

Common Entrepreneur Mistakes

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The Wrong Business Structure

The “De Facto” Partnership

- What is it?
- Problems:
 - Ownership of IP
 - Vicarious Liability

The “Wrong” State of Formation

- California vs. Delaware
 - California is shareholder friendly
 - Delaware is management friendly
- Special Case of the So-Called Quasi-California Corporation
- Why You DON'T Necessarily Want to Be in Nevada
 - You will most likely pay taxes
 - The law is not as well defined

Failing to Make the “S Election”

- Consequences of Subchapter S Election
 - Pass-Through of Income
 - Pass-Through of Losses
 - Pros
 - Cons
- DON'T Miss Filing Deadline
 - RU Dead in the water?
 - Retroactive S Election?

Keep it Simple!

- Don't Over-Build at Start-Up. Avoid the Following:
 - Multiple operating companies or special business units (Subs)
 - Related party engineering, development or service companies
- Restructuring Can Be Expensive and Involve Negative Tax Consequences

The Wrong Team

These are
managers

Putting off the Inevitable

- Most Start-Ups Tend to Be Too Quick to Hire and Too Long to Fire
 - Don't hire just because someone will work for equity or for free
 - Things will get worse and much more complicated to unwind
- Avoid Urge to Hire friends & Family
- Avoid Those With "Checkered" Pasts
- Recognize Your Own Limitations

Mishandling the Inevitable

- DON'T Violate California Labor Laws
 - An employee who is discharged must be paid all wages, including accrued vacation, at time of termination
 - An employee who quits must be paid all wages, including accrued vacation, within 72 hours of quitting
- ALWAYS get releases from liability on separation (even if you have to pay for it!)

Failing to Protect the IP

Failing to Get IP into Company

- Two Typical Approaches:
 - Contribution for equity
 - Licensing arrangements
- Factors to Consider:
 - Protection from creditors
 - Additional “Fields of Use”
 - Tax considerations

Creating Clouds on Title to IP

- The “Moonlighting” Founder
 - Under Section 2870 of the California Labor Code, Employer owns IP unless:
 - Employee developed entirely on her own time; and
 - Employee did not use employer's equipment, supplies, facilities or trade secret information
 - Exception for any of the following IP, that:
 - Relates at time of conception to employer's business, or actual or demonstrably anticipated research or development of employer; or
 - Results from any work performed by employee for employer.

Creating Clouds on Title to IP (cont.)

- Other Employment Related Issues:
 - Get employment agreement in place before employee starts work
 - Obligations to execute assignments and to reasonably cooperate
 - Non-solicitation of employees, customers and vendors
 - Check for pre-existing duties of confidentiality to former employer
 - Ask to see employment agreement from former employer

Creating Clouds on Title to IP (cont.)

- Issues Relating to “Work for Hire” (*i.e.*, Contractors)
 - GET consulting agreement in place BEFORE consultant starts work
 - Without a suitable agreement, you may “own” nothing more than a limited license to use what was developed, even though you paid for the work!
 - Negotiate for ownership UP FRONT, before a deal is pending

Treating Stock Like Water

treating stock like water

Oral Promises of Equity

- Oral Agreements ARE Enforceable
- The Problems with Oral Agreements are:
 - Terms are never well defined or fully thought out
 - Difficult for employer to disprove claimed existence of such an arrangement
- “Sleeping Dogs” Tend to Wake Up When Exit is imminent

Using Equity as Cheap Currency

- Know What is Market. How Much is Too Much?
- Keep an Accurate Capitalization Table
- Look for Alternative Ways to Finance the Business: Bootstrap!
- DON'T Forget About Compliance with Applicable Securities Laws

Not Enough Strings Attached

- Use of Restricted Stock and Vesting
- ALWAYS use a probationary period
- Repurchase Rights Upon Termination
- All Equity Should Be Made Subject to a Shareholders' Agreement
 - Restrictions on Transfer
 - Rights of First Refusal
 - Repurchase Rights on Trigger Events
 - Tags, Drags and Shotguns
 - Proxies and Voting Agreements

Failure to Maintain Corporate Formalities

What Corporate Formalities?

- Hold and Properly Document Meetings to Authorize All Requisite Corporate Actions
- Maintain and Keep Separate:
 - Minutes Books & Accounting Records
 - Bank Accounts
 - Insurance & Licenses
 - Contracts and Leases
 - Letterhead and Stationary
- Don't Run Personal Items Through the Company

Consequences to So Maintain

- Alter Ego Liability (aka “Piercing of the Corporate Veil”) to Third Parties
- Contracts May Be Voidable at Option of Third Parties
- Liability to Equity Holders for Breach of Fiduciary Duties
- The Company May be “Unfundable”

Not Leaving Enough Runway

Underestimating Capital Requirements

- Make Sure Your Projections Are Sound (Then Double Your Cash Requirements!)
- Make Sure Your Capital Sources are For Real – Get it in Writing!
- Think Long and Hard About Quitting Your Day Job

Seeking Capital Too Early

- Build the Business First, Then Seek Capital
- DON'T Lose Focus and Permit the Business to Suffer While You Seek Capital
- Only Seek Capital From Appropriate Sources

Wasting Time by Spinning Wheels

- GET Educated; Learn What is Market
- Network with Appropriate Referral Sources
- DON'T Work with Finders Unless You Have a Referral from a Trusted Source
 - They will gladly take your money
 - They could waste precious time

No Contingency Plan in Place

- ALWAYS Have a Back-Up Plan
- Pull the Trigger BEFORE it is Too Late

Questions?

research

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Thank you!

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