

# Legal Issues for Startups

Von Allmen Center for Entrepreneurship  
Bootcamp Presentation

11/14/19



# Tonight's Agenda

1. Overview of C3; C3Legal
2. Intellectual Property for Entrepreneurs
3. Founders' Issues
4. Employment Law Considerations
5. Investment/Equity Funding Considerations



# WHAT IS C3?

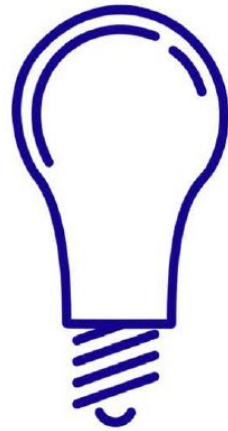
The Commonwealth Commercialization Center (C3) is Kentucky's unprecedented engine for statewide innovation, created to **fuel economic growth and ignite life-changing impact** for individuals, businesses and communities.



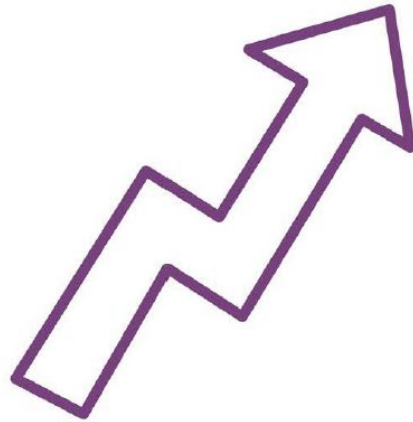
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## C3 CORE PILLARS

INNOVATION



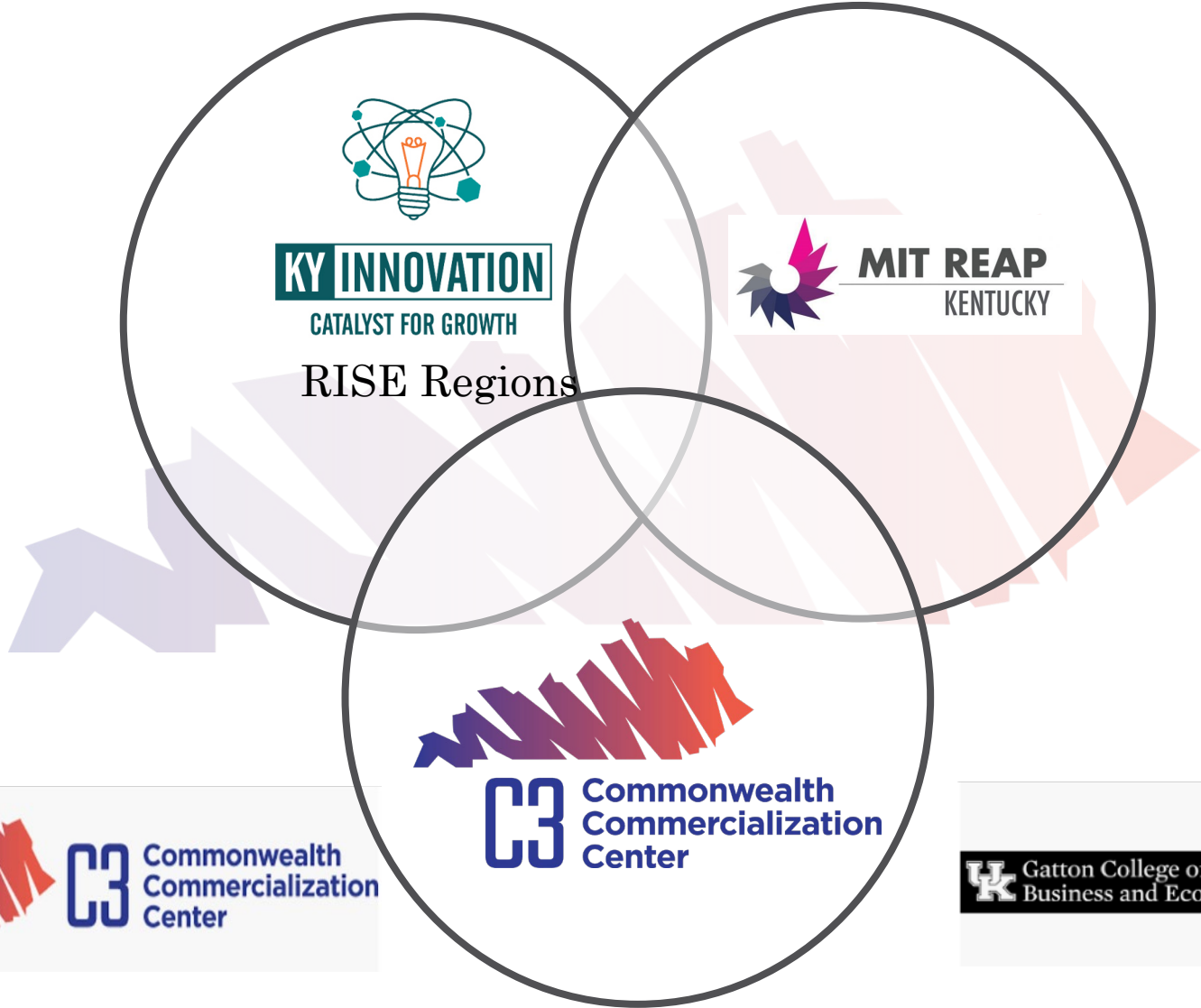
ACCELERATION



CAPITALIZATION




# Kentucky's Entrepreneurial Ecosystem - 2019



# ...So where are the lawyers?



 Gatton College of  
Business and Economics

Von Allmen Center for  
**Entrepreneurship**



# C3 Legal



# Legal Needs Assessment



 Gatton College of Business and Economics | Von Allmen Center for Entrepreneurship

# Three Prongs of C3 Legal

## Connections to Counsel

- ❑ **Front door** for startups in need of legal education, resources, counsel.
- ❑ **Connect startups** to appropriate, high-quality, and affordable legal services.
- ❑ Implement measures to **incentivize participation + bridge gaps**.

