
CONTENTS

Preface	xxi
Acknowledgments and Editorial Note	xxv
Chapter 1 Introduction to Business Planning	1
A. What Is “Business Planning”?	2
B. Meet Our New Clients	5
C. What Is an Entrepreneur?	8
D. Thinking Like a “Deal Lawyer” vs. Thinking Like a “Business Litigator”	15
Lee R. Petillon & Robert Joe Hull, Representing Start-Up Companies	16
E. Attributes of a Great Business Lawyer	18
Praveen Kosuri, <i>Beyond Gilson: The Art of Business Lawyering</i>	18
F. Ethical Obligations When Representing Entrepreneurs	25
1. Who Is the Client? Multiple Party Representation	25
Selected Provisions—ABA’s Model Rules of Professional Conduct (2004)	26
<i>Waggoner v. Snow, Becker, Kroll, Klaris, & Krauss</i>	31
2. Business Advice vs. Legal Advice	38
Martin B. Robins, <i>Recipe for an Overdue Change: Why Corporate Lawyers Sometimes Need to Give Business Advice</i>	38
3. Lawyers That Invest in Their Clients	41
ABA’s Model Rules of Professional Conduct Rule 1.8 Conflict of Interest: Current Clients: Specific Rules	42
California Rules of Professional Conduct, Rule 1.8.1 Business Transactions with a Client and Pecuniary Interests Adverse to a Client	42
Therese Maynard, <i>Ethics for Business Lawyers Representing Start-Up Companies</i>	44
4. Lawyers That Serve as Directors of Their Clients	57
Felix J. Bronstein, <i>The Lawyer as Director of the Corporate Client in the Wake of Sarbanes-Oxley</i>	58
Lubomir P. Litov, Simone M. Sepe, and Charles K. Whitehead, <i>Lawyers and Fools: Lawyer-Directors in Public Corporations</i>	63

Chapter 2	Choice of Business Entity	69
A.	Overview of Key Attributes of Different Forms of Business Entities	70
	1. Sole Proprietorship	70
	2. The (General) Partnership	71
	3. The Limited Partnership	75
	4. The Corporation	78
	5. The Limited Liability Company	82
	Richard A. Booth, <i>Form and Function in Business Organizations</i>	84
	6. Social Enterprises	85
	a. What Is “Social Entrepreneurship”?	85
	b. Development of “Social Enterprise” Legislation	87
	Michael B. Dorff, <i>Why Public Benefit Corporations?</i>	87
	c. California’s Social Enterprise Legislation	90
	d. Delaware’s “Benefit Corporation” Statute	91
	Michael R. Littenberg, Emily J. Oldshue, Brittany N. Pifer, Anne-Marie L. Beliveau, and Nellie V. Binder, <i>Taking a Fresh Look at Delaware Public Benefit Corporations—Recent Legal and Market Developments</i>	92
B.	Non-Tax Considerations That Influence the Choice of Entity Decision	98
	1. Costs of Formation and Operation	100
	2. Liability for Business Debts—Limited Liability vs. Personal Liability	103
	3. Management and Control	104
	4. Continuity of Existence	107
	5. Allocation of Profits and Losses and Payments to Owners	109
	6. Flexibility in Raising New Capital	114
	7. Fiduciary Duties	115
	8. Transferability of Ownership Interests	117
C.	Tax Considerations That Influence the Choice of Entity Decision	119
	Daniel S. Kleinberger, <i>Two Decades of “Alternative Entities”: From Tax Rationalization Through Alphabet Soup to Contract as Deity</i>	119
	Charles A. Wry, Jr., <i>Tax Considerations in Choosing the Form of Organization for a New Business</i>	121
	Effective Tax Rate on an Asset Sale: C Corporation Compared to LLC	130
	Daniel Kleinberger, AGENCY, PARTNERSHIPS, AND LLCs: EXAMPLES & EXPLANATIONS	131

