Legal Checklist for Entrepreneurs

Getting you out on the Road, and keeping you safe

A 30 minute briefing on legal issues for New Businesses, with forms and lots of Q & A

UC Berkeley New Business Community Law Clinic
Starting a New Business – How it Feels at First
B.E.C.O.M.E.
a Survivor!

- Business Modeling
- Entity Formation
- Capitalization
- Operational Relationships
- Manage Risks
- Extra Permits/Licenses
BUSINESS MODELING
Business Modeling – Why First?

**Internal Uses:** to clarify what’s involved, organize thinking, prioritize tasks, spot issues, & bring together co-venturers.

**External Uses:** to enlist key stakeholders such as investors and banks) – the canvas can easily be formalized and directed to a particular audience (a “Business Plan”).
<table>
<thead>
<tr>
<th>Key Partners</th>
<th>Key Activities</th>
<th>Value Proposition</th>
<th>Customer Relationships</th>
<th>Customer Segments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cheap Airports as “Hubs”&lt;br&gt;Car Rental Companies&lt;br&gt;Hotels&lt;br&gt;Insurance&lt;br&gt;Web Search Engines (e.g., Kayak, Expedia)</td>
<td>Fly and Maintain Fleet of Planes&lt;br&gt;Book Flights; Process Payments&lt;br&gt;Hire and train Staff&lt;br&gt;Market</td>
<td>Cheap Flights&lt;br&gt;No Frills</td>
<td>Web: automated searches; Impersonal&lt;br&gt;Counter and in-Flight: Friendly, can-do attitude</td>
<td>Travelers on a Budget</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Key Resources</th>
<th>Channels</th>
<th>Revenue Streams</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Aircraft Model (e.g., 737’s)&lt;br&gt;Branding&lt;br&gt;Large Inventory of Aircraft Model Parts&lt;br&gt;Maintenance staff knowledgeable about Aircraft Model&lt;br&gt;Enthusiastic, Friendly customer-facing staff</td>
<td>Call Centers&lt;br&gt;Web&lt;br&gt;In-person (Counter &amp; In-flight)</td>
<td>Airline Tickets&lt;br&gt;Fees for Extra Services: e.g., Early Loading, Meals</td>
</tr>
</tbody>
</table>

Source: [www.businessmodelgeneration.com](http://www.businessmodelgeneration.com)
ENTITY FORMATION
Choosing an Entity

The Options

- Sole Proprietorship
- Partnership (several kinds)
- Corporation (several kinds)
- Limited Liability Company (LLC)

>> CAREFUL-!!

Presumptions if NO CHOICE is made:

- If Single/Married Couple: Sole Proprietorship
- If 2+ People: Partnership

>> Neither are “limited liability” entities
How to Choose an Entity

**IMPORTANT QUESTIONS:**

- **Governance**: Who should make decisions for my business?
- **Tax**: How should the business’s income be taxed?
- **Liability**: Do I need a legal liability backstop to protect myself?
- **Capital**: Do I need a vessel for capital providers to pay into?

**NOT Important:**

- What’s Easiest to Form?
- What are Lowest Filing Fees?
- What’s the Least Amount of Paperwork?
# How to Choose an Entity

## IMPORTANT QUESTIONS:

- **Governance**: Who should make decisions for my business?
- **Tax**: How should the business’s income be taxed?
- **Liability**: Do I need a legal liability backstop to protect myself?
- **Capital**: Do I need a vessel for capital providers to pay into?

## Ask Yourself:

- Will decisions be shared with others? Do I want a formal structure (i.e., a Board)?
- Should the entity pay tax, or only report the income “passed through” to the owners?
- Should I separate myself from the business’s obligations, by paying $800 CA Franchise Tax?
- Will the business be seeking venture capital in the next couple years?
# The Most Common Entities