## Legal Education

- ❑ **Bolster classroom and experiential opportunities** across law schools.
- ❑ **Facilitate connections** between students, entrepreneurial communities, and the private bar to grow the pool of legal talent in Kentucky's startup ecosystem.
- ❑ Offer startup law-focused **CLE courses** and **other educational opportunities**.

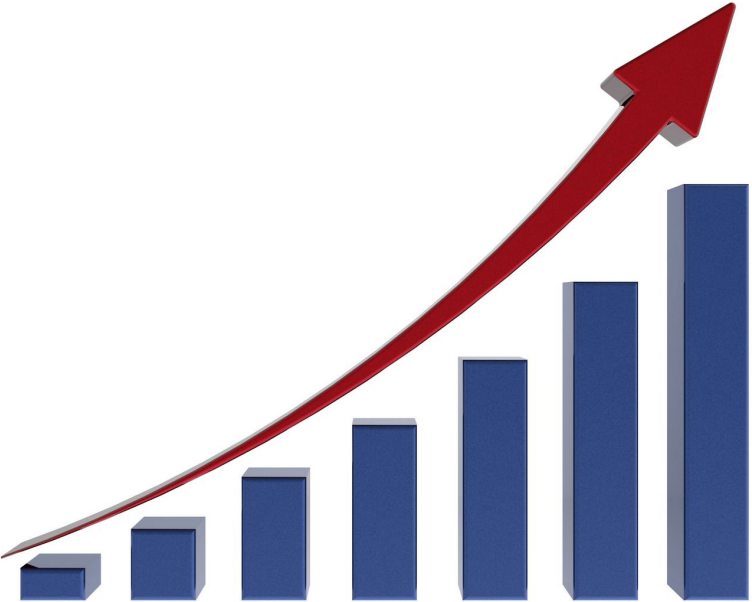
## Ecosystem Catalyst

- ❑ **Serve as connective tissue** for entrepreneurs, startup attorneys, and law schools.
- ❑ Introduce platforms and projects to **connect startup attorneys** to one another **across distances and specialties** and **facilitate collaboration for mutual gain**.
- ❑ **Position Kentucky's collective talents** to function as a **national thought-leader**.





The goal: to build a  
*functional continuum of legal resources*  
to grow the pipeline of Kentucky entrepreneurs



# Questions?



# Intellectual Property for Entrepreneurs

Tony Bonner, Fletcher Lyon, & Max Penn



# What is Intellectual Property?

- Intellectual property is work that is the result of creativity.
  - This encompasses trademarks, copyrights, patents, and trade secrets.
- How does this affect my business?



# What's the difference?

- Trademarks identify a source
- Copyrights protect creative works
- Patents protect processes, designs and inventions
- Trade secrets protect know-how, etc.

**TM** vs. **®**



# What's the big deal?

- Your startup is exactly that, a startup.
- Startups are pre-revenue, so your most valuable asset is your intellectual property.



# Questions to Consider for trademark

What does trademark law protect?

Do I need to register my trademark?

How can I ensure am the true owner of my trademark?



# Trademark

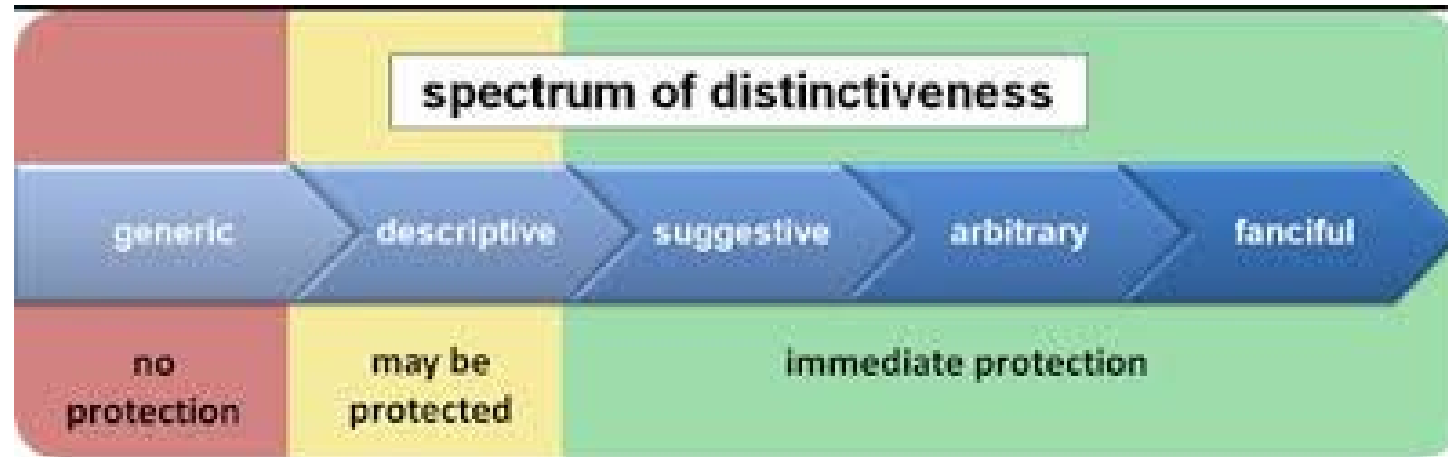
Trademark law is about identifying the source of a product or service.

