

# Top 10 Legal Mistakes That Startups Make

(Except Yours, Now That You're Here)



## Who we help

Seed and early stage entrepreneurial ventures that have not yet raised significant amounts of outside capital

## What we do

Legal advice and assistance in formation, intellectual property protection, commercialization strategies and operational issues

## Who we are

### Student-Attorneys

Robert Barnes

Dani Glazer

Kimberly Jachimek

### Supervising Attorneys

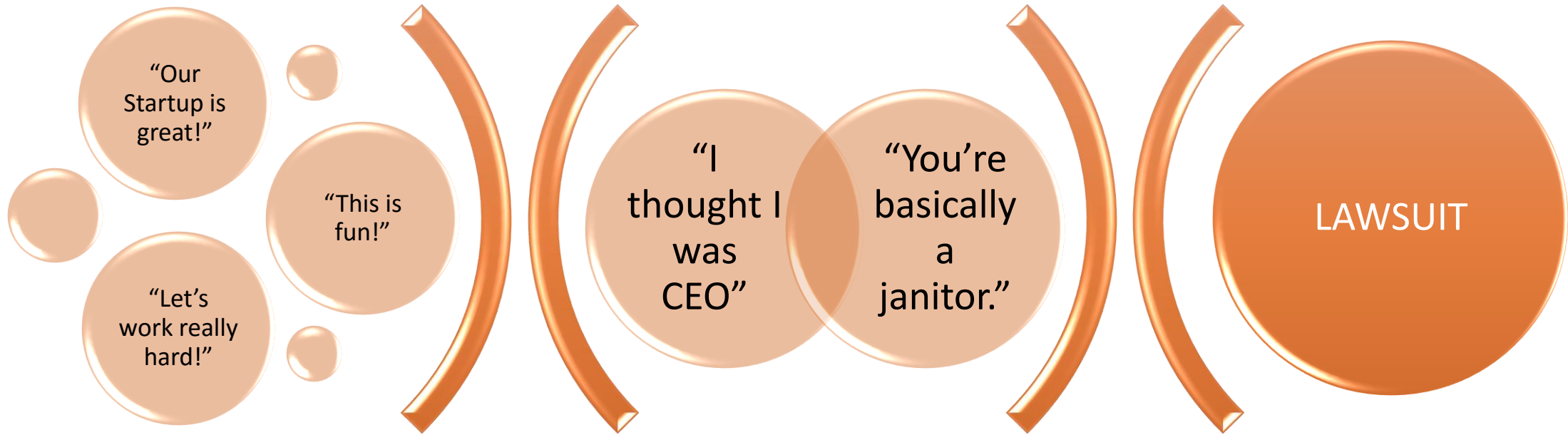
Jeff Ward

Darrell Fruth

# Mistake 1

“We Trust Each Other. We Don’t Need a Founders’ Agreement.”

# Yes You Do.



1. Founders Are Happy

2. Two Founders Disagree

3. Chaos Ensues

# Benefits of Founders' Agreements

## Firm Commitment

- Role in company
- Responsibilities and corresponding incentives

## Clear Goals

- Negotiation = Communication
- Literally write them out

## Power and Process

- How to vote
- Who pays what & when
- Special circumstances

## Backup Plan

- Noncompete
- Nondisclose/ confidentiality
- Exit procedures

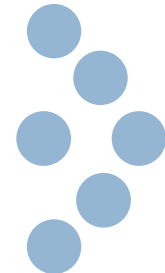
# Mistake 2

“I’ve heard you should just keep all your tech under wraps.”

# No! Be clear about technology transfer issues.

## Student Tech

- Usually not a huge issue



## Employee Tech

- Can be a bigger issue



# Mistake 3

Accidental Partnerships & Sole Proprietorships



Don't even \*think\*  
the word Partner.

Working  
together



Talking with  
clients



Signing contracts



Finding investors

Don't even \*think\*  
the word Partner.

# PARTNERSHIP

Working together

Working with investors

Working with clients

Signing contracts



“But what if we never signed any contracts or wrote up any formal documents?”

But what if we've never signed an contract or were  
by a lawyer for an document?

**PARTNERSHIP**

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“But what if we’re just about to file our Articles of Incorporation? We’re basically a real business now.”

