Get Up and Go – Navigating Startup Issues

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Key Considerations in the Formation Process

- **Selecting Professional Advisors**
- **Choice of Entity**
- **Founder Agreements and Corporate Governance**
- **Protecting Intellectual Property**
- **Contracts and Commercial Agreements**
- **Organizing Due Diligence**

Selecting Professional Advisors

LEGAL COUNSEL

ACCOUNTING AND FINANCIAL

OTHER ADVISORS AND ADVISORY BOARDS

Selecting the Appropriate Entity is Critical

Consideration	C-Corporations	Limited Liability Company
General	More regulated; well-developed case law and statutes	Flexible; case law less developed
Tax	Generally subject to two levels of tax on income (entity level & stockholder level)	At member-level only
Liability	Stockholder generally insulated from liability	Members and managers generally insulated from liability unless set forth in the Operating Agreement.
Management	Governed by a board of directors	Flexible
Fiduciary Duties	Directors and officers owe fiduciary duties	Default is that managers owe duty of care and loyalty

Founder Agreements and Corporate Governance

1 **Determine Equity Ownership**

- Voting/Nonvoting Stock

2 **Determine Vesting and Equity Terms**

- Restricted Stock and 83b Elections
- Voluntary Termination and Termination without Cause
- Repurchase Rights
- Termination with Cause

3 **Board of Directors and Corporate Governance**

Protecting Intellectual Property

Proprietary Information and Inventions Agreements

Non-Disclosure Agreements

Consider Importance of Trademarks and Branding

Develop Patent/Intellectual Property Strategy

- Consult with Patent Counsel
- Understand Patent Traps for the Unwary

Contracts and Commercial Agreements

Website Terms and Conditions / Privacy Policy

Regulatory Matters and Compliance with Law

Form Customer Contract

Change of Control / Assignment Provisions

Consulting Agreements

Common Legal Mistakes and How to Avoid Them

Handle Founder Decisions Early. Navigate choice of entity, equity split, governance and immigration considerations. Use vesting provisions and transfer restrictions to protect the equity issued. Execute founder agreements and stockholder agreements.

Follow Corporate Formalities. Understand tax implications and corporate law requirements. Keep good corporate records. Plan and prepare for regular board meeting to involve board members and advisors.

Build Good Hygiene Habits. Obtain, compile and store all signed documents. Keep track of amendments to agreements.

Understand Regulatory Landscape. Pay attention to employment, securities, corporate, tax, & other laws governing regulated industries and your business generally. Regulatory compliance will be important to investors, so know the answers.

Choose Partners Carefully. Be careful about bringing in outside investors too soon and not thinking about the right investors with proper view of company and its business strategy. Be optimistic, but do not over promise to investors.

Avoid Showstoppers. Eliminate or mitigate prior employer IP, confidential information or non-compete entanglements. Appropriately consider any applicable University IP policy and rights.

Develop Your IP Strategy. Obtain proper IP assignments from all who touch IP. Also consider IP protection strategy and options early. Implement IP protection options based on cost-benefit analysis, taking into account stage of venture, cash position, industry and relationship of IP to long-term success.

Be Careful About Promising Equity. Specify amounts, not percentages, when discussing equity. Be clear that all equity discussed will be subject to vesting and actual execution of grant documents. No napkins!

Read and Understand Documents. In the frantic world of growing a start-up, it is easy to gloss over documents. Read and understand the business implications of all documents, even if reviewed by counsel or other advisors.

Pay Attention to Privacy, Data Protection and Cyber Security. Privacy, cyber security and protecting customer data are critical issues and must be thought about in the context of your business.

