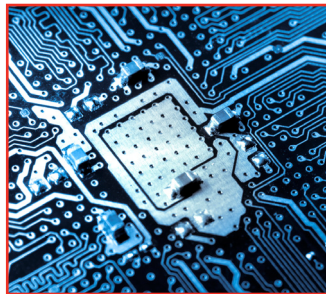


BAKER DONELSON EMERGING COMPANY BOOT CAMP



BAKER DONELSON
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BAKER DONELSON EMERGING COMPANY BOOT CAMP



Baker Donelson Emerging Company Boot Camp

Louisiana Technology Park
Baton Rouge, Louisiana
Friday, November 11, 2011

AGENDA

- | | |
|------------------|---|
| 8:30-9:00 a.m. | Breakfast and Registration |
| 9:00-9:15 a.m. | Welcome and Opening Remarks
<i>David Rieveschl, Baker Donelson</i> |
| 9:15-9:45 a.m. | Corporate Formation/Taxation
<i>Biff Bayard, Baker Donelson</i> |
| 9:45-10:15 a.m. | Trademarks and Copyrights
<i>Ben Janke, Baker Donelson</i> |
| 10:15-10:45 a.m. | Patents
<i>Warner Delaune, Baker Donelson</i> |
| 10:45-11:00 a.m. | Break and Networking |
| 11:00-11:30 a.m. | Labor and Employment Basics
<i>Phyllis Cancienne, Baker Donelson</i> |
| 11:30-12:00 p.m. | Accounting and Back Office Basics
<i>Ernst & Young</i> |
| 12:00-12:30 p.m. | Outside General Counsel: A Relationship that Counts
<i>David Rieveschl, Baker Donelson</i> |
| 12:30-1:30 p.m. | Lunch and Networking
Sponsored by <i>IBERIA BANK</i> |
| 1:30-2:00 p.m. | Contract Basics
<i>Chris Sloan, Baker Donelson</i> |
| 2:00-2:30 p.m. | Tax Incentives for Emerging Companies
<i>Rob Wollfarth, Baker Donelson</i> |
| 2:30-3:00 p.m. | Venture Capital Basics
<i>Clayton White, South Coast Angel Fund</i> |
| 3:00-3:30 p.m. | Open Questions
<i>All presenters</i> |
| 3:30-4:30 p.m. | Reception and Networking |

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Step One: Establishing An Entity

**The Right Type
in the Right Place
at the Right Time**

Presented by:

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EXPAND YOUR EXPECTATIONS™

The Right Type – Choice of Entity

- **Primary considerations:**
 - Nature of business (active or passive; tax-sensitivity)
 - Number of owners
 - Role of owners (active or passive)
 - Allocation of profits, losses, and cash flow
 - Ability to attract outside capital
 - Taxation
- **Other considerations:**
 - Cost of organization
 - Formality of governance
 - Transferability of ownership interests
 - Continuity of existence
 - Ability to attract and retain management and employees
 - Estate planning objectives

Common Forms of Organization

- Sole proprietorship
- General partnership
- Limited partnership (LP)
- Corporation
 - NOTE: An S-corporation is an election to be taxed a certain way for federal tax purposes, not a different kind of corporation
- Limited liability company (LLC)



Sole Proprietorship

- Simplest form of business
- Most widely used form of business, by far
- Business is alter ego of owner
- Single owner has complete control, but also full personal liability
- Generally requires nothing more than filing a certificate of assumed name and obtaining a business license
- All income and losses flow through to owner's personal tax return
- When owner dies, business dies



General Partnership

- Two or more persons (or entities) undertaking a business endeavor
- Agreement as to respective duties and allocation of profits, losses, and cash flow
- Agreement may be oral but should be written; implied by law when two persons act in concert to conduct business
- Each partner is fully liable for 100% of the partnerships debts and obligations



General Partnership

- Each partner has a fiduciary obligation to the others, but one partner can unilaterally bind the others to a contract or incur liability for all
- Tax effects flow through to partners; tax accounting rules can be very complicated
- Partnership dissolves upon death or withdrawal of any partner
- Not a good choice for most businesses; if two or more owners, a liability-shielded entity should be considered