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# PARTNERSHIP

What if we're just about to find out? Articles of  
Incorporation? We're really, really business savvy.

Why is this bad?

Shared  
Profits

Unclear Terms

- \*Partnership Agreement

100%  
Liability

## How to Make Sure You're Not a Partnership

Choose  
entity

- C Corporation
- S Corporation
- LLC
- Benefits Corp
- Cooperative
- Other variations

File  
Documents

- Articles of Incorporation
- Bylaws



# Mistake 4

“LLCs Are the Only Way to Go.”

# C Corporations



## **PROS**

- Perpetual existence
- Easier to incentivize investment:
  - Well-known laws
  - Transferability easy



## **CONS**

- Double taxation
- Expensive yearly filings
- Operational formalities

# S Corporations



## PROS

- Well-known laws
- Transferability easy
- NO double taxation
  - Pass-through
  - Split into reasonable compensation & investment income (excluded from taxable self-employment income, unlike LLC)



## CONS

- Expensive yearly filings
- Operational formalities
  - Single class of shares
  - Proportional earnings
  - US Resident/citizen
- Harder to get funding (compared to C Corps)

# Limited Liability Companies (LLCs)



## PROS

- Flexible
  - Based on contract, not regulations
  - Can insulate management from members
- NO double taxation



## CONS

- Harder to incentivize investors
  - Less transferability
  - Less predictable (newer laws)

# Nonprofit, Tax-Exempt Companies



## **PROS**

- No taxes
- Donations from individuals or organizations
- Fiscal sponsorship options
- Labeled a nonprofit

## **CONS**

- Additional reporting requirements
- Restrictions to remain qualified under 501(c)(3)
- No equity ownership of company



# Public Benefit Corporations



## PROS

- Operates as a corporation
  - Transferability easy
  - *Some* well known laws
- Insulated from investor pressures
  - Fiduciary duty includes social mission

## CONS

- Additional reporting requirements
- Only available in 24 states
- Investors sometimes turned off by fiduciary duty change
- Additional shareholder right of action

# B-Corp Certification



## **PROS**

- Clear, recognized stamp to lend credibility
- No restrictions on type of entity
- In peer network with Patagonia, Ben & Jerry's, New Belgium Brewing, etc.

## **CONS**

- Expensive yearly fees (\$500+)
- Rigorous evaluations every two years (4+ hrs)
- Potential audits every year (6-8 hrs)