Early Stage Financing Considerations

Term sheets	**Term sheets** are an essential part of any corporate financing transaction – whether angel or venture capital financing.
Key information includes:	– Amount to be Raised – Minimum Amount Accepted – Qualification of Investor – Documentation of Investment – Special rights of Investor – Confidentiality – Exclusivity – Governing Law

Early Stage Financing Considerations

Convertible Note	An interest bearing note that convertible into future equity in the company's next financing or upon the meeting of certain agreed upon terms (but if the terms are not met, it must be repaid in cash at the agreed upon maturity date).
Simple Agreement for Future Equity (SAFE)	An equity alternative to convertible debt instruments, generally considered equity but are not really either debt or equity. A SAFE will result in the issuance of shares at the next equity financing, if no equity financing occurs, typically no trigger for repayment or conversion results.
Preferred Equity	An equity instrument issued at a per share price determined based upon an agreed upon pre-money valuation of the company. Entitled to a liquidation preference, which may be participating or non-participating. Includes other rights negotiated among parties.

Key Characteristics of Convertible Debt

- Debt, not equity with stated maturity date
- Interest will accrue on principal balance
- Convertible into a "Qualified Financing" at a discount or price determined with reference to a valuation cap
- Not subject to prepayment
- May be voluntarily converted by an investor

Early Stage Financing Considerations

Advantages of Convertible Debt

- Allows company to defer establishing a valuation.
- Valuation cap is typically higher than what could be achieved in a priced round.
- Typically a faster (and also a less expensive) option to a more traditional equity investment.

Areas of Concern

- Determining appropriate maturity date, valuation cap and discount rate.
- Company has a limited time frame before the note needs to be repaid; if the conversion event has not occurred at maturity, the investors could elect to renegotiate terms (rather than accelerate) but company is at a disadvantage in terms of negotiating leverage.

Key Characteristics of SAFEs

Essentially works like a convertible note, but is never repayable and can be considered and be treated like equity.

A SAFE is not a debt instrument and largely considered to be equity.

A SAFE is treated like other convertible securities, i.e., warrants and options.

Converts to "SAFE preferred stock" when any amount is raised in a preferred equity round. Conversion is automatic and terminates the SAFE.

Allows for a discount to be applied to the future valuation associated with the preferred equity round.

Early Stage Financing Considerations

Advantages of SAFEs for Company

- Not debt on balance sheet. No termination, maturity date or interest payments.
- No interest payments to investors, but the company can choose to make discretionary dividend payments.
- Also a faster (and also a less expensive) option to a more traditional equity investment

Areas of Concern

- Generally, SAFEs are an advantageous way to raise early stage capital.
- Often, not as attractive to investors, so may be more difficult to raise additional capital with this instrument.

Key Characteristics of Preferred Equity

1 **Issued at a price based upon an agreed upon valuation.**

2 **Entitled to a liquidation preference, participating or non-participating.**

3 **Generally includes a variety of additional terms which must be negotiated**

- Board of Directors
- Protective Provisions
- Size of Equity Pool
- Information, Preemptive and Other Investor Rights
- Redemption Rights
- Drag-Along Rights
- Transfer Restrictions

QUESTIONS?

Biography

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Andrew Hamilton is a transactional lawyer who focuses his practice on representing clients in venture capital, private equity, and mergers and acquisitions transactions in a wide variety of industries, including technology, life sciences, consumer products, digital health, energy, clean technology, and fintech. Involved in the successful representation of many businesses, Andrew strives to develop a trusted advisor relationship with clients. In this role, an important aspect of his work involves providing advice on strategies and preparation for a sale or exit event, whether anticipated in the short or long term, and Andrew often handles the ultimate sale or exit transaction for clients he has represented for many years.

Andrew typically represents startup, early-stage, and emerging growth enterprises, as well as family-owned businesses, throughout their entire life cycles, including business plan development, equity financings, corporate restructurings, and sale and other change-of-control transactions. As an extension of his relationship-oriented approach, Andrew spends significant time working in the role of outside general counsel for clients, assisting with corporate governance and board matters, executive employment agreements, customer and other commercial agreements, and other general corporate matters, and he remains closely involved in the coordination of legal advice provided to clients in important areas such as intellectual property, labor and employment, employee benefits, and executive compensation.

Andrew is a frequent lecturer on topics of interest to entrepreneurs and investors, and is actively involved in supporting the Mid-Atlantic entrepreneurial community as a board member of both Philadelphia Alliance for Capital and Technology (PACT) and Mid-Atlantic Diamond Ventures (MADV), and as a member of the Physical Sciences Investment Advisory Committee for Ben Franklin Technology Partners of Southeastern Pennsylvania.

