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Discussion of Legal Considerations for Startup Entrepreneurs

Presented to Berkeley Lab Innovation Corps Entrepreneurs

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Founders' Equity & Initial Capitalization— Overview

- Initial Assumptions... "C" corporation, technology start up, big opportunity
- Who is a founder? Does it matter?
- Thoughts on apportioning founders' equity
 - » Whose idea?
 - » What IP is being contributed?
 - » Have one or more of co-founders founded a start up, and had a "successful" exit?
 - » Commitment?
- To vest or not to vest, all or some, how long?
- Staying in Control
- Founder Funding
- Initial Capitalization (DE or CA, authorized vs. outstanding vs. fully diluted, stock plan, early employees or contractors, advisory board; have an equity budget)

Initial Assumptions... "C" corporation, technology start up, big opportunity

- "C" corp vs. LLC (briefly) (rarely "s" corp)
 - Typically a C corp
 - Different discussion if not looking to raise much outside financing, hire lots of employees, build the prototypical "big idea" startup → if so, consider LLC (which, if more than one member, can be a good deal more complicated than standard C corp startup formation documents)

Founders' Equity – to vest or not...

■ Single or co-founders?

■ Arguments for and against...just do it

» For:

- Co-founder could leave/not work out
- How quickly will company raise \$\$ - investor expectations; protecting against the alternative...

» Against:

- Founder lose unvested equity if terminated
- 280G golden parachute tax

■ All or a portion?

- » Standard: 4 year vest, usually no cliff for true founders
- » How long has each co-founder been involved?
- » Any real IP being contributed (beyond the "idea")

■ Don't forget your 83(b)

Initial Capitalization

- **DE or CA** (most developed body of law and generally known and accepted by relevant parties;)
- Authorized vs. outstanding, outstanding vs. fully diluted
- How many shares to authorize and issue
- Stock Plan – future hires
- Early employees
- Advisory Board
- Hiring Plan budget
- Cap table example (next page)

Mechanics of Incorporation

- **Incorporation of the entity**
- **Appointment of the Board of Directors**
- **Appointment of Officers**
- **Opening a Bank Account**
- **Sale of Stock to Founders (file Sec. 25012(f) exemption)**
- **“Back-Office” Administration: Payroll (if any), Insurance (if any), Tax withholding (if employees), etc.**
- **Employment or contractor agreements; invention assignment**

Employees or consultants

- Startups faced with decision to engage themselves as W-2 employees or independent contractors.
- Independent contractors are *self-employed* individuals, not company employees.
- Benefit is that many complications and costs associated with employees (for example, payroll taxes, workers' compensation insurance and employee benefits costs due to minimum wage requirements) are avoided, and not legal for even startup founders to “defer” salary due to IRS rules.
- However, because independent contractor arrangements avoid many of the tax and other employment law requirements of an employment relationship, the IRS, state government agencies and courts construe independent contractor status **narrowly** and impose **large** penalties for improper classification. Penalties can include back payment of wages (including overtime), Benefits, Unpaid taxes and other significant monetary penalties.
- If the characterization of a founder as a contractor is challenged, the relevant test is very fact specific like whether founder has another job, sets his/her own schedule, commits to a certain amount of time (x hours a day, x days a week as a job), offers his/her services to others.

Hiring employees or engaging consultants

- Federal, state and local laws regulate employment matters. Employment contract matters are regulated at the state level.
- A written employment agreement is generally not required, but practice dictates a short offer letter and certain an invention assignment agreement.
- California is an “*at-will*” employment jurisdiction meaning that an California based employee may be terminated at any time for no reason, subject to any employment or similar agreement providing for contractual rights and to certain anti-discrimination laws and regulations and payment of owed wages, etc.
- Founders, if employees, often have strong protections against “involuntary termination” (without cause or good reason).
- Bringing in other individuals? BE careful - if work for equity, be sure to carefully draft contractor agreement and don't treat individual as an employee.