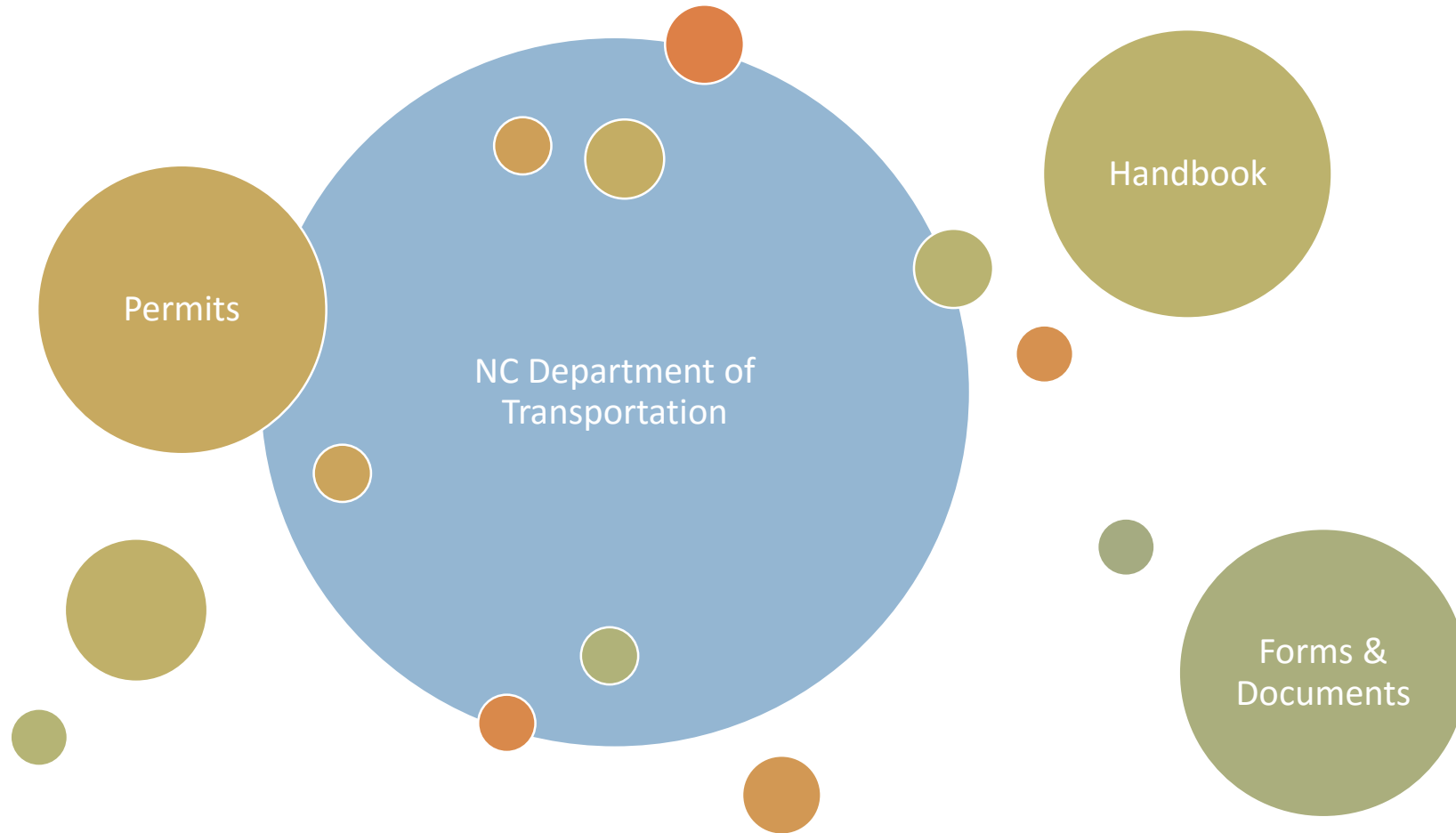


# Mistake 5

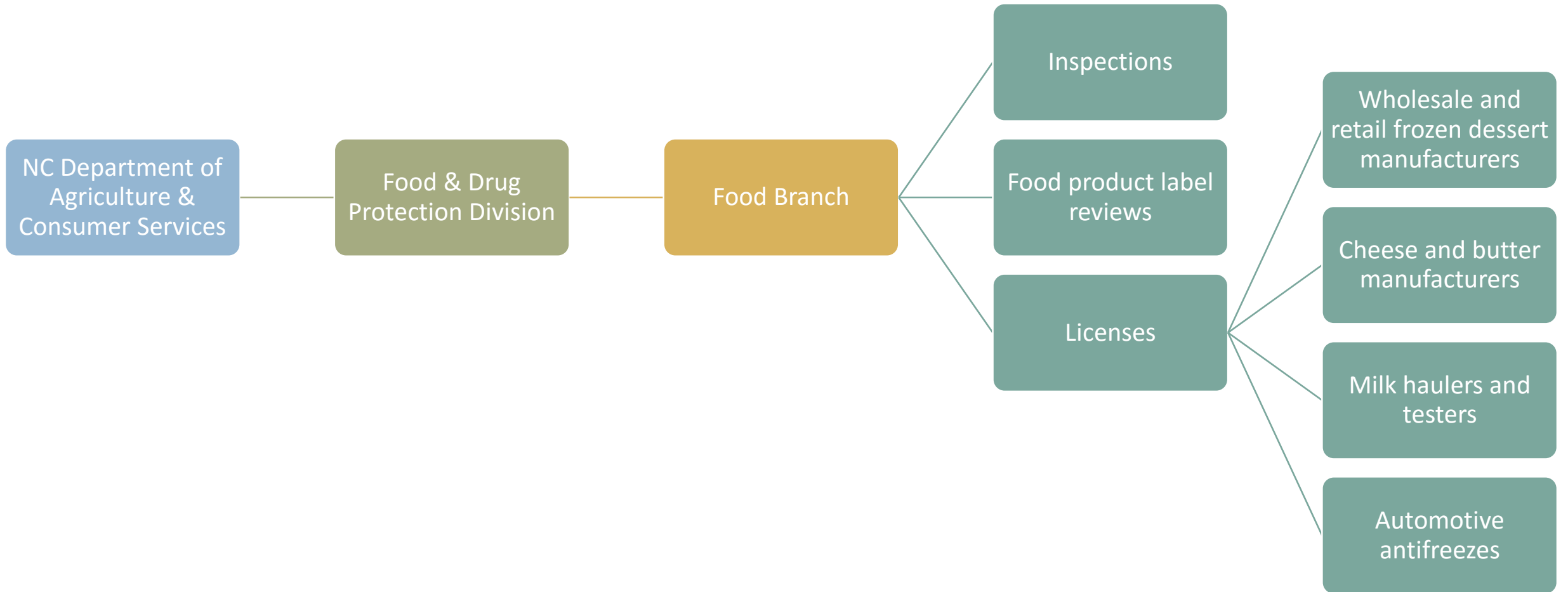
Permits, Licenses, and Certificates



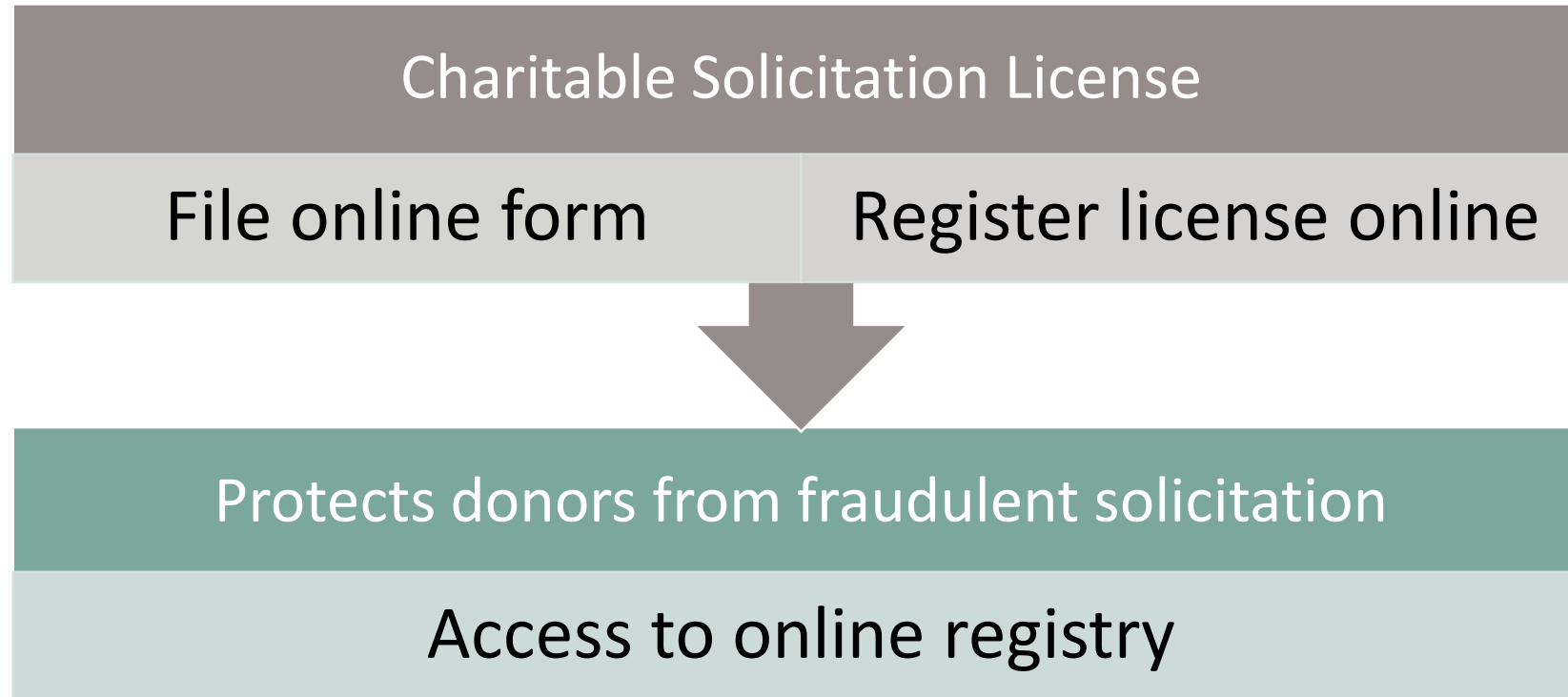
# Transportation



# Food Service



## Tax-Exempt Nonprofits



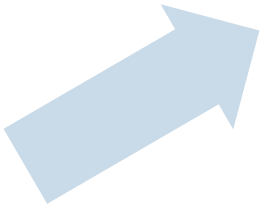
# Mistake 6

“Nana’s Investment Isn’t a *REAL* Investment.”