Biography

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Douglas E. Kingston counsels clients on a wide variety of business law matters, focusing on mergers and acquisitions (M&A), venture capital, and financing transactions. He represents entrepreneurs, startup and emerging growth companies, as well as privately held companies, through their entire life cycle, including start-up matters, equity and debt financings, corporate restructurings, and sale transactions. Douglas has represented clients across numerous industries, including beverage distribution, pharmaceutical, medical device, digital health, consumer products, technology, data management, energy, and fintech. In addition, he serves as a counselor to privately and publicly held companies on a wide variety of general corporate matters.

Biography

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Paris S. Dupree advises clients on a variety of corporate matters, with an emphasis on mergers and acquisitions, venture capital and emerging growth company investments and transactional matters, private equity transactions, securities compliance, and corporate governance. Paris advises clients ranging from Fortune 500 companies and investment banks to emerging market companies. The breadth of Paris' experience encompasses a wide range of industries including information technology, social media, life sciences, health sciences, education, digital marketing and software. Prior to joining Morgan Lewis, she was a corporate associate in the Philadelphia office of a national law firm.

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Almaty	Chicago	Houston	Orange County	Shanghai*
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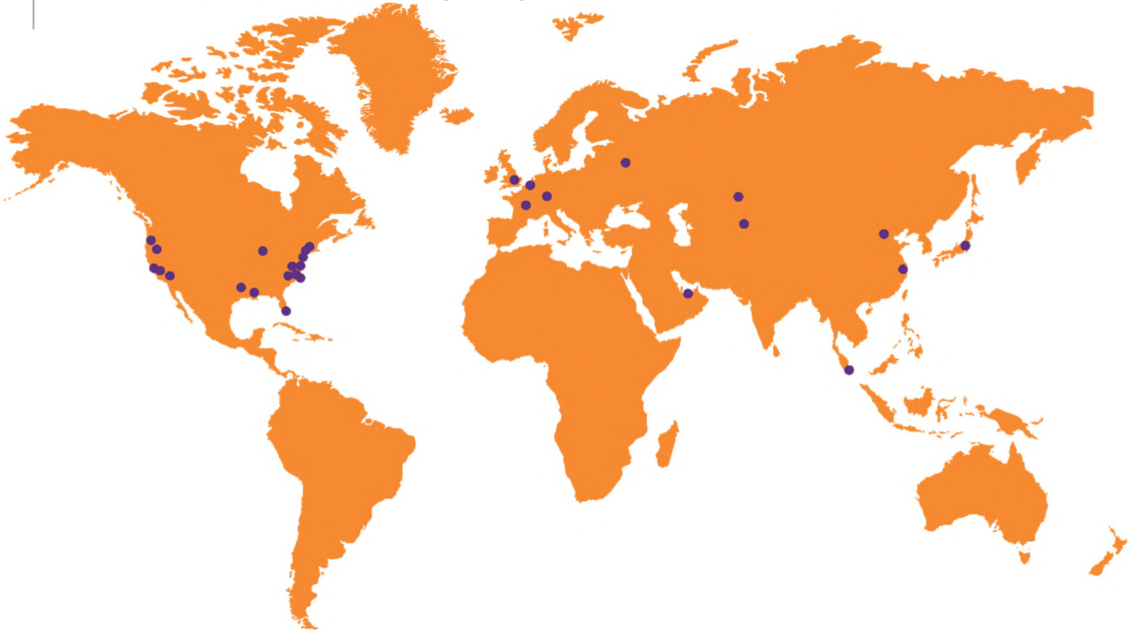
Beijing*	Dubai	Los Angeles	Philadelphia	Singapore
Boston	Frankfurt	Miami	Pittsburgh	Tokyo
Brussels	Hartford	Moscow	Princeton	Washington, DC
Century City	Hong Kong*	New York	San Francisco	Wilmington



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