

Top Ten Legal Mistakes Made By Entrepreneurs

Presented to



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“Understand the ways in which the law is a constraint, but also the ways in which it is a tool to help you create and capture value.”

--Constance Bagley, Harvard Business School

Failure to Incorporate Soon Enough

- Establishes vehicle with limited liability
- Specifies relationship among founders, including share ownership
- Creates “vehicle” to hold IP
- Provides impetus to organize

Creating Tax Issues with Equity

- Founders “cheap stock” when sold below “fair market value”
 - e.g., price sold to investors
- Blowing the 83(b) election
- IRC §409A: Issuing “discounted” options
 - Result: Employee suffers additional 20% income tax, at the time of vesting
 - Company matching and withholding obligations and potential for lawsuits

Failure to Subject Founders Shares to Vesting

- Vesting protects those who take venture forward
- Regardless of the reason for the departure, someone must be compensated to replace the departed founder

Angel/Friends & Family Financings

- Sales to non-accredited investors
- Often overpriced
 - Creates barriers to future rounds
 - Dilution and disappointment
 - “Dumb money”
- Inadequate resources to continue to invest and “protect” prior investment
- Administrative hassles
 - Expensive to administer and may deter VCs

Failure to Adequately Protect IP

- Patents
 - U.S.: Filing required one year from public “disclosure” or sale
 - Rest of world: Filing required prior to public disclosure or sale
- Trademarks
 - Failure to protect valuable brand
 - Overinvesting in unprotected/unprotectable brand
- URLs
- “Bootstrapping” with consulting services without adequate ownership of services/product delivered

Failure to Seek or Receive Adequate NDAs

- Can lose patent/trade secret protection without NDA or other reasonable steps to protect
 - Watch out for termination dates, residuals, concurrent development clauses
 - Failure to police
 - Using inadequate or outdated forms
- Business plans and offering memorandums
 - At least include confidentiality statement
 - VCs will not sign – choose carefully before sending

Hiring Employees Without Regard to Prior Employer Agreements

- Non-competes, non-solicitation
- Trade secrets, inevitable disclosure
- Software code, open source
- No short cuts

Inadequate Agreements with Employees and Contractors

- Employees
 - Documented offer letters
 - IP assignments, non-competes, non-solicits
- Contractors
 - Misclassification when acting as employee
 - IP assignments; restrictions on competition

Failure to Maintain Proper Documentation

- Inadequate Capitalization Hygiene
 - Too many “promises”; too little documentation
 - Promising a %, especially when non-dilutable
 - Failure to approve at Board level
- Inadequate Recordkeeping
 - e.g., NDA tracking

Fundraising Errors

- Seeking institutional capital too early
- Soliciting the wrong type of investor for the venture
- Choosing the “wrong” VC
- Must do your diligence on the investors

Choosing Wrong Attorney for Venture (or not using one)

- Expertise, experience, personality must be a match
- Relationships; understands terms, market, process
- Make the complex simple
 - Avoid doing too much, too early
 - Focus on right things, avoid subtle traps
- Pay me (a lot less) now, or (a lot more) later...
IF it can be fixed
- Not being involved in the legal process

Q&A

Thank you!
Open discussion / Q&A

A Focus on Emerging Growth

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