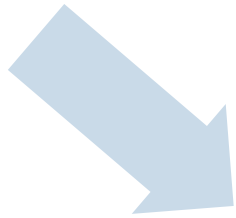
Taking Money



Security



Registration



Exemption

# Avoiding registration

## Exemptions



- 4(a)(2) Private Placement
- 506(b) or 506(c)
- Intrastate offering

## Alternatives



- Grants
- Incubators
- Start-up Contests, Crowdfunding, etc.

Why worry about securities violations?

Past

Present

Future

Even more headaches...

## Reporting Costs

- Public disclosures to the SEC

## Tax

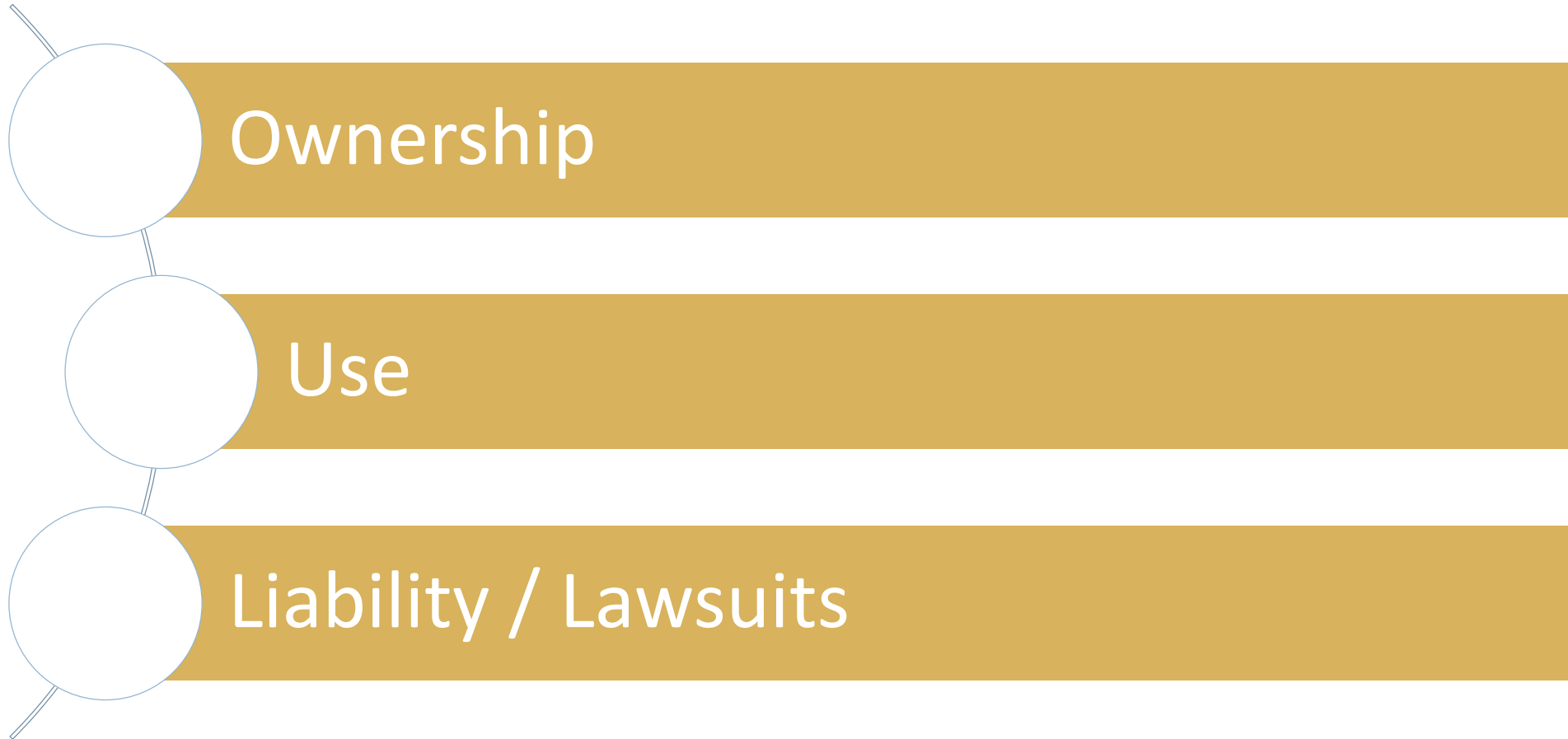
- Shareholders could get hit with major taxes



