TOP 10 MARKET ENTRY & LEGAL MISTAKES STARTUPS CAN AVOID

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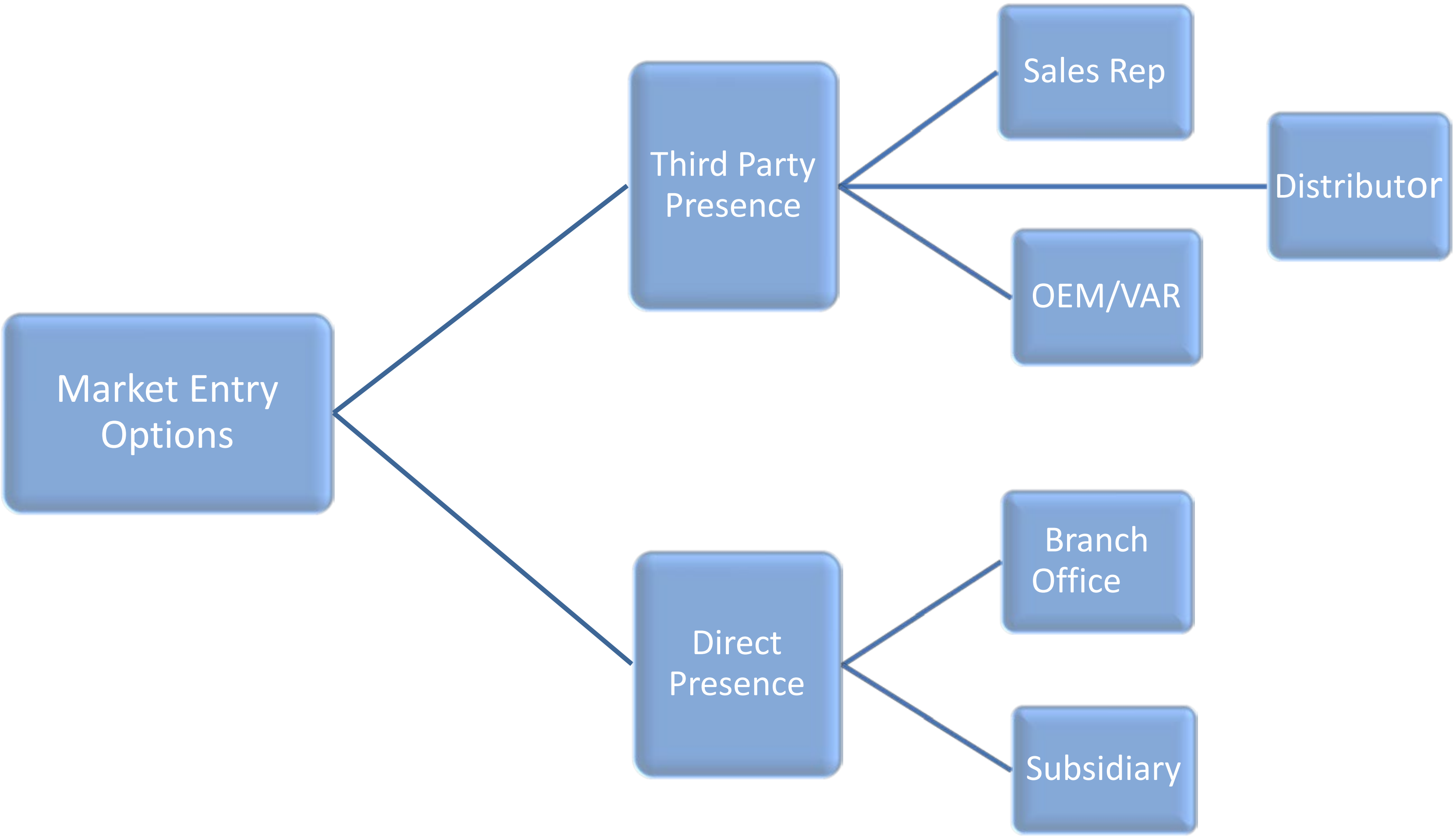
10. Failing to identify the right market-entry strategy



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9. Choosing the wrong entity structure

