



Legal Essentials for Startup Founders

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Disclaimer

- Tell me you did not see this coming ...
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What Type of Entity Should the Company Form?

- Three choices that provide limited liability for owners
 - LLC
 - tax pass through entity
 - generally not acceptable to institutional investors
 - inability to provide tax-beneficial equity incentives
 - not QSBS eligible
 - equity swap transactions taxable even w/o liquidity event
 - **C-Corp**
 - theory of double taxation
 - **preferred by investors**
 - **easy to provide tax favorable equity incentives**
 - **QSBS eligible**
 - S-Corp
 - hybrid – combines elements of LLC and Corp
 - not QSBS eligible
 - restrictions apply as to number and type of stockholders
 - limited to one class of stock (disparate voting power is ok)

What Type of Entity Should the Company Form? (cont'd)

- Where should this entity be formed?
- Organization process – do it right the first time!
- “Starter kit” for each:
 - Certificate of Incorporation (Corp) versus Certificate of Formation (LLCs);
 - Bylaws (Corp only);
 - Statement of the Incorporator (Corp only);
 - Organizational Consent – the initial resolutions (Corp only);
 - Omnibus Stock Incentive Plan – mechanism to equitize employees, directors and consultants. MAJOR DIFFERENCE LLCs v. CORPS;
 - Stockholder’s Consent (Corp only);
 - Stock Certificates (generally Corp only);
 - Stock Ledger – current capital structure, to be updated as needed (Corp only/for LLCs: schedule to operating agreement);
 - Non-Disclosure Agreement – third parties (Corp and LLCs);
 - **Invention Assignment, Confidentiality and Non-Solicitation Agreement (Employees) (Corp and LLCs); and**
 - **Invention Assignment, Confidentiality and Non-Solicitation (Consultants) (Corp and LLCs).**
- **Equity Allocation and importance of vesting/repurchase rights and 83(b)**

How Do You Protect Your Intellectual Property?

- Protect IP through CONTRACTS – Invention Assignment, Confidentiality, Non-Solicitation Agreements; Non-Disclosure Agreements
- Patents
 - Limited property right to exclude others from making, using, or selling an invention.
 - Quid Pro Quo – must balance the full disclosure of you invention (share the secret sauce) with the limited (20 year) monopoly
- Trade Secret
 - Secret information with commercial value – almost like a perpetual patent, for so long as you can safeguard the secret
 - Must use reasonable degree of protection (physical security, limited access to material, need to know)
 - Possible uses: recipes or formulas, business plans, customer lists, manufacturing processes
 - Ex: The formula for CocaCola (secret for more than 125 years); the recipe for KFC
- Copyrights
 - Do not protect ideas, but rather the manner in which ideas are expressed (“original works of authorship”)
 - Ex: written works, art, music, architectural drawings, or even programming code for software
- Trademarks
 - Protects words, phrases, symbols, sounds, smells and color schemes.
 - Ex: “McDonald’s”. “Apple”.

Hiring/Incentivizing Employees, Including the Co-Founders

- **Equity Incentive Plans allow the company to attract, retain and incentivize talented people**
- Typical plan allows the company to grant options (ISOs and NQSOs), restricted stock, stock appreciation rights
- **LLCs don't allow for favorable tax treatment of equity incentives for employees**
- **Founders stock/vesting/forfeiture provisions/repurchase rights and 83(b)**
- **MUST STILL PAY MINIMUM WAGE** (except to founders) (special NY rules/state law applies)

Raising Capital!

- Why raise capital at all?
- From whom should you raise capital?
 - Bootstrapping
 - Accelerators
 - Friends and family (and fools)
 - Angel investors
 - Venture capitalists
 - Corporate partners
- Types of Financings
 - Convertible Note v. Priced Equity Round v. SAFEs/KISSes
 - Ubiquity of convertible securities v. priced equity (a thing of the past?)
 - **Return of priced equity – new security “Pre-Seed Preferred Stock” – best of both worlds?**
 - Differences in timing, transaction costs, acceptability to investors and QSBS

Immigration Law Issues

- Any non-citizen or non-resident alien owners/board members/officers/employees?
- Consult with immigration counsel

Bonus [Non]Legal Issue and Discussion

- Solve a problem – no longer “nice to have,” need something the addressable market “has to have”
- **Not every great idea supports a business**
- **Not every business is a financeable one** (requirement of scalability)
- **Not every financeable business has to be a unicorn** thanks, in part, to declining capital intensity

Questions?



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