate, maturity date, security interest
 - But, probably won't survive a venture financing
- **Convertible Debt**
 - Postpones the Valuation Discussion
 - Key terms: Maturity and conversion
 - "Sweeteners:" warrants and/or discounts on conversion
- **Equity**
 - Requires a Valuation of the Company
 - Typically issue a "watered down" Preferred Stock
 - Anticipate VC concerns



Questions?

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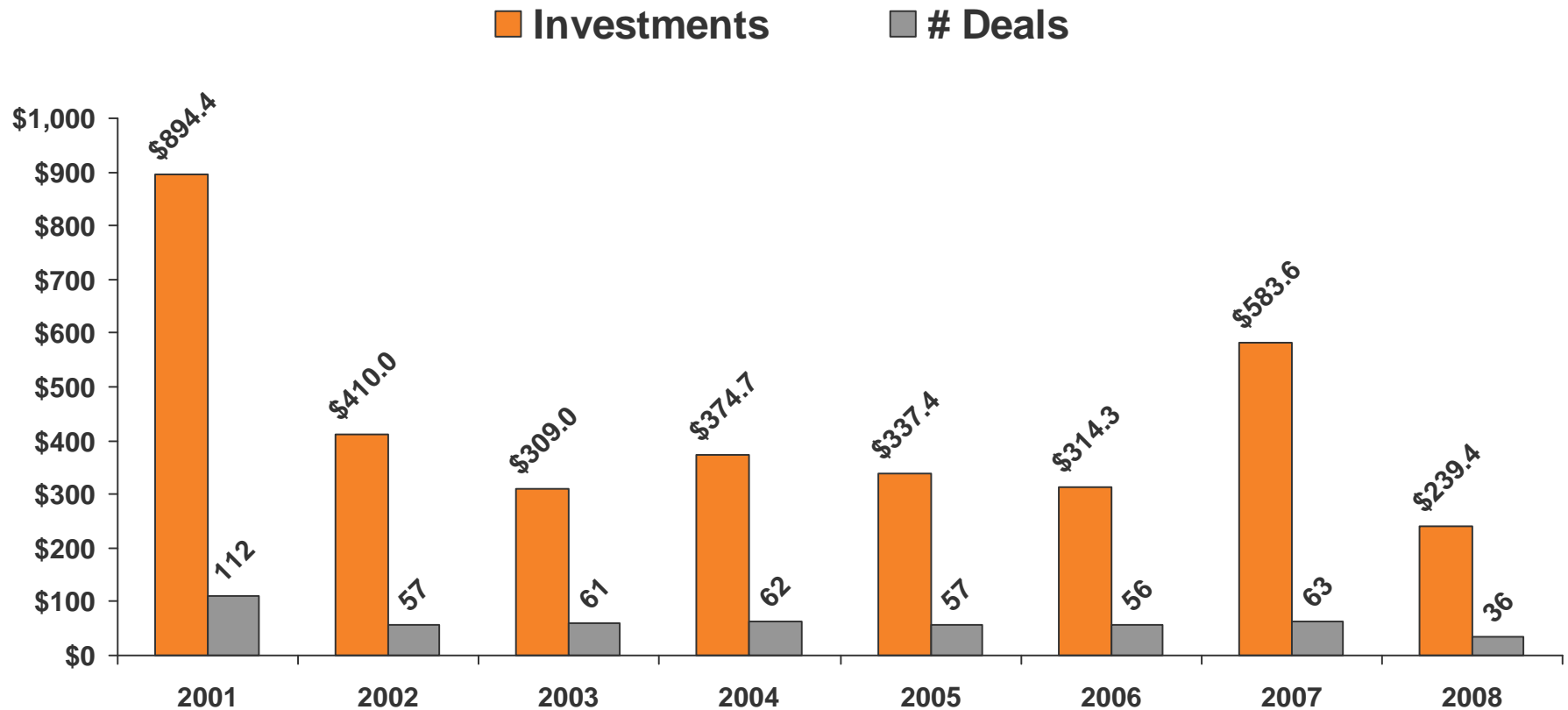
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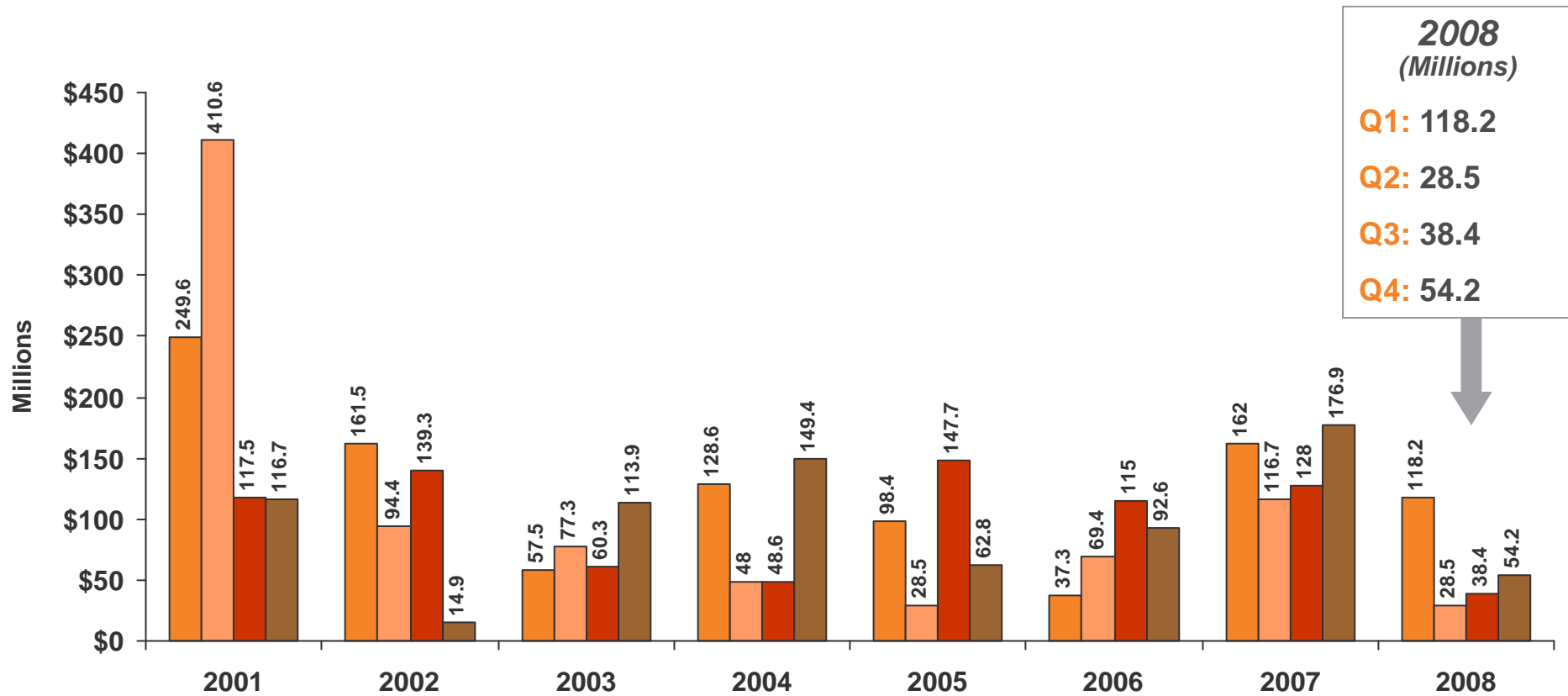
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MoneyTree Total FL Investments/Deals 2001 – 2008

