CRITICAL LEGAL ISSUES FOR EARLY STAGE COMPANIES

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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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