You will need to understand the principles of trademark law when coming up with a name and a logo.



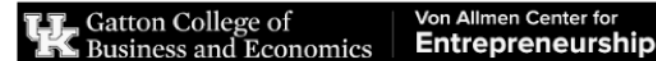


# Abercrombie Spectrum



# Registration

- While registration is not necessary, it is helpful to register your mark to add extra protection if you sue or are sued for infringement and to gain broader exclusive rights to the mark. Incorporation does not automatically register your mark.
- To register you must actually use your mark for commercial purposes. You will also want to use a lawyer to take care of registration.



# Copyrights

- A **copyright** protects original works of authorship including literary, dramatic, musical, and artistic works, such as poetry, novels, movies, songs, computer software, and architecture.
- The work must be **expressive** and **fixated** in a tangible medium.



# Copyrights may affect your business in the following ways:

- Software
- Promotional Materials/Advertising
- Packaging
- Presentation (with fair use exception)



# How to obtain a copyright

- Fixate your work in a tangible medium.
- Registration affords additional rights.



# Patents

- Protects Inventions: systems, methods, articles of manufacturing
- Must be new, useful, nonobvious
- Filing is mandatory to protect rights
- Timing of filing is important – on sale and publication bar
- Secured patents carry value during fundraising



# Trade Secret

- A trade secret is:
  - Information
  - That has economic value to the business
  - That value is due to the confidentiality of the info
  - Steps are taken to maintain confidentiality
- Customer lists, pricing, software, agreements, etc.
- Measures taken to maintain protection: physical and electronic security, NDAs, etc.



# So my company's value is in IP, what next?

- Legally solidify your ownership
- File when necessary
- Notify investors that your IP is protected





# What do I need to do with my Intellectual Property to protect it?

- Trademarks: Put it in commerce – register for statewide or federal protection (must be used across state lines)
- Copyrights: Create it – additional protections for registration
- Patents: Register it
- Trade Secrets: Take steps to keep it a secret (NDAs, etc.)



# Questions?



# VACE Bootcamp Presentation

Founder's Issues; Entity Formation

Sam Jones & Tommy Staffieri



# Common Problems

- *Who's in charge?*
  - + Management and decision-making authority
- *Who gets what?*
  - + Equity distribution
- *"I work harder and am more invested in this company"*
  - + Personal liability
- *"I can't work with her because we have the same skills, but different opinions"*
  - + Team Dynamic
- *"We're going down, and I want out"*
  - + Exit strategy
- *"Business would be great if it wasn't for Uncle Sam..."*
  - + Tax benefits of business entity



# Founder's Issues

- Leadership of the Company
  - + Understand the dynamic of group/founders
    - Who will be “in charge?”
    - What parties were involved in the development of idea?
    - Who has “skin” in the game?
  - + Foresight - who will continue to lead the company?
    - Idea generation versus managing the day-to-day business
  - + Determine the company's objectives
    - Recognize specialties of each party involved
    - Full-time commitment to the company?
    - For profit? Non-profit?
- Agreement + Foresight = Imperative



# Sole Proprietorship; General Partnership

- Default entity - not a separate legal entity
  - + Unlimited liability
  - + Partners share in all aspects of company (profits, financial, legal)
  - + Increased flexibility
    - Unilaterally agree to binding agreements
  - + Reduced Cost
- General Business Liability Insurance available, but not required
  - + Protect against general claims against partnership



# Entity Formation (LLC, Corporation)

- Business structure affects founder's rights
  - + Liability
    - LLC & Corporation = Protect personal assets
    - Sole Proprietorship = Personal liability
  - + Tax treatment
    - LLC = “pass through”
    - Corporation = “double taxation”
    - S Corp = “pass through”; no employment tax
- Location
  - + Where to incorporate? Why?
- Operating agreement will govern
  - + Details of agreement (ownership structure, rights granted)



# Limited Liability Company (LLC)

- Overview
  - + Avoid personal liability
  - + “Pass through” Tax
  - + “Transferability restriction test”
- Process
  - + Entity Name
  - + Articles of Organization
  - + Operating agreement
  - + State approval and fee
    - EIN number





# Corporation (C vs. S)

## C Corp

- Separate legal entity
  - Owned by shareholders (limited liability)
- Sale of stocks and bonds to unlimited investors
- Must be incorporated

“Double tax”

Perpetual life

Tax deductible expenses  
(insurance, retirement plan)

Tax filings + Government

Oversight

## S Corp

- Separate legal entity
  - Owned by shareholders (limited liability)
  - Maximum 100 shareholders
- One class of stock
- Must be incorporated

• Avoids “Double tax”

• Perpetual life

• Tax deductible expenses  
(insurance, retirement plan)

• Tax filings + Government  
Oversight

# Benefit Corporations & Low-Profit Limited Liability Companies (L3C)

- Benefit Corporations
  - + “Triple bottom line”
  - + Focus on value for non-shareholders
  - + NOT the same as “Certified B-Corps”
- Legally, no drastic difference between Benefit Corp and C Corp
  - + Different legal process to meet social requirements



# Sam & Tom start a business...

- What's the business?
- Who owns what?
  - + IP? Idea generation verse creating prototype?
- Who will run the business?
  - + Who will run the business in the future
- Outside investors involved?
- Personal liability?
- Tax purposes?
- Exit Strategy?