<table>
<thead>
<tr>
<th>Corporation (for-p/non-p)</th>
<th>LLC</th>
<th>Sole Prop/Partnership</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Governance:</strong></td>
<td><strong>Governance:</strong></td>
<td><strong>Governance:</strong></td>
</tr>
<tr>
<td>• Board makes decisions</td>
<td>• Entrepreneur(s) make decisions or appoint a Manager to manage most operations</td>
<td>• Entrepreneur(s) make decisions; Partnerships can have Limited Partners</td>
</tr>
<tr>
<td><strong>Tax:</strong></td>
<td><strong>Tax:</strong></td>
<td><strong>Tax:</strong></td>
</tr>
<tr>
<td>• For-p C-Corp: Entity level taxation &amp; CA franchise tax: $800/year min.; owners pay cap gains on any dividends</td>
<td>• Pass-through taxation</td>
<td>• Pass-through taxation</td>
</tr>
<tr>
<td>• Non-p Corp: No tax (if apply &amp; obtain tax exemption)</td>
<td>• Gross Receipts Tax (if &gt; $250K); CA franchise tax: $800/year min.</td>
<td>• Sole-p and active partners pay self-employment tax</td>
</tr>
<tr>
<td><strong>Liability:</strong></td>
<td>• Active owners pay self-employment tax</td>
<td><strong>Liability:</strong></td>
</tr>
<tr>
<td>• Limited liability</td>
<td></td>
<td>• Personal liability</td>
</tr>
<tr>
<td><strong>Capitalization:</strong></td>
<td></td>
<td><strong>Capitalization:</strong></td>
</tr>
<tr>
<td>• For-p: Personal funds, Debt &amp; Shareholders’ equity</td>
<td>• Limited liability</td>
<td>• Personal funds &amp; Debt (Partnerships can have Partners’ equity)</td>
</tr>
<tr>
<td>• Non-p: Debt, Grants, &amp; Donations (NO equity)</td>
<td>• Personal funds, Debt &amp; Members’ equity</td>
<td></td>
</tr>
</tbody>
</table>

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## New/Less Common Entities

<table>
<thead>
<tr>
<th>Benefit Corp/Social Purpose Corp</th>
<th>S Corp</th>
<th>Cooperatives (LLC or Cooperative Corporation)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Governance:</strong></td>
<td><strong>Governance:</strong></td>
<td><strong>Governance:</strong></td>
</tr>
<tr>
<td>• Shareholders elect Board, Board makes decisions</td>
<td>• Shareholders elect Board, Board makes decisions</td>
<td>• Workers are owners and share decisionmaking</td>
</tr>
<tr>
<td><strong>Tax:</strong></td>
<td><strong>Tax:</strong></td>
<td><strong>Tax:</strong></td>
</tr>
<tr>
<td>• Entity level taxation &amp; CA franchise tax: $800/year min.; owners pay cap gains on any dividends</td>
<td>• Pass-through taxation; active owners pay income tax on salaries; owners pay cap gains tax on passive profits</td>
<td>• Pass-through taxation</td>
</tr>
<tr>
<td><strong>Liability:</strong></td>
<td><strong>Liability:</strong></td>
<td><strong>Liability:</strong></td>
</tr>
<tr>
<td>• Limited liability</td>
<td>• Limited liability</td>
<td>• Limited liability</td>
</tr>
<tr>
<td><strong>Capitalization:</strong></td>
<td><strong>Capitalization:</strong></td>
<td><strong>Capitalization:</strong></td>
</tr>
<tr>
<td>• Same as For-p C-Corp, but Shareholders must be okay with dual purpose – profit making + social mission</td>
<td>• Same as For-p C-Corp but Shareholders must be humans w/ legal status</td>
<td>• Same as For-p C-Corp, but only very limited passive investment possible</td>
</tr>
</tbody>
</table>
Where to Form

Primary Pros:
- Generally low franchise taxes & fees (min. of $800/year)
- Well-developed corporate code

Primary Cons:
- VCs & Public Investors less familiar with it

Primary Pros:
- Well-developed law; specialized biz courts
- Choice for most publicly traded co.’s and startups
- Filings are fast!

Primary Cons:
- More expensive franchise taxes & fees

CAUTION: Forming in DE, but Operating in CA makes you subject to BOTH States’ Taxes and Laws (= Expensive; Need to register in CA as foreign corporation)
CAPITALIZATION
A Typical Capitalization

Founders put in own money; may raise equity funds from friends, family and Angels

Founders may take on Debt (secured or unsecured)

Venture Capital

Venture Capital (Second round)