Contents	xiii
Chapter 3 Overview of LLC Law	133
A. Development of the LLC	133
Daniel S. Kleinberger, <i>Two Decades of “Alternative Entities”: From Tax Rationalization Through Alphabet Soup to Contract as Deity</i>	134
Wayne M. Gazur, <i>The Limited Liability Company Experiment: Unlimited Flexibility, Uncertain Role</i>	138
B. Formation of an LLC	143
Fredric J. Bendremer, <i>Those Delaware LLCs—Another Look: How They Could Work for You</i>	144
C. Preparation of LLC Operating Agreement: Analysis of Management Rights	152
<i>Elf Atochem North America, Inc. v. Jaffari</i>	152
<i>Taghipour v. Jerez</i>	160
D. The Scope of Fiduciary Duties in the Context of LLCs	165
Daniel S. Kleinberger, <i>Two Decades of “Alternative Entities”: From Tax Rationalization Through Alphabet Soup to Contract as Deity</i>	166
<i>Gatz Properties, LLC v. Auriga Capital Corporation</i>	170
<i>Auriga Capital Corp. v. Gatz Properties, LLC</i>	185
Mohsen Manesh, <i>Equity in LLC Law?</i>	196
E. Oppression: Remedies for Dissension and Deadlock	200
Sandra K. Miller, <i>What Buy-Out Rights, Fiduciary Duties, and Dissolution Remedies Should Apply in the Case of the Minority Owner of a Limited Liability Company?</i>	200
<i>Haley v. Talcott</i>	203
Chapter 4 Selected Issues Under the Federal Securities Laws	207
A. Overview	207
B. Overview of Exemptions from the Registration Requirement of the 1933 Act	212
1. Statutory Private Placements	215
2. Regulation D	217
3. Wholly Intrastate Offerings: Section 3(a)(11) and Rule 147; Rule 147A; Intrastate Crowdfunding	228
4. Regulation Crowdfunding	230
a. What Is Crowdfunding, and Where Did it Come From?	231
David M. Freedman and Matthew R. Nutting, <i>A Brief History of Crowdfunding Including Rewards, Donation, Debt, and Equity Platforms in the USA</i>	231

b. Regulation Crowdfunding	234
5. Amended Regulation A—“Regulation A+”	239
6. Overview of Resale Exemptions: Restricted Securities and Rule 144	241
a. What Are “Restricted Securities”?	241
b. Rule 144	242
Morrison & Foerster LLP, <i>Frequently Asked Questions About Rule 144 and 145</i>	242
7. The “Section 4(a) (1-1/2)” Exemption	244
8. The FAST Act and New Section 4(a) (7) of the 1933 Act	245
9. Rule 701 and the Google IPO	246
<i>In the Matter of Google, Inc. and David C. Drummond</i>	248
Stanley Keller, <i>Securities Enforcement: Searching Google for Meaning—Equity Compensation Pitfalls and a Changed Climate for Lawyer Responsibility</i>	253
C. Role of the Lawyer After SOX in Planning Financing Transactions	260
Mitchell E. Herr and Stephen P. Warren, <i>Lawyer Liability: Why the SEC Should Clarify Policy on Its Actions Against Attorneys for Advising Clients</i>	260
D. State Blue Sky Laws After the JOBS Act	267
Rutheford B. Campbell, Jr., <i>The Role of Blue Sky Laws After NSMIA and the JOBS Act</i>	268
Summary of Securities Offering Exemptions	271
Chapter 5 Incorporation Process	277
A. Introduction: Choice of State of Incorporation	277
B. Preparing the Articles (Certificate) of Incorporation: Herein of “Private Ordering”	279
1. Corporate Name	279
2. Statutory Requirements: Mandatory vs. Optional Provisions	280
3. Agent for Service of Process	281
4. Statement of Purposes, Powers, and/or Duration	281
5. Statement of Authorized Capital	282
6. Incorporators and Initial Directors	282
7. Signature	283
8. Optional Provisions	283
9. Amendments to the Charter	285