# Main Takeaways

- Founder's impact and role will determine business structure
  - + Must be decided prior to formation!!
- The business entity becomes the beneficiary of the business
  - + Shield personal liability
  - + All things done and assets held in name of business
  - + Tax implications based on the type of the business
- Foresight is needed when forming the business
  - + Do not avoid “difficult conversations” (e.g. management, leadership roles, exit potential)
- Trust your attorney's legal opinion
  - + Don't go blindly into company's formation
  - + Anticipate issues and plan accordingly
  - + Read Operating Agreement before signing



# Questions?



# EMPLOYMENT LAW CONSIDERATIONS

With Allison Cooke & Myles Chaney



# What is "Employment Law"?

Employment Law deals with the rights and obligations between employers and employees.

Many of these rights and obligations arise through employers and employees entering into contracts and from statutes passed by the government.

As you grow your business, it is important to consider any contractual or statutory obligations you may have toward your employees.



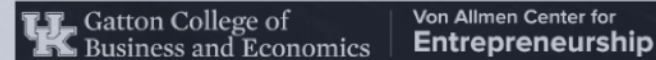


# Types of Workers

The individuals who work for your company can usually be categorized as either:

- 1) Employees
- 2) Independent Contractors
- 3) Volunteers
- 4) Interns

The category an individual falls into is dependent upon a variety of different factors.





# Who is an Employee?

As a general matter, the law considers a person who is working for somebody else to be an employee.

Some typical traits of an employee include:

- 1) The employer determines what work a person will perform.
- 2) The employer determines *how* a worker performs assigned tasks.
- 3) The employee is paid through a W-2.

# Who is an Independent Contractor?

Employees and independent contractors often perform similar (or even the same) work.

The difference between employees and independent contractors lies in the control the worker has over the work that they perform.

Generally, the more autonomy a worker has in how they perform a task, the more likely they are to be considered an independent contractor.



# Who is a volunteer?

Volunteers donate their time and services without the expectation of financial gain.

Rather than a monetary motivation, volunteers may engage in a task for public service.

For one to be a volunteer, the work they perform must not displace the work performed by normal employees.

For-profit businesses can  
*Never* have volunteers.





# Who is an intern?

Generally, the default rule is that interns are employees.

Interns are motivated by a desire to develop a skill set, receive class credit, etc.

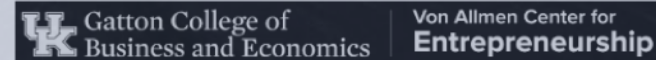
In determining whether an intern can be unpaid *some* factors to consider are:

- 1) Do both parties understand the work is unpaid?
- 2) Does the employer accommodate the worker's academic schedule?
- 3) Is the worker receiving some sort of academic benefit due to their work?
- 4) Does the work of the intern compliment the work of the business' regular employees or displace it?



# Which Type of Worker is “Best”?

What are some of the pros and cons of each of the different types of workers we just discussed?



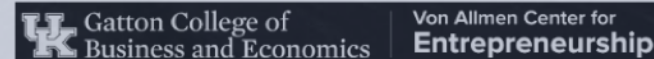
# Statutory Employee Protections

Employment in the United States is "at will". However, some statutes have placed limitations on at will employment.

It is illegal under Federal and Kentucky Law to take adverse employment actions against employees based on classifications such as: race, sex, religion, age, national origin, or disability (*see e.g.* Title VII and Kentucky Civil Rights Act).

These laws make it illegal for workplaces to engage in discrimination, harassment, or retaliation based on protected characteristics.

Businesses become subject to these laws when they reach a certain number of *employees*.



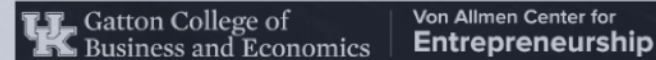


# Statutory Employee Protections (Cont.)

Federal and Kentucky labor laws require all employees be paid a minimum wage.

Labor laws have guidelines by which employers must track the hours certain employees have worked.

Generally an employee is entitled to payment for time they have spent acting to the benefit of the employer.



# Employees and Growth

- Growing a business will necessitate the hiring of employees.
- Some benefits of employees include:
  - Loyalty
  - Consistency
  - Better Work Product





# Employees and Growth (Cont.)

- Hiring and retaining employees give new responsibilities to a business.
- The responsibilities that come with hiring employees can be mitigated through:
  - Planning and preparation
  - Creating a healthy work environment
  - Establishing a consistent payment system



