

# STARTUP BASICS

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# A Necessary Legal Disclaimer



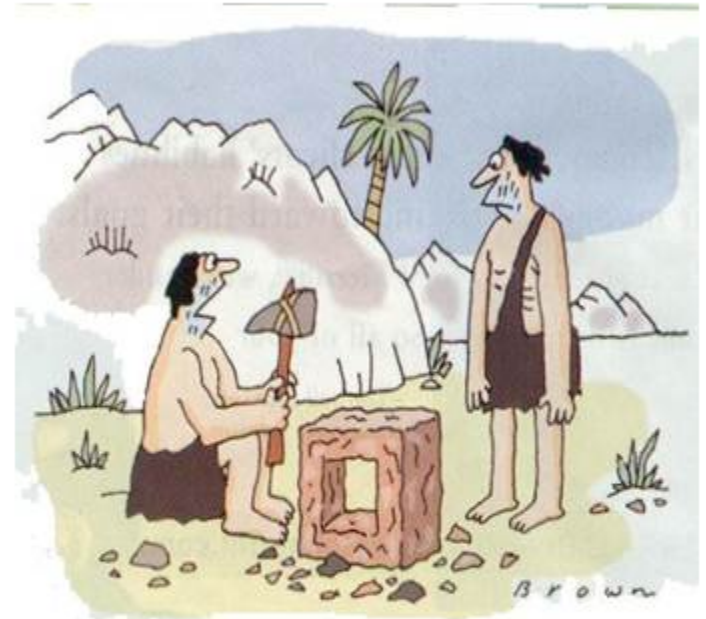
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- This is a summary. The law is full of caveats, some of which may apply to your situation but will not be discussed here
- We are not entering into an attorney-client relationship with you by engaging in this presentation or any subsequent discussion
- We are not giving you legal advice or legal opinions

# Insights from the field

## Do not reinvent the wheel

- Delaware C-corporation
- Standard Organization
  - Certificate of Incorporation and Bylaws
  - Stock Purchase Agreements
  - Invention Assignments
  - Employment Agreements
- Standard capitalization
- Counsel who understands the environment



*"I call my invention 'The Wheel,' but so far I've been unable to attract any venture capital."*

36 FORBES ■ November 1, 2004

# Are you ready?

## Team

- Founders
- Board Members
- Advisors
- Employees

## Technology

- Protectable?
- Reproducible?
- Do others have rights?



# A few words about intellectual property

- **Often a high-tech company's most important asset**
- **Make sure you own it**
  - Employers and schools sometimes have claims
- **Make sure you contribute it**
  - For equity
  - For royalties
- **Make sure you get it from others**
  - Enter into consulting agreements/employment agreements before it is a problem
- **Make sure you protect it**





# Overarching Themes



- Many standard terms are designed to keep founders at the company and give investors power
  - Vesting requirements
  - Right of first refusal
  - Restrictions on transfer
  - Voting obligations

- Once you lose control of the Board, you've lost control of the Company
- Once you are no longer on the Board, there is no one there to protect your interests

- Raising money is a serious business
  - Potential liability for the company
  - Potential personal liability
- You must comply with securities laws

# A PRIMER

# Getting ready for your first financing

- **Incorporation**
- **Board of Directors**
- **Capitalization**
- **Standard Documents executed by everyone**
- **Getting relevant IP into your company**
- **Identifying prospective Investors**
- **Considering your first investment offering**



# Why a Corporation?

## Advantages

- **Simpler structure and less expensive**
- **Easier to issue stock and options to employees than in LLC**
- **Customary for investors**

## Disadvantages

- **No tax deductions for investors**
- **Double taxation of dividends**

## Subchapter S

- **No double tax, but...**
- **limited to US individuals**
- **Only one class of stock**

# Board of Directors / Advisors

- **Try to maintain control of the Board as long as possible**
- **Board composition can help you with investors**
- **Advisors can also help you build credibility with only a limited time commitment**
- **Consider your network – who is marketable at first blush**
  - **Previous successful entrepreneurs**
  - **Highly regarded business professionals**
  - **Experts in areas where the team has none**

# Common Stock / Options

- **Common Stock**
  - Founder's stock – what is it? Who gets how much?
  - Vesting – do you need it?
    - Typically four years
    - Importance of a cliff
    - Voluntary vs. involuntary termination
    - “Double-trigger” acceleration
  - Stock vs. options – what's the difference?
  - Stock pool – how much?
- **Preferred Stock**
  - Typically issued to investors

# A typical capitalization table

- **4,000,000 shares of Common Stock issued to Founders**
- **1,000,000 shares of Common Stock in Option Pool**
- **Why?**
  - **Grants are of a size that are competitive with other offers service providers may be receiving**
  - **At typical valuations, this capitalization structure leads to expected price per share calculations**
- **Allocations must be thoughtful and based on value and importance to the company**

# Standard Documents Executed By Everyone

- **Non-Disclosure Agreement**
- **Consulting Agreement**
- **Offer Letter or Proprietary Information Agreement**
- **Stock Award**

**It cannot be stressed enough – this is easy, but failure to do this correctly will impact your success.**

# Getting the right IP into the Company

- **Most often, IP is assigned, not licensed into the Company**
- **There are notable exceptions**
  - University IP
  - IP that has multiple applications
- **Before you leap, consider whether the IP being contributed to the Company is broader than need be**
  - Many successful entrepreneurs slice and dice their IP into multiple different company opportunities
  - But also pick your favorite, as lack of focus is a common contributor to funding difficulties and/or company failure

# Types of Angel Financing

- **Convertible debt / SAFE?**
  - **Simpler and less expensive**
  - **No need to agree on valuation**
  - **Converts at next equity financing**
  - **Discounts / warrants**
  - **What happens on sale of company?**
- **Preferred stock?**
  - **Sets valuation now for investors**
  - **Usually larger financings than convertible debt**
  - **More complex negotiation**



# Types of Financing

- **SAFE**
  - Also Simpler and less expensive
  - No need to agree on valuation
  - Converts at next equity financing
- **Preferred stock?**
  - Sets valuation now for investors
  - Usually larger financings than convertible debt
  - More complex negotiation