Contents	xv
C. Organizational Meeting	286
1. Initial Board of Directors	286
2. Preparing and Adopting Bylaws	287
3. Issuance of Shares	287
D. Capital Structure of the New Corporation	287
1. Number and Classes of Shares	287
2. Consideration	288
3. Par Value	288
4. Issuance of Shares	289
5. Voting Rights	291
6. Dividend Rights	291
7. Rights on Dissolution: Herein of Liquidation Rights	293
8. Redemptions and Repurchases	296
9. Conversion Rights	296
10. Preemptive Rights	297
11. Blank Check Shares	297
12. Restrictions on Transferability of Shares	298
E. Role of Shareholders	299
1. Shareholder Meetings	300
2. Action by Written Consent	301
3. Shareholder Voting Process	302
4. Election of Directors	304
5. Removal and Resignation of Board Members: Filling Vacancies on the Board	306
6. Shareholders' Rights of Inspection	307
F. Role of Directors	308
1. Meetings of Directors	308
2. Fiduciary Duties of Directors, Officers, and Controlling Shareholders	310
Edward Gartenberg, <i>A Review of Fiduciary Duties in California and Delaware Corporations</i>	310
G. Choice of State of Incorporation—Delaware vs. California	317
Fenwick & West, LLP, <i>Guide to Starting a Corporation</i>	317
<i>VantagePoint Venture Partners 1996 v. Examen, Inc.</i>	323
Hayden Smith, <i>So You Owe Thousands of Dollars in Delaware Franchise Tax?</i>	329
Joel Beck, "We're Not Lawyers or Accountants, and Won't Give You Advice." <i>Where's the Value in That? (Or, Why You Shouldn't Do Legal Work for Yourself Online)</i>	330

Chapter 6	Equity-Based Compensation: Stock Options, Incentive Compensation, and Related Founder Issues	333
A.	Stock Options Generally	335
1.	What Is a Stock Option?	335
2.	Granting an Option	336
3.	Term of an Option and Vesting	338
4.	Exercise Price	340
5.	Exercising an Option	342
6.	Accounting Treatment for an Option Grant	342
B.	Nonqualified Stock Options	345
1.	The Default Form of Option	345
2.	Tax Treatment of NQSOs	345
3.	Effect of I.R.C. §409A	350
C.	Incentive Stock Options	353
1.	Special Requirements for ISO Treatment	353
2.	Tax Treatment of ISOs and Disqualifying Dispositions	358
D.	Restricted Stock	363
1.	Restricted Stock Compared to Stock Options	364
2.	Application of Section 83	365
3.	The Section 83(b) Election	366
4.	Application of Restricted Stock Concepts to Founder's Stock	371
E.	Other Equity Incentive Mechanisms	374
1.	Employee Stock Purchase Plan	374
2.	Phantom Equity Plans	375
F.	Common Contractual Variations for Stock Options and Restricted Stock	377
1.	Equity Incentive Plan Options and Restricted Stock	377
2.	Variations for Repurchase Rights Applied to Founder's Stock	383
3.	Other Founder's Stock Issues	385
Chapter 7	Intellectual Property Protection—A Primer for the Non-Expert	389
A.	What Is Intellectual Property?	389
1.	Introduction to Intellectual Property	389
2.	Trade Secrets	390
3.	Patents	397
4.	Copyrights	403
5.	Trademarks	407
B.	Protecting Intellectual Property by Contract	412
1.	Third-Party Non-Disclosure Agreements	413