# Questions?



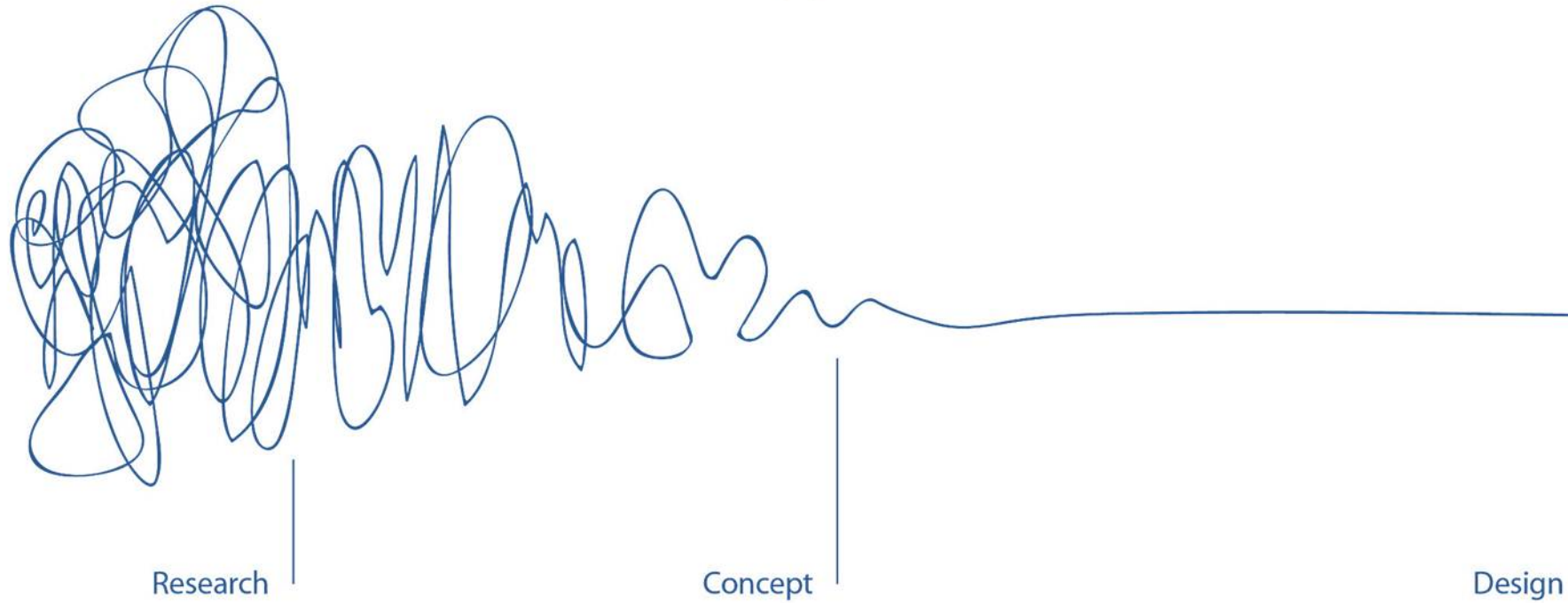
# Funding Opportunities For Entrepreneurs

