

Welcome to **RISE WEEK 2011**

Top Ten Legal Mistakes Made By Entrepreneurs

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STRAIGHT TALK IS GOOD BUSINESS.®

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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, business plan / ideas
- Provides impetus to organize
- **CONVERSE:** Incorporating too soon

Creating Tax Issues with Equity

- Blowing the 83(b) election
- Founders “cheap stock” when sold below “fair market value”
 - e.g., price sold to investors
- 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”
 - Option pricing issues when common stock sold
- Inadequate resources to continue to invest and “protect” prior investment
- Administrative hassles
 - Expensive to administer and may deter VCs
 - Complex Structures for small dollars

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, Facebook, Twitter, etc. accounts
- “Bootstrapping” with consulting services without adequate ownership of services/product delivered
- Copyrights: Must register CR before pursuing legal remedies against infringer. In the case of web software (e.g. iphone app), often costs less than \$1,000.

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 - Using inadequate or outdated forms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
- Prior employer documents in possession
- 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; Capitalization Errors

- Inadequate Capitalization Hygiene
 - Too many “promises”; too little documentation
 - Promising a %, especially when non-dilutable
 - convertible note should not convert into a % interest, but rather a number of shares based on share price formula
 - Failure to approve at Board level
 - “handshake” deals
- Inadequate Recordkeeping
 - Failing to maintain adequate organizational records
 - Failing to track agreements (e.g. NDAs)
- CONVERSE: Too many agreements

Fundraising Errors

- Seeking institutional capital too early
- Soliciting the wrong type of investor for the venture
- Choosing the “wrong” VC
- Selecting a “strategic” in the first round
- 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
- **Not using AK Fixed Fee Start Up Package**

AK Start-Up Package

- **Incorporation, Organization and Qualification**

- Reservation of corporate name
- Preparation and filing of Delaware Certificate of Incorporation
- Preparation of Bylaws and Certificate of Secretary
- Preparation of Action by Incorporator
- Preparation of Organizational Board Consent regarding various organization and corporate governance matters
- Preparation and filing of Form SS-4 Application for Employer Identification Number
- Preparation and filing of qualification to do business as foreign corporation
- Preparation and organization of corporate records and minute book
- Preparation of Stockholder Consent
- Preparation of form Indemnification Agreements for directors & officers

- **Capitalization matters**

- Entry of capitalization data and corporate records into capitalization tracking software and corporate records database
- Preparation of Founder's Restricted Stock Purchase Agreement for up to four Founders
- Preparation of Stock Certificates for up to four Founders
- Preparation of Memorandum re 83(b) Elections for Founders
- Preparation and filing of state securities filings for stock issuances to Founders
- Preparation of Stock Option/Stock Issuance Plan
- Preparation of forms of Early and Standard Exercise Stock Option Agreement
- Preparation of form of Stock Issuance Agreement
- Preparation/filing of Form U-2 Uniform Consent to Service of Process

AK Start-Up Package

- Employment and Consulting Matters
 - Preparation of form of At-Will Employment Offer Letter
 - Preparation of form of Proprietary Information and Inventions Agreement
 - Preparation of Form of Independent Contractor Services Agreement
- Intellectual Property Matters
 - Preparation of form of Unilateral Nondisclosure Agreement
 - Preparation of form of Mutual Nondisclosure Agreement
 - Preparation of Assignment of Intellectual Property from Founders to the company
 - Preparation of Memorandum re Trademark Matters for a new company
- Consultations
 - One hour of advice on employment matters
 - One hour of advice on employee benefits matters
 - One hour of advice on protecting intellectual property
 - One hour of advice on venture capital term sheets

Thank you!

Open Discussion / Q&A

A Focus on Emerging Growth

ANDREWS KURTH LLP Technology & Emerging Companies Practice Growth

Andrews Kurth is a leading law firm for entrepreneurs, public and private emerging growth companies, and venture capital and private equity firms. Our Technology and Emerging Companies Practice Group comprises a dedicated team of attorneys providing focused representation to public and private emerging growth companies and entrepreneurs as well as the venture capital and private equity firms that finance them. We take pride in having a practical, business-like approach to advising our clients, and we share their entrepreneurial spirit and drive.

Our client service teams combine relevant experience with an understanding of a client's business and markets to provide efficient legal services and solutions with an outstanding degree of responsiveness.

We thrive in the fast-paced entrepreneurial world by combining flexibility and speed with the experience that comes from taking billions of dollars in new ventures from inception to IPO and beyond.



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Matt Lyons is a partner with Andrews Kurth, where he specializes in representing private and public emerging growth companies and entrepreneurial interests. He advises on all aspects of forming new businesses, raising capital, M&A, and securities laws & regulations. He also regularly counsels companies and their boards on corporate governance and executive compensation. Matt represents and maintains relationships with a number of prominent venture capital, private equity and investment banking firms.

Matt has consistently been named as one of the leading lawyers in Texas for the area of Technology: Corporate and Commercial in the Chambers USA Rankings. He also has been Martindale-Hubbell "Peer Review Rated" for Ethical Standards and Legal Ability. Matt has been named a "Texas Rising Star" in the area of Securities and Corporate Finance by Texas Super Lawyers and Texas Monthly Magazine. Matt received his undergraduate and law degrees from the University of Texas at Austin.