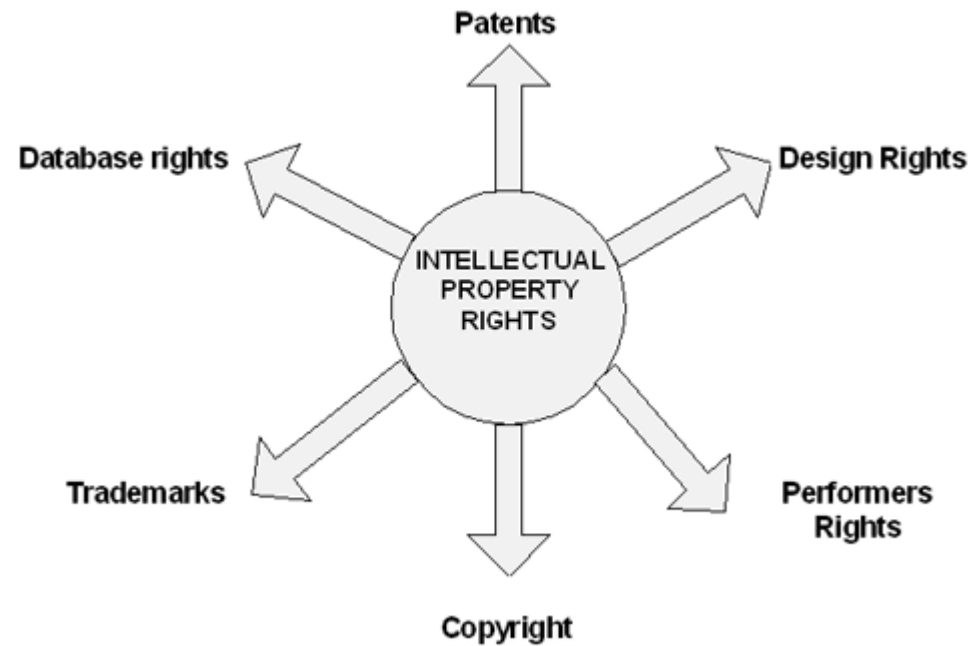
Naming the U.S. Company

- » Consider running a trademark (and copyright) search if intend to use company name as a trademark, domain name or trade name or just generally to develop a brand around.
- » Also, check whether the name is available in the state that you intend to incorporate (Delaware for instance) and also where you intend for the company to be based (e.g., California). In Delaware, you can search and reserve a desired name online by going to the Delaware Division of Corporation's website. A registered agent/service company can also handle this in the course of filing the charter.

IP Overview

■ Types:

- » Patents
- » Copyrights
- » Trade marks
- » Trade secrets



■ Each vary in scope and duration

Early Protection of IP

■ Securing ownership of early IP

- » Assignment of IP per employment agreement or in exchange for stock or other consideration
- » Careful documentation of early employment and consulting relationships (consideration, carve-outs, rep, that no technology from prior employers)
- » Internal processes to ensure effective IP spending, strategy, and pursued value

Confidentiality & NDA Agreements

- **With employees to prevent disclosure of confidential information during employment and following departure**
- **With contractors, vendors, professionals, potential business partners, potential merger and acquisition partners, joint ventures exposed to trade secrets and confidential information**
- **Use broad definition of confidential information**
- **Enforceable by injunction and damages.**

The Gating IP Issue: Who else might claim ownership in the IP?

Key → assign the IP to company (PIAA, contractor agreement (“work for hire”)) for “*consideration*”

- **Co-Founders**
- **Former Co-Founders?**
- **Consultants**
- **Open source?**
- **Previous Employers (review prior agreements)**
- **Based on research? (university or government research or grants?)**

Common IP Issues cont...

- File for IP before talking to VCs?
- Don't publish/disclose without asking the "IP Question"
- Lab notebooks
- Confidential Disclosure Agreements
- Employment Agreements/Consultant Agreements
- Collaboration Agreements
- Emails and Good Documentation Practices

Thank you for your time.



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