Warren Nash & Aaron Johnson

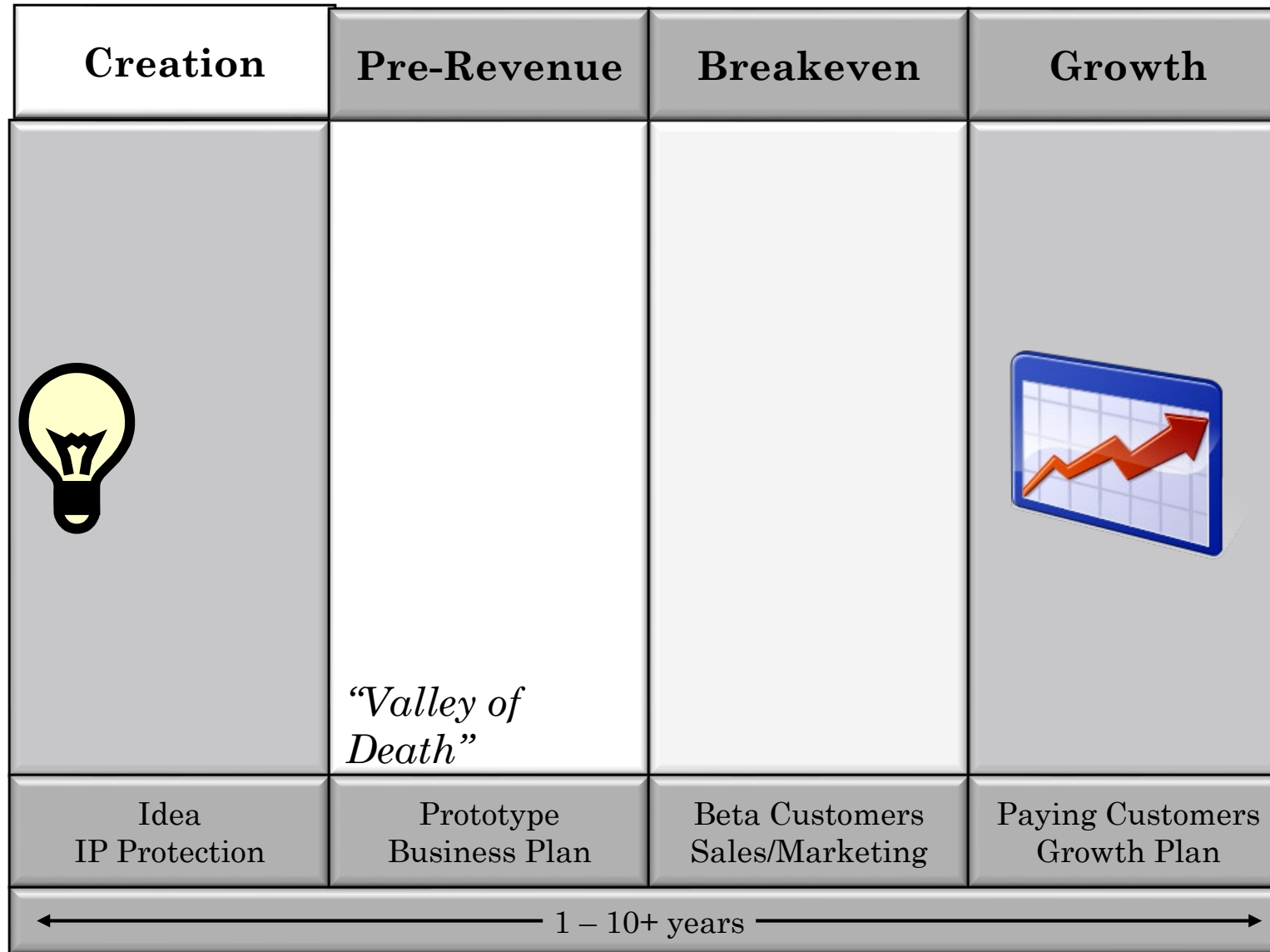


Uncertainty / patterns / insights

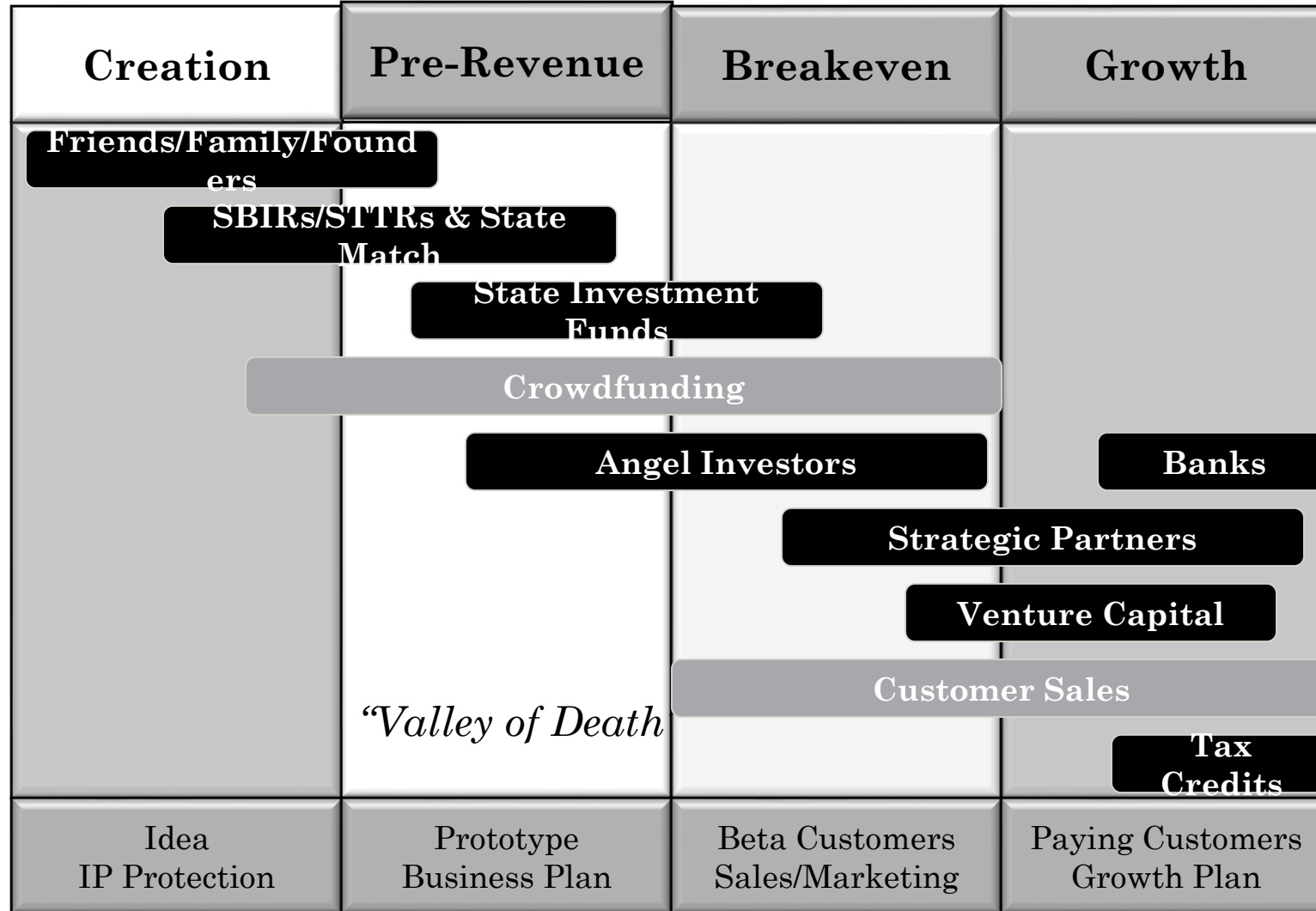
Clarity / Focus



# Startup Company Funding



# Funding Roadmap



# Early stage programs / options

- Launch Programs
  - BGA Launch Grant / Launch Fund; Cherub Fund
- Pitch Competitions – 5 Across, etc.
- Incubators / Accelerators
  - XRate Health, Awesome Fellowship



