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 Law’s New Business Practicum

Hosted by Richmond Main Street Initiative
www.RichmondMainStreet.org
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 – 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”).
Business Model Canvas

Key Partners
Key Activities
Value Proposition
Customer Relationships
Customer Segments

Key Resources

Channels

Cost Structure
Revenue Streams
## The Business Model Canvas

### SOUTHWEST AIRLINES

<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>
</table>
| • Cheap Airports as "Hubs"  
• Car Rental Companies  
• Hotels  
• Insurance  
• Web Search Engines – (e.g., Kayak, Expedia) | • Fly and Maintain Fleet of Planes  
• Book Flights; Process Payments  
• Hire and train Staff  
• Market | • Cheap Flights  
• No Frills | • Web: automated searches; Impersonal  
• Counter and In-Flight: Friendly, can-do attitude | • Travelers on a Budget |

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

### Cost Structure

• Purchase Planes and Equipment  
• Maintenance  
• Labor Costs/Staff Training Costs  
• Airport Fees  
• Call Centers  
• Insurance  
• Marketing Costs

### Revenue Streams

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>• Board makes decisions</td>
<td>• Entrepreneur(s) make decisions or appoint a Manager to manage most operations</td>
</tr>
<tr>
<td><strong>Tax:</strong></td>
<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>
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<tr>
<td></td>
<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>
</tr>
<tr>
<td><strong>Liability:</strong></td>
<td>• Limited liability</td>
<td>• Active owners pay self-employment tax</td>
</tr>
<tr>
<td><strong>Capitalization:</strong></td>
<td>• For-p: Personal funds, Debt &amp; Shareholders’ equity</td>
<td>• Limited liability</td>
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<tr>
<td></td>
<td>• Non-p: Debt, Grants, &amp; Donations (NO equity)</td>
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</tbody>
</table>
# 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>
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<tbody>
<tr>
<td><strong>Governance:</strong></td>
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<tr>
<td>• Shareholders elect Board,</td>
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<td>but Shareholders must be</td>
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<td>okay with dual purpose –</td>
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<td>profit making + social</td>
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<td>on salaries; owners pay</td>
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<td>cap gains tax on passive</td>
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<td>only very limited passive</td>
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<td>investment possible</td>
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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

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)

**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
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

## Traditional Securities

- Highly regulated by Federal SEC and State
- If use one of the Small Business EXCEPTIONS, possible to have limited sales without much paperwork
- Generally no advertising
- Generally can only sell to Insiders and Accredited Investors (= RICH people)

## Kickstarter

- Presales of product, to raise money to fund prototypes or initial production
- These are technically NOT sales of securities
- Have contractual obligations to follow through to provide product purchased.

## Crowdfunding

- Federal JOBS Act allows limited sales of securities over the web to non-accredited investors
- Limits on company re: amount of equity that can be raised per year
- Limits on % of income and total $ amount can invest per year
- Arranged through funding portals, which monitor above limits
- Usually arranged via convertible notes
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 FIDUCIARY DUTIES
  * Duty of Care
  * Duty of Loyalty
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
Get Certified! For Contracts with Anchor Institutions

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8/20/2018

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QUESTIONS?

For More Information, contact: UCB New Business Practicum

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Phone: 510-642-4050

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