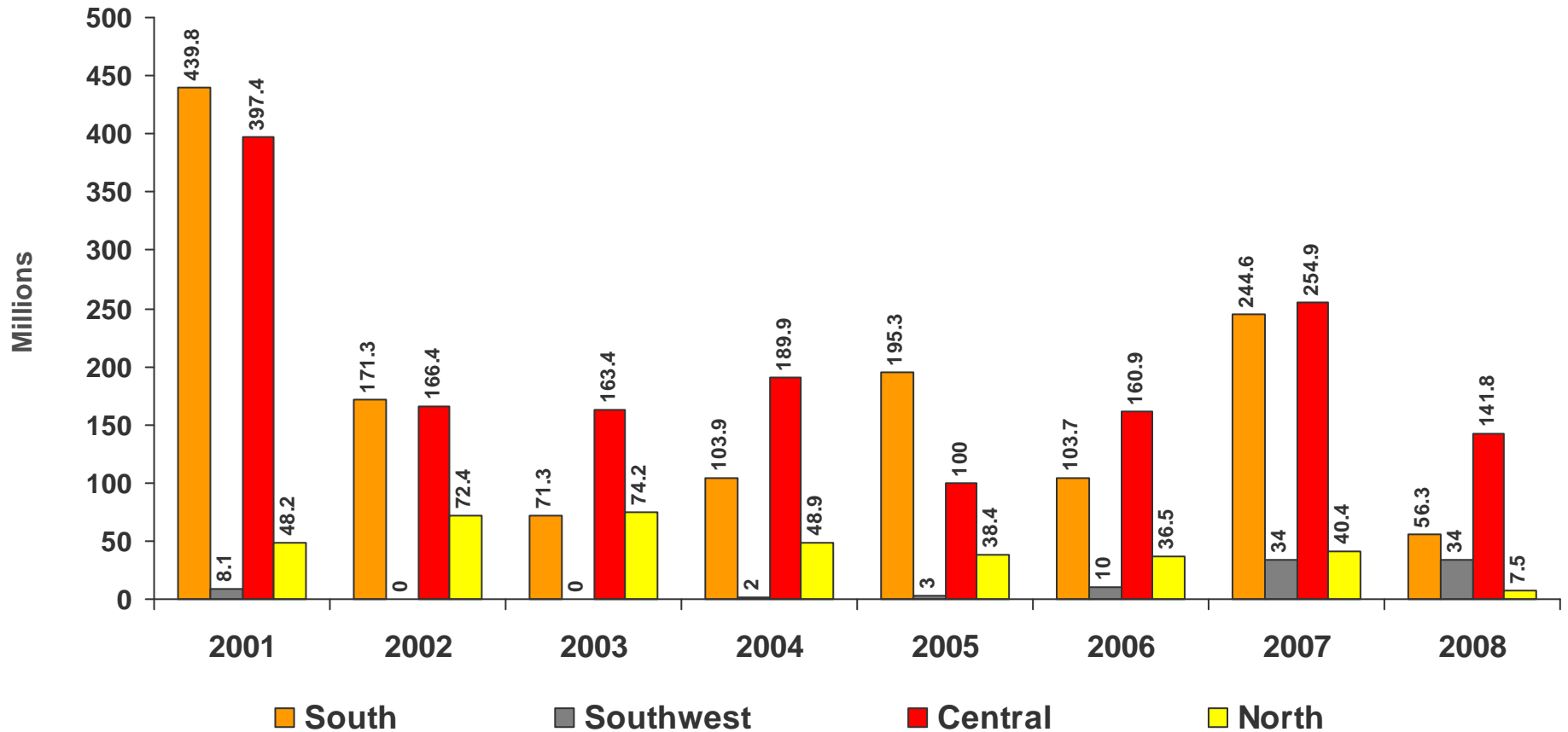


MoneyTree Total Investments, FL 2001 – 2008



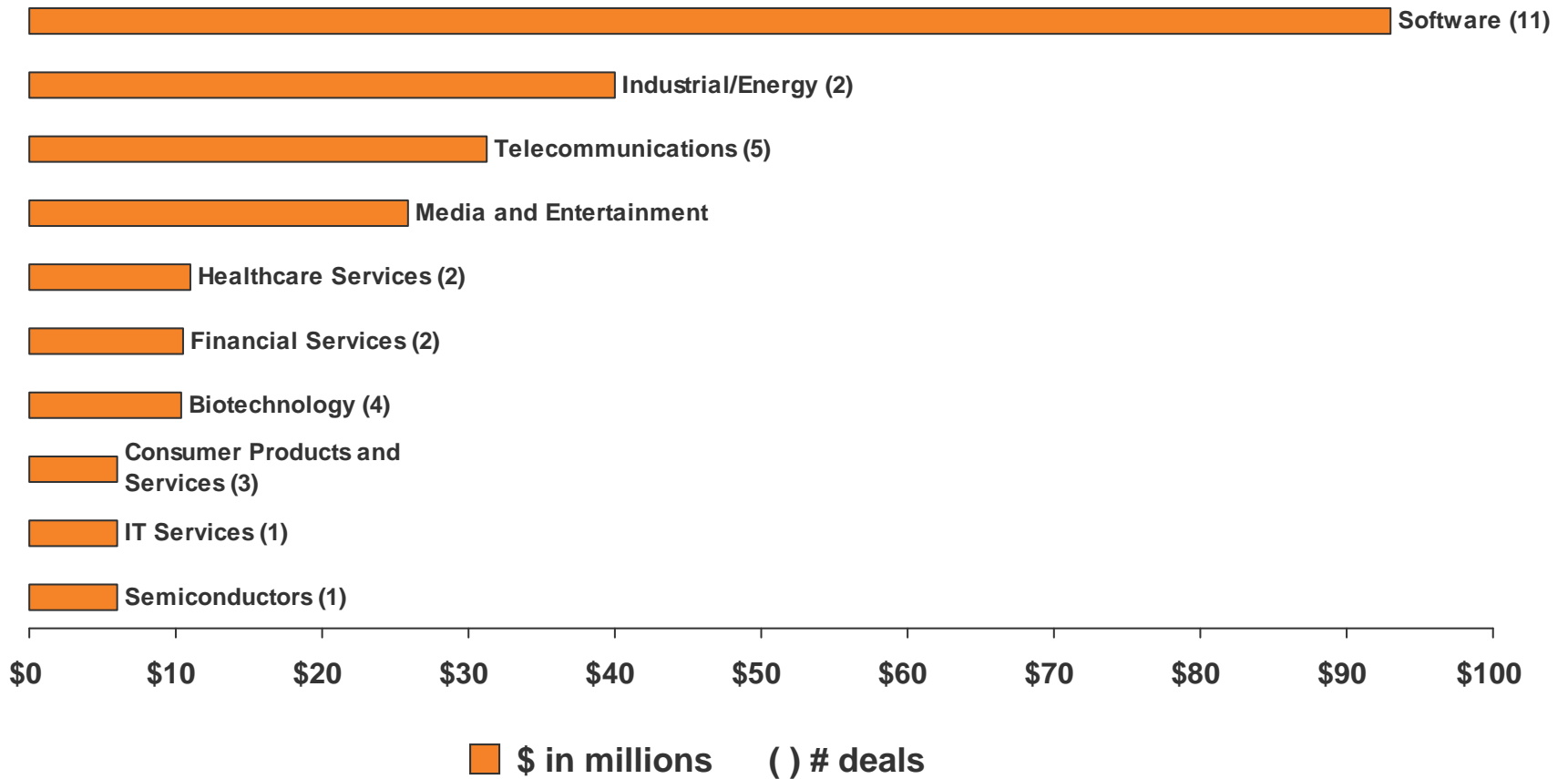
FL Investments by Region

2001 – 2008



FL Investments by Industry

Full Year 2008



Average Deal Size – FL vs. U.S. 2001 – 2008