# Types of Financing

	Grants	Loans/Debt	Investment/Equity	Revenue
Sources	Federal & state agencies Foundations	Banks Credit cards Friends & family	Angel investors Venture capital State programs Friends & family	Customer Sales
Pros	No payback Non-dilutive Keep control	Non-dilutive Keep control	Shared risk “Smart” money	Nothing better
Cons	Lengthy process Highly competitive Usually technology based	Payback with interest Security required	Dilutive Give up some control	None



# Investment / equity

Funding Opportunities



# What is Investment Funding?

- Dilutive Capital
  - Sell Equity for Cash
  - Common Stock – least amount of rights, privileges, and preferences
  - Preferred Stock – stock that has preferential terms, rights, and privileges compared to common stock
    - Antidilution – provides price protection for investors
- Investors
  - Friends and Family
  - High net worth individuals, SEC Accredited
- Investors Expectations
  - Return on Investment (Exit)
  - Influence / Mentor Relationship



# Friends, Family, Fools

- Founders
  - 57% of startups are funded by personal loans and credit
  - 38% percent receive funding from family and friends



# “Accredited” Investors

SEC restricts investments in private firms to the following:

- a natural person who has individual net worth, or joint net worth with the person’s spouse, that **exceeds \$1 million** at the time of the purchase, excluding the value of the primary residence of such person
- a natural person with income exceeding **\$200,000** in each of the two most recent years or joint income with a spouse exceeding **\$300,000**
- a bank, insurance company, registered investment company, business development company, or small business investment company
- a business in which all the equity owners are accredited investors
- a trust with assets in excess of **\$5 million**

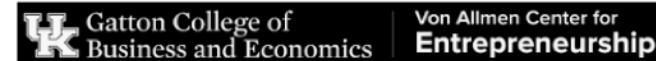


# Private Investors

	Angel	VC
Stage	Seed / Early-stage	Early-revenue & growth
Investment (per deal)	\$25K - \$100K **	\$2-5 million
Source of funds	Personal	Institutional & wealthy individuals
Investment decision	Individual	Professional managers
Investment type	Equity	Equity
Control	Limited	Active

\*\* Angel groups have in common...

- Larger investments as a group (\$100K - \$500K)
- Shared due diligence
- Diverse backgrounds of members
- Sidecar funds mitigate risks



# Angel Expectations

**Scalable business opportunity**

Team that has the ability to execute

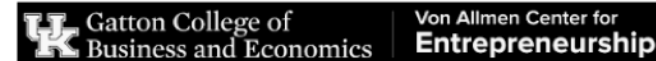
Differentiated product/service with...

Strong IP position and business model

*and/or*

Proven market traction – working prototype, early customers/revenue, sustainable business model

Potential for a 3x-10x return to investors within 2-7 year period



# Valuation

**The process of determining the current worth of an asset or company**

- ***For a public company***...market capitalization; i.e., # of outstanding shares X share price
- ***For a startup company***...what the entrepreneur negotiates with investors
  - Pre-money: the value before investment
  - Post-money: value after investment (pre-money + investment)
  - Investor equity: investment ÷ post-money



# Example

Pre-money Valuation	\$1,000,000
Investment	\$250,000
Post-money Valuation	\$1,250,000
Investor Equity	20%
Founders Equity	80%

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Company gets:

- Funding needed to start/grow business
- Advice/mentoring from experienced investors

Investors get:

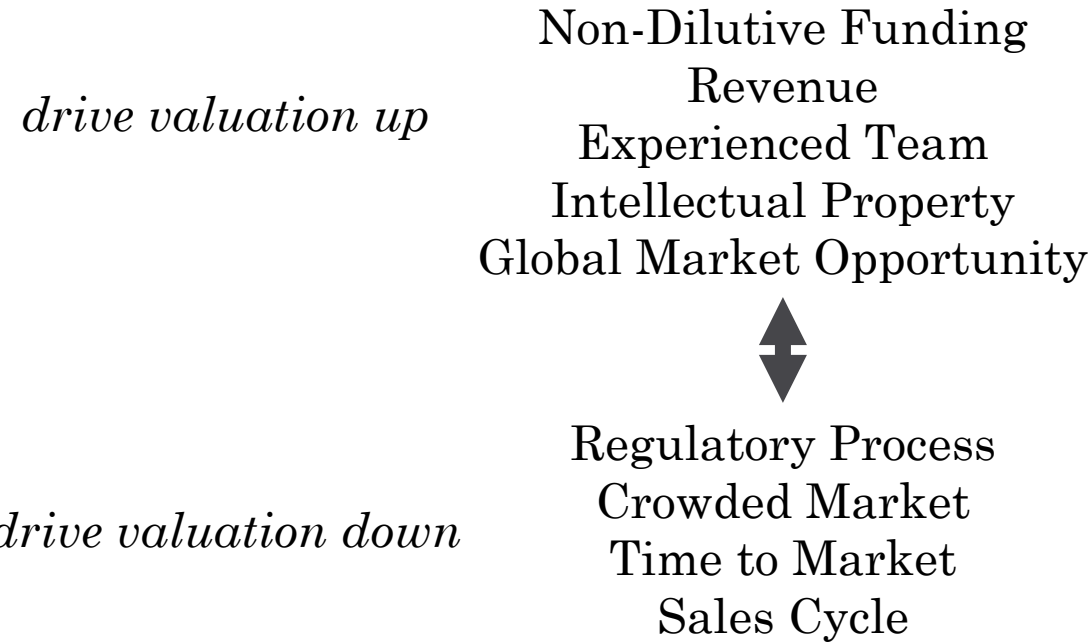
- Opportunity to profit from company success

