BULLETIN

HOW TO GO FROM CONCEPT TO COMPANY, LEGALLY.

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Entrepreneur's Guide to Legal Hurdles

Entrepreneurship is not a venture for the faint of heart. While support and guidance are available from the Technology Transfer Office and other groups, the entrepreneur's path to prosperity is marked by numerous legal issues. Here are a few tips and an organizational checklist to help traverse the road to success. (The TTO thanks Jeffrey A. Bojar of Biodesix, Inc. for providing this information to CU faculty inventors. Mr. Bojar can be contacted at jeff.bojar@biodesix.com.)

Forming the Business

A range of tax, accounting, structural, corporate governance and certain personal considerations will drive the process of selecting an appropriate business entity. While an entrepreneur is free to operate as a sole proprietorship or general partnership, the entrepreneur will be personally liable for the debts of the business. Fortunately, there are alternative structures — C-corporation, S-corporation, limited partnership, and limited liability company (LLC) — that offer enhanced liability protection. Additionally, these structures offer a range of attributes that are beneficial or detrimental to the entrepreneur depending upon their specific set of circumstances.

In addition to its favorable tax attributes, the LLC provides the most flexibility with respect to allocation of profits and losses, capitalization and corporate governance. Accordingly, the LLC has been gaining popularity as the entity of choice. An S-corporation also takes advantage of favorable tax attributes and may be easier to convert into a C-corporation if that is a longer term goal. Regardless of the business structure chosen, the entrepreneur is forewarned to respect corporate formalities by maintaining corporate records and minutes, holding an annual shareholders meeting, and taking care not to mix personal and corporate property. The absence of these measures could lead to a "piercing of the corporate veil," depriving the entrepreneur of protection against liability.

Raising Money

To grow operations and in-license technology, many entrepreneurs find that they must seek outside capital. This typically results in the sale of company stock but may also involve promissory notes or a combination of the two. There are only two ways to offer company stock for sale without violating the securities laws (i) register the transaction with the Securities and Exchange Commission or (ii) seek an exemption.

For a startup with limited funds, the enormous cost and time involved with registration makes that option impractical if not impossible. The most popular exemption available to the entrepreneur is a "Regulation D offering," referring to Regulation D (Rules 501-508) of the Securities Act of 1933, as amended. To comply with Regulation D, the entrepreneur should limit sales of stock to "accredited" investors if at all possible. An accredited investor is an officer or director of the start-up, a person with a net worth of $1 million, or a person who consistently earns at least $200,000 per year individually or $300,000 with a spouse.

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Protecting Proprietary Assets

The value of many companies is contained in proprietary technology and ideas; to preserve this value, an entrepreneur is well advised to properly protect all intellectual property. This involves a multifaceted approach that includes a trade secret policy and a combination of trademark, copyright and patent protection. It is also important to capture newly invented intellectual property into the company with applicable licensing agreements/clauses with the University and possibly consulting/employment agreements through the Company. While an attorney can assist in establishing and implementing a plan for protecting intellectual property, it is ultimately that entrepreneur's diligence that determines its value and integrity.

Assistance from TTO

Often, the TTO takes a founding role in start-ups. As a founder, the TTO seeks to complement the entrepreneur's efforts and facilitate the acquisition of the company's core building blocks. The entrepreneur in many cases will need to secure the IP rights from CU in the form of a license. The TTO will vet the merits of the entrepreneur's venture — for more information about this, view TTO's Startup Bulletin at https://www.cu.edu/techtransfer/downloads/Bulletin-StartupCompanies.pdf.

Checklist

Bringing an idea to market can be a monumental task, intensified by the appearance of unforeseen problems. However, the entrepreneur who approaches these challenges armed with the knowledge of what lies ahead has the ability to defeat disaster and significantly improve their chances of success. The following checklist provides a good starting place for start-ups. While the volume of documents may seem overwhelming, the goal is to provide a solid foundation for the company's organic growth. Once in the midst of the peaks and valleys of building a company, bringing on shareholders, raising capital and creating intellectual property, it becomes more challenging and expensive to address these foundational matters.

1. **Organizational resolutions:** Written approval of the incorporators, directors, and shareholders of each of the organizational matters set forth below, in addition to other basic authorizations regarding banking, election of officers, fiscal year, and general authority. Provide a solid foundation for good corporate hygiene. Maintaining such formalities will serve to limit liability and produce clear, consistent, and accurate corporate records.

2. **Bylaws:** Establish the ground rules and manage the relationships among the Company and its shareholders, directors, officers, and third parties.

3. **S-election (if applicable):** Election to be treated as a partnership for tax purposes, which needs to be filed with the IRS within two months and 15 days of the Company's formation.

4. **Capitalization table:** Reflects the authorized and/or outstanding capital stock and other equity instruments of the Company. Determined with a sensitivity toward long-term goals, including additional investors, dilution, and related matters.

5. **Stock ledger:** Clear, concise record of all stock certificates outstanding with related shareholder contact information.

6. **Stock certificates:** Actual certificates indicating ownership of capital stock labeled with appropriate restricted transfer legends

7. **Shareholder Agreement:** Sets forth the rights of shareholders to purchase, acquire, encumber, sell, dispose, and otherwise transfer capital stock of the Company.

8. **Stock Incentive Plan; Notice of Award and Award Agreement:** Plan designed with long-term view toward promoting the success and value of the Company by aligning the personal interests of the directors, employees, officers, and consultants with the success of the Company. Provides stock and vesting terms to key people.

9. **Charter for Scientific Advisory Committee or Business Advisory Committee:** State the purpose and obligations of the Advisory Committees organized by the Company to provide strategic advice and recommendations.

10. **Consulting Agreements:** For key management and advisory committee members of the Company, designed to define obligations with respect to services to be performed, compensation, expenses, and ownership of intellectual property.

11. **Indemnification Agreements:** Provide adequate assurances and protection against inordinate risks of claims related to actions by directors on behalf of the Company.

12. **Federal Trademark Application and Intellectual Property Plan:** To protect the name of the Company and its chief product lines and detail the Company's proactive plan to develop and protect its intellectual assets and competitive advantage.