Common Stock IPO

Entities

LLC, Partnership, or Corporation

Private corporation

Public corporation

Time
## Raising Equity Capital

<table>
<thead>
<tr>
<th>Traditional Securities</th>
<th>Kickstarter</th>
<th>Crowdfunding</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Highly regulated by Federal SEC and State</td>
<td>• Presales of product, to raise money to fund prototypes or initial production</td>
<td>• Federal JOBS Act allows limited sales of securities over the web to non-accredited investors</td>
</tr>
<tr>
<td>• If use one of the Small Business EXCEPTIONS, possible to have limited sales without much paperwork</td>
<td>• These are technically NOT sales of securities</td>
<td>• Limits on company re: amount of equity that can be raised per year</td>
</tr>
<tr>
<td>• Generally no advertising</td>
<td>• Have contractual obligations to follow through to provide product purchased.</td>
<td>• Limits on % of income and total $ amount can invest per year</td>
</tr>
<tr>
<td>• Generally can only sell to Insiders and Accredited Investors (= RICH people)</td>
<td></td>
<td>• Arranged through funding portals, which monitor above limits</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Usually arranged via convertible notes</td>
</tr>
</tbody>
</table>
OPERATIONAL RELATIONSHIPS
Most Common Relationships to Know

• **CAPITAL PROVIDERS** - Who help fund the business

• **WORKERS** - Who will work to offer/produce the services or products

• **SUPPLIERS** – Who will provide other essentials needed to operate the business

• **CONSUMERS** - Who will receive the services/products

Focus on *how to LEGALLY set up each relationship*

Need to know what is:

• Government-Required

• Minimally Necessary

• Optimal/Optional
Workers: The 3 Buckets

**Employees** (PRESUMPTION: ALL Workers are Employees)
- Highly regulated, 17+ federal/state requirements
- California = At Will State
- Best to use Payroll Service to manage the requirements

**Independent Contractors (IC) -- New “ABC Test”:**

- A. Can’t control the IC much – pay by the PROJECT, not via salary; usually can’t set hours or use for key positions (e.g. CEOs)
- B. Can’t be used to provide regular or continuous services of the business
- C. IC needs to have own business and be able to work for others

**NOTE:** > Big penalties for misclassification

> Need to arrange in written contract, address IP & Liability Issues

**Volunteers/Interns:**
- Non-profits =OK, For-profits = Highly Regulated (need educ. purpose)
Manage Risks
What are Reasonable Steps to Manage Risks?

• Form a Limited Liability Business Entity (Corporation or LLC)
• Purchase Insurance (use a broker)
• Control Your Agents (e.g., employees, volunteers)
  - screen
  - hire
  - train
  - supervise carefully
• Indemnify Your Agents (e.g., employees, board, volunteers)
• Use Contracts to Share/Limit Liability with Others
• Choose your Activities Carefully
• Avoid Risky Activities if Possible

>> Note: All of the above efforts = helps the leadership meet
  * Duty of Care
  * Duty of Loyalty

FIDUCIARY DUTIES
Managing Risks -- Securing IP for the Company

ABC, Inc.

Founders

Consultants/Advisors

Engineers

Interns/Volunteers

Independent Contractors
Intellectual Property – Legal Protections

Trade Secrets
- To protect a company’s secret information regarding products or services
- Requires reasonable steps to protect secrecy, (e.g., use NDAs, lock-up, pass protection)
- No formal filing required to obtain State law protection

Patents
- To protect a product or process with unique design or utility
- Patents are public documents that expire after 20 years
- Patents must be filed with the USPTO to obtain Federal protection

Copyrights
- To protect the content of creative works (e.g. books, music) from unauthorized copying or use
- Copyright protection attaches automatically to tangible expression of the content
- To enforce copyright in a lawsuit: must file with the USCO to obtain Federal protection

Trademarks / Service Marks
- To protect marketing aspect of products or services, rather than utility or design
- The main goal is to protect consumers from confusion in the marketplace (e.g. Rolex)
- Trademarks must be filed with the USPTO to obtain Federal protection

IP by Contract
- Agreements can create/restrict IP rights: NDAs, Terms of Use, Creative Commons licenses

**For more information, see our IP PowerPoint**
EXTRA PERMITS & LICENSES REQUIRED
Key Questions for Permits & Licenses

• As to my business’s activities, would government care:
  • **What activities I do?** – Answer: USUALLY you will have to file for a business license/DBA (“doing business as”) form
  • **Where I do my activities?** – Answer: USUALLY there will be zoning restrictions to observe, even with home-based businesses

• Doing regulated activities without approval = major lawsuit risk

• Most regulations will come from state or local government – good search engine to find them:

• **>> Check out “CALGOLD” =** www.calgold.ca.gov
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- Manage Risks
- Extra Permits/Licenses

a Survivor!
QUESTIONS?

For More Info, contact UCB’s New Business Community Law Clinic

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