Contents	xvii
2. Confidentiality and Invention Assignment Agreements	423
C. Intellectual Property Protection and the Early-Stage Company	439
Chapter 8 Capital Raising and Overview of Venture Capital	443
A. Introducing Capital: What It Is, and Common Stages of Investment	443
1. The Need for Capital	444
2. Stages of Investment	444
a. Formation Funding—Self or Friends and Family	445
b. Seed Stage	445
c. Start-up or Early-Stage Funding	447
d. Expansion Stage Funding	448
e. Later-Stage Funding	448
f. The Exit Event	449
Christopher M. Barlow, C. Michael Chitwood, Howard L. Ellin, P. Michelle Gasaway, and Gregg A. Noel, <i>The Year of the SPAC</i>	451
B. Capital: Who Provides It?	452
1. Founders, or Self-Funding	453
2. Friends and Family Financing	454
3. Outside Investors—Alternatives to Professional Venture Capital	455
a. Strategic Investors	455
b. Angel Investors	456
c. Seed Funding Firms	457
Paul Graham, <i>How to Fund a Startup</i>	457
d. Venture Capital Funds	459
e. Corporate Venture Capital	459
f. The General Public—Join the Crowd	461
C. Capital: What Must You Give to Get It?	461
1. Capital for Debt	462
2. The Structural Limitation of Debt	463
3. Capital for Common or Preferred Stock	464
4. Capital for a Debt/Equity Combination	465
a. Debt with a Warrant	465
b. A Note on Venture Debt	466
c. Bridge Loans	467
d. Convertible Debt	468
Peter Werner, <i>Primer on Convertible Debt</i>	469
e. Simple Securities—“Convertible Debt Without the Debt”	471
f. Series Seed Financings	474

D. Capital: Paths for Raising It	475
1. Private Placements	475
2. Franchising	476
3. Public Offerings	478
E. Venture Capital and the Venture Capital Investor	478
1. Introduction to Venture Capital	479
2. Recent History of the Venture Capital Industry	481
F. The Venture Capital Fund	482
1. Fund Structure	482
2. The Limited Partners	486
3. Operating the Fund	488
4. The Economics of Venture Capital Investing	491
G. Taking on a Venture Capital Investment	502
1. Preparing a Company for Venture Capital Investment	502
2. Making Venture Capital Investment Work	505
Chapter 9 Venture Capital Financing—Preferred Stock Attributes	513
A. Overview of Convertible Preferred Stock	513
1. Classes of Equity Securities	514
2. Preferred Stock—Charter Versus Contract Rights	515
B. Dividend Preferences	517
1. Dividends Generally	517
2. The Dividend Priority Preference	519
3. The Dividend Participation Right	520
4. Cumulative Dividends	524
C. The Liquidation Preference	526
1. A “Liquidation”	526
2. The Liquidation Priority Preference	530
<i>Mathews v. Groove Networks, Inc. et al.</i>	542
3. The Liquidation Participation Preference	544
D. The Conversion Right and Anti-Dilution Protection	562
1. The Conversion Right	563
2. The Effect of Dilution	573
3. Dilution to Participation Rights	578
4. Dilution to Economic Value—Price Protection	588
E. Redemption Rights	611
1. The Statutory Treatment of Redemption	611

Contents	xix
2. Redemption as Part of Venture Capital Financing	617
3. Redemption Provisions in the Charter	619
F. Voting Rights	625
1. Voting as a Participation Right	625
2. Director Election Rights	627
3. Protective Provisions	631
<i>Benchmark Capital Partners IV, L.P. v. Vague</i>	639
4. Blank Check Provisions	647
Chapter 10 Documenting the Transaction: Venture Capital Financing Agreements	653
A. “Pre-Contract” Contracts: Use of Letters of Intent and Non-Disclosure Agreements	653
1. Overview	653
2. Use of Non-Disclosure/Confidentiality Agreements	654
3. Issues Regarding the Letter of Intent	654
<i>SIGA Technologies, Inc. v. PharmAthene, Inc.</i>	655
Gregory Gosfield, <i>It’s a Question of What’s Binding: A Look at Letters of Intent</i>	669
B. Venture Capital Investment Documents	675
1. Overview	675
2. The Preferred Stock Purchase Agreement	676
3. Due Diligence and the SPA	683
4. The Amended and Restated Charter	686
5. The Investor Rights Agreement	687
Valerie Ford Jacob, Stuart H. Gelfond, Michael A. Levitt, and David A. Kanarek, <i>Key Considerations in Drafting a Registration Rights Agreement from the Company’s Perspective</i>	689
6. Right of First Refusal and Co-Sale Agreement	712
7. Voting Agreement	720
8. Closing Checklist	727
Appendix A. Homework Assignments	733
Appendix B. Documents	759
Index	911