Company and investors share in success/risk of new business opportunity





*Valuation Drivers - Value Creation is directly proportional to Risk Reduction*



# crowdfunding

Funding Opportunities



# Crowdfunding – Donation Based

Donation-based crowdfunding gives people and creative projects the opportunity to raise money via online donations or pre-purchasing of products or experiences

- [Kickstarter](#)

- Projects must fit within certain categories - personal interests & charities are not allowed
- All-or-nothing funding policy
- Kickstarter takes 5% fee for successfully funded projects

- [Indiegogo](#)

- Looser guidelines – almost any type of project
- Flexible funding allows creators to keep the funds they have raised
- Indiegogo takes 4% fee for successfully funded projects



# Crowdfunding – Equity Based

Equity crowdfunding is the sale of securities

- Securities can be debt, revenue share, convertible note, and more
- On going relationship unlike Donation Based

Forms and Regulatory requirements

- Regulation Crowdfunding –
  - Raise up to \$1.07M annually
  - Companies can start raising capital for free after filing a Form C with the SEC
  - Thresholds trigger review/audit by independent CPA
- Regulation A+ - the mini IPO – can raise up to \$50M annually but more heavily regulated and must submit Form 1-A for qualification with the SEC



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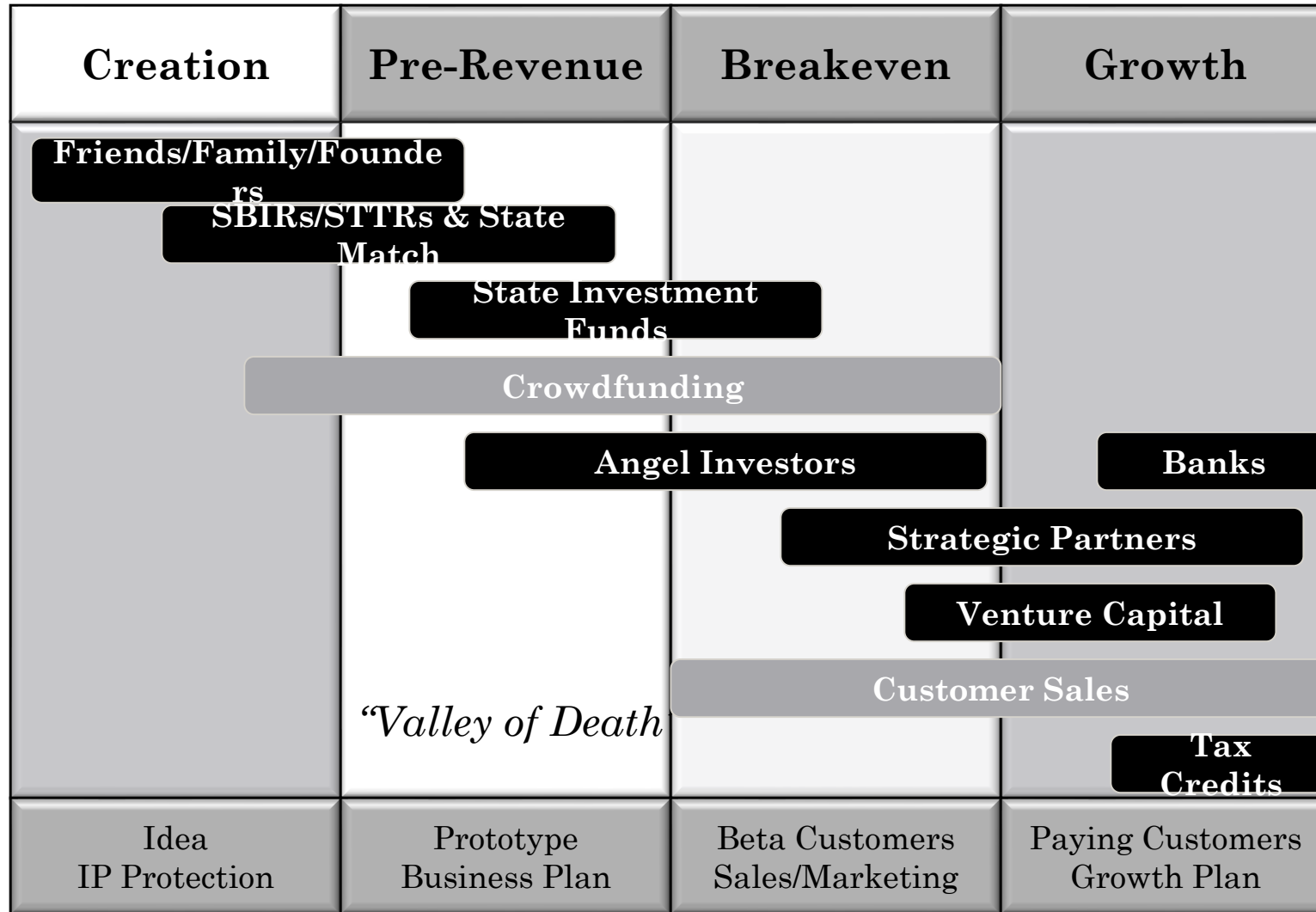
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# Funding Roadmap



# Questions?

