

CRITICAL LEGAL ISSUES FOR EARLY STAGE COMPANIES

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Presented to ENET: The Boston Entrepreneurs' Network

December 4, 2019

Overview

- Starting a Business
- Choice of Entity
- Capitalization
- Stockholder Agreements
- Employee Arrangements
- Financings

Starting a Business

- Limitation of Liability
- Shared Ownership
- Singular Ownership of Assets
 - Especially important for IP assets

Choice of Entity Type

- C-Corporation
 - Common structure, with well defined governance regulations
 - Not very flexible
 - Tax disadvantages
- Limited Liability Company
 - “Pass-through” entity for tax purposes
 - Difficult to provide equity incentives
 - Not favored by investors
- S-Corporation
 - “Pass-through” entity
 - Particular requirements must be met

Capitalization

- Equity / Cap Table
 - Get it right up front and keep meticulous records
 - Construct a pro-forma capitalization table, showing how stock is allocated among founders, employees, expected investors, etc.
- Types of equity to be issued (common stock vs. preferred stock)
- Employee incentive equity - restricted stock vs. stock options; vesting restrictions (83b's)
- The company is not your piggy bank - observe formalities

Capitalization (cont'd)

- Bills of Sale
 - Get all founders' contributions into the Company on day one.
- Stockholders Agreement: Keep shares in the hands of those continuing to add value
 - Vesting relating to term of service (83b's)
 - Right of first refusal
 - Restrictions on the transfer of stock
 - Voting for specified directors; drag along

Employee Arrangements

- Employees
 - Assignment of Inventions; Non-Disclosure Agreements
 - Pay Minimum Wage
- Contractor Agreements
 - Beware! Default is for Contractor to own his own work
- Massachusetts Non-Compete Law

Financings

- Other People's Money
- Investors are helpful, but are not your friends
- Understand financing terms
 - Ask questions
 - Think about impact on future rounds
 - Be realistic



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