- Incorporating provides liability shield
- Choosing the right entity is critical to the life of the business: determines liability protection for founders and investors, and flexibility of the company
- LLCs: limited liability, pass-through taxation, minimal formality
- S Corporation: pass-through taxation, restricted to US persons, certain trusts and tax-exempt entities
- C Corporation: limited liability, double taxation, flexible capital structure, most favorable for VC funding
- Partnerships: General partners have unlimited liability, favorable for joint ventures
- Choose the right place of incorporation: Delaware need not be suited for everyone

8. Failure to establish intellectual property strategy

- Be aware of IP ownership of your prior employer, and how your current asset relates to it. Check your prior employer's obligations ***before*** you start working on your idea!
- Register trademarks, patents, copyrights and any other intellectual property that is key to your business
- IP protection is jurisdiction specific, obtain an IP strategy for those markets that you intend to do business in
- Invention assignments are critical if the core asset is IP being created
- Privacy Policy and Terms of Use

7. Violating Employment/Labor Laws

- California Labor Code enforced by the Labor Commissioner's office
- Minimum Wage laws apply to startups: San Jose: $10/hour; San Francisco: $10.55/hour
- Employee v. Independent Contractor classification
- Enforceability of post-termination restrictive covenants (non-compete and non-solicitation clauses) varies with each state
- While hiring employees, check that their employment agreements with their prior employers and their knowledge of trade secrets are not restrictive to your startup

6. Not complying with Securities Law

- Securities cannot be issued by a company unless (i) the securities have been registered with the SEC and registered/qualified with the respective State securities commission or (ii) there is an exemption from registration.
- Issuing stock to unaccredited investors can have disastrous consequences
- Consultants who are not registered broker-dealers engaged to sell company stock for a fee is a violation of securities laws.
- Ensure you make state and federal securities law filings each time securities are issued or, find an exemption.
- Failure to comply with securities laws can result in rescission of the securities, injunctive relief, fines, penalties, possible criminal prosecution.

5. Lack of tax planning

- 409A valuations are mandatory
- Missed 83(b) elections cannot be rectified by paying a fine. Ensure the election is postmarked within 30 days of purchase of the stock
- Deferred Compensation Plans: specific rules required to be followed to qualify for a ‘deferred compensation plan’

4. Lack of adequate corporate structure resulting in entrenched management

- Class F Common Stock: Using multiple classes of common stock has its advantages but may be detrimental to funding propositions
- Beware while using stock as currency – securities laws, tax laws and state laws might make it restrictive
- Using percentages while splitting the equity is not as effective as using number of shares
- Lack of a vesting schedule for founders and early employees
- Lack of buy-sell/stockholder’s agreements between founders
- Provisions that are relevant to preventing entrenched management issues: right of first refusal, drag-along rights, tag-along rights, veto rights.

3. Not using the right equity compensation structure

- Use option plans to compensate employees, consultants, directors and advisors
- Option plans usually make up about 10-20% of the total authorized stock (smaller the pool, lesser the dilution)
- Issue options when valuation is low in order to be able to realize some return on the investment
- Establish vesting schedules for option grants
- Options are securities, and have to comply with securities laws
- 409A compliance is mandatory for option plans
- Restricted Stock is a close alternative, more attractive to retain talent

2. Failure to ensure compliance with FCPA and immigration laws

- Anti-bribery laws apply to all U.S. persons and certain foreign issuers of securities
- Also applies to foreign firms and persons who cause a corrupt payment to take place within the United States.
- Check the immigration status of all founders: if sponsorship is required by the startup, you need good immigration counsel.

1. Substituting legal counsel with online incorporation services

- Relying on generic contracts can result in key provisions being left out of ownership and charter documents
- Ensure that the provisions are enforceable by state law (eg. Non-compete and non-solicitation in California)
- Obtain documents that evidence your ownership interest in the company
- Obtain proper business licenses, qualifications in states where business is being conducted, permits in the county etc.
- Lawyers don’t have to be unaffordable: some services can be provided at fixed fees
- Engaging lawyers from the start is often more efficient than a last minute or a hurried engagement
- Use a lawyer for legal counsel but do your homework

Questions?

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