# Mistake 7

“You’re an investor? Well let me tell you about this awesome trade secret we’ve got!”

# Common IP issues



# Avoiding IP problems



Docs

Strategic Choices

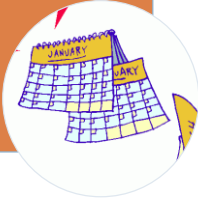
Thorough Research

# Mistake 8


“Let’s Name our Company... Google.”

# Why does name choice matter?

Time

A circular icon containing a colorful calendar grid with the month 'JANUARY' visible at the top.

Money

A circular icon containing a green one-dollar bill.

Market  
Confusion

A circular icon containing a white question mark on a blue background.

# Avoiding problems with names

Choosing a Name: Brainstorm multiple flexible names

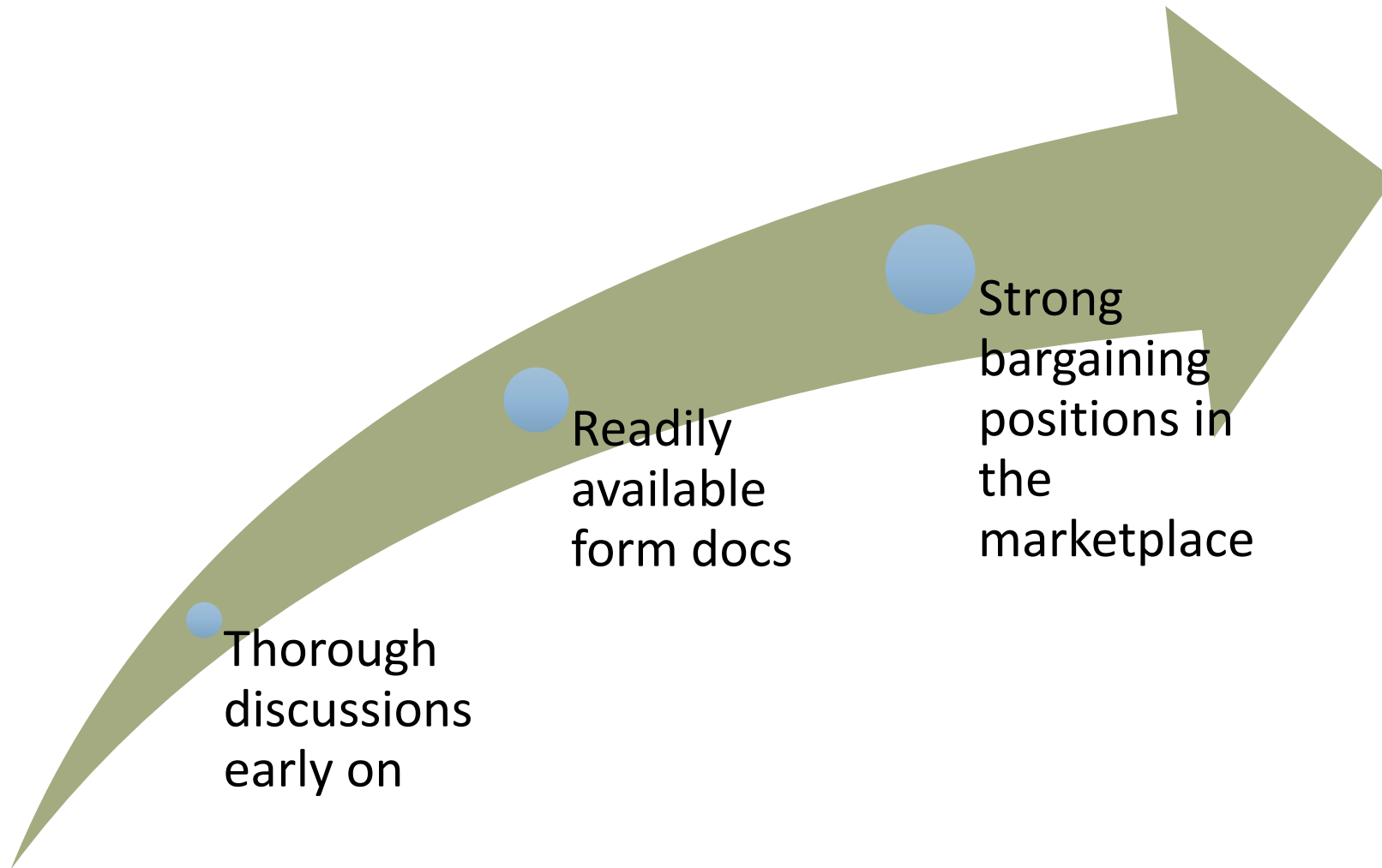
Trademark and Copyright

Thorough, diligent searches

# Mistake 9

Policies and Standard Documents: “We’ll Just Wing It.”

# The benefit is in the process

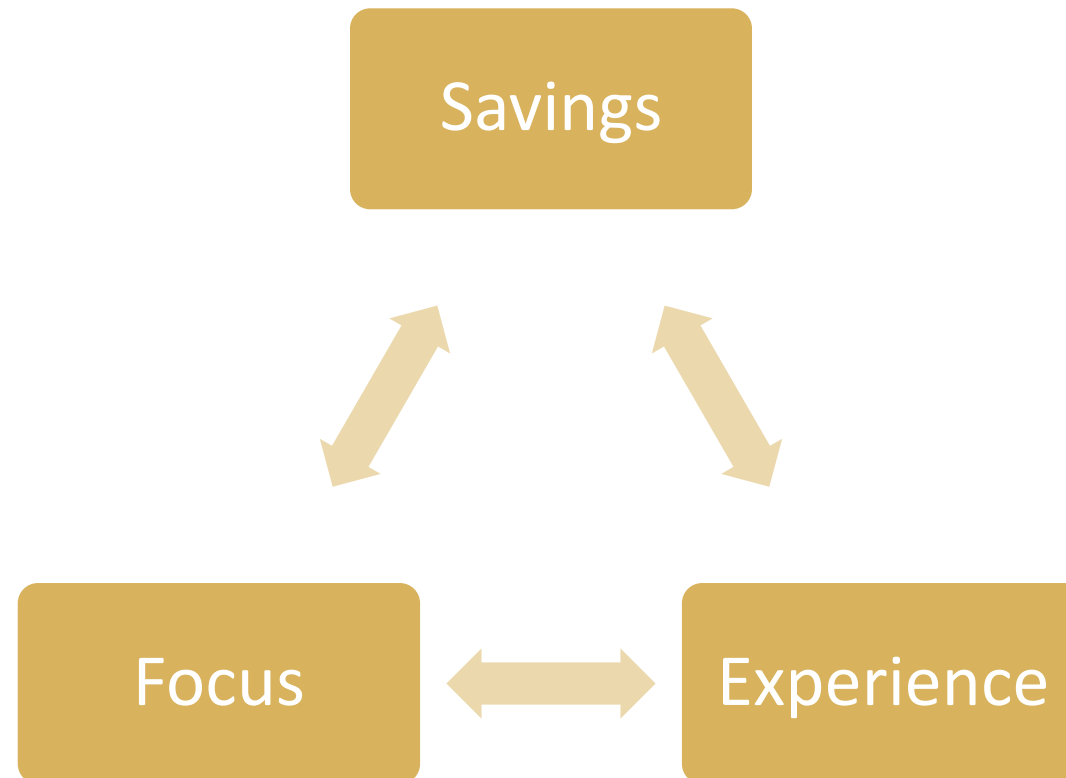




# Mistake 10

Do-It-Yourself Lawyering

# What can lawyers add?



# Bonus! Mistake 11

“Our business plan... is to be awesome.”

Yeah, that's nothing.

Thorough

- Helps clarify goals & next steps

Ready to present to investors

- PowerPoint
- 10/20/30 Rule

You must know all of it

Questions?