

# **How to Avoid Snatching Defeat from the Jaws of Victory**

**The Most Common Legal Problems  
Entrepreneurs Encounter and How to  
Solve Them**

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# Areas of Concern

- Ownership
- Employees (and Independent Contractors)
- Tax Matters
- Securities Law Matters
- Accounting Matters
- Stock Option Plan
- Recordkeeping
- Intellectual Property

# Ownership

- Problems:

- Ownership of company undocumented
- Ambiguous or conflicting agreements concerning ownership of the company
- No agreement specifying what happens to stock of company upon stock transfers, death, disability, termination of employment, etc.

# Ownership

- Solutions:

- Coach clients to have you review documentation concerning stock issuances *before* the stock is issued
- Adopt Board resolutions approving stock issuances *when issuances are made*
- Keep a stock ledger
- Enter into shareholders agreement specifying what happens to stock upon proposed transfers, death, disability, termination of employment, etc.

# Employees (and Independent Contractors)

- Problems:
  - Employees are subject to agreements with their former employers that subject the company to the risk of a lawsuit for violation of non-compete or confidentiality obligations
  - Employees leave the company and take intellectual property with them
  - Company hires a consultant to develop IP and doesn't enter into an agreement delineating who owns the IP

# Employees (and Independent Contractors)

- Solutions:
  - Investigate and ask for documentation about agreements with former employers
  - Make prospective hires represent in employee offer letters that they are not subject to these types of agreements
  - Employment agreements signed by all employees should contain enforceable non-competition and confidentiality agreements and clauses assigning IP to the company
  - Enter into consulting/work for hire agreements

# Tax Matters

- Problems:
  - Restricted stock issuances to employees may constitute taxable compensation *as stock vests*
  - Property transferred in exchange for stock may result in taxable gain to shareholders

# Tax Matters

- Solutions:

- File 83(b) election *within 30 days of stock issuance*
- Involve a tax lawyer when property is being contributed in exchange for stock

# Securities Law Matters

- Problems:

- Stock is issued in transactions that are not clearly exempt from SEC registration
- Company conducts a “general solicitation” that violates SEC rules

- Solutions:

- Limit stock issuances to “accredited investors”
- Avoid unusual publicity and all press about proposed financings

# Accounting Matters

- Problems:

- Company issues “cheap stock”, which results in accounting charge against earnings
- Company issues common stock to angel investors at a price too high to use for stock options

# Accounting Matters

- Solutions:

- Document evidence supporting valuation of stock issued and pass Board resolutions supporting determination of fair value
- Show an increase in stock value over time
- Use higher value preferred stock to support lower valuation for common stock

# Stock Option Plan

- Problems:

- Stock options are granted in a form that imposes significant tax burdens on employees (*e.g.*, ordinary income, alternative minimum tax, no liquidity when taxes are imposed)
- Stock options granted are not what employees consider to be customary in the marketplace
- Stock options do not serve as “golden handcuffs” to incentivize employees to stay

# Stock Option Plan

- Solutions:

- Talk to a lawyer who has the requisite experience in structuring stock option plans
- Avoid automatic acceleration of vesting upon a change in control

# Recordkeeping

- Problems:

- Minutebook and other records aren't adequately maintained
- Agreements aren't evidenced by written contracts

- Solutions:

- Board should approve significant transactions and agreements
- Keep minutes of Board and shareholder meetings

# Intellectual Property

- IP filing deadlines are missed:
  - Domestic
  - International