Limited Partnership (LP)

- Like a general partnership with shareholders
- Must have at least one general partner with full liability (may be a person or an entity)
- Unlimited number of limited partners, shielded from personal liability but also having very limited voice in management of business
- Written partnership agreement and filing of certificate with state required
- Tax effects flow through to partners, but almost inevitably extremely complex
- Expensive to set up (accounting and legal costs)
- Generally not well-suited for active business; frequently used for passive businesses such as commercial real estate where highly structured tax planning is desirable

Corporation

- Legal entity having separate existence recognized by state
- Governed by board of directors elected by shareholders; directors responsible for hiring and overseeing executive management
- May be only one shareholder, who serves as sole director and as president; must be at least one other officer (unless only one shareholder, in most states)
- Bylaws are the constitution, defining how corporation will be governed
- Shareholders not liable for debts and obligations of corporation, *provided that corporate formalities adhered to*
- Policy is to encourage business risk-taking by protecting owners from liability, so long as persons dealing with corporation are on notice that it is a corporation

Corporation (cont'd)

- Generally best choice for attracting outside capital
- May have multiple classes of ownership
 - Common stock represents basic equity ownership
 - Preferred stock can be created to represent ownership that gets dividends ahead of common stock holders and/or that gets a specified rate of return before common holders get any cash and/or that has special voting privileges



Corporation (cont'd)

- Multiple classes of preferred stock can be created, each having different rights and preferences
- Venture capital investors typically want preferred stock
- In terms of distributions and voting, all common stockholders must be treated same, on pro rata basis; likewise, all holders of a given preferred stock class must receive equal treatment



Corporation (cont'd)

- For federal tax purposes, corporation is treated as a separate entity (a C-corp) unless it qualifies for and elects to be taxes like a partnership (S-corp)
- Many states do not recognize S-corp status and tax the corporation as a separate entity
- Corporations (S or C) and partnerships (including LLCs) not permitted to be S-corp shareholders; neither are non-resident aliens
- S-corporation limited to 100 shareholders and one class of stock (but S-corp is permitted to have differences in voting rights within single class of stock as long as all other rights are identical)

Corporation (cont'd)

- Election of S-corp status requires unanimous consent of current shareholders
- Corporation can switch from S to C status and vice-versa (assuming it meets S-corp qualifications), but substantial tax effects may arise, especially from C to S
- Cost of organizing a corporation generally less than setting up an LLC



Limited Liability Company – LLC

- Like corporation, LLC is legal entity separate from its owners (called “members”)
- Depending upon your state, governed either by board of directors elected by members, by members as a group, or by managers selected by members (who may or may not be members themselves)
- Operating agreement is the constitution for LLC, defining the rules for governance
- Operating agreement also serves as the partnership agreement, defining how profits, losses, and cash flow will be allocated
- Operating agreement also can serve the function of a shareholder agreement or buy-sell agreement
- Relative complexity of operating agreement makes setting up an LLC more costly than creating a corporation

Limited Liability Company – LLC (cont’d)

- LLC allows maximum flexibility in terms of governance and economic allocations
- Single-member LLC now expressly or implicitly recognized in all states
- Single-member LLC will be disregarded for federal tax purposes; owner (member) reports income on Form 1040 like a sole proprietorship
- Like shareholders in a corporation, members of an LLC are fully shielded from personal liability for debts and obligations of LLC provided appropriate formalities are followed
- Unlike limited partners in an LP, members can be fully involved in management and control of LLC
- Unlike S-corps, no restrictions on types of owner for LLCs

Limited Liability Company – LLC (cont'd)

- Until a few years ago, taxation of LLCs as partnerships (i.e., flow-through taxation rather than entity-level taxation) required careful planning and jumping through hoops; now LLC can merely “check-the-box” to elect how whether to be taxed like a corporation or a partnership
- Price for tax flexibility of LLC is increased expense for preparing partnership tax returns (can be substantial if complicated structure involved)
- LLC structure can be somewhat cumbersome for attracting outside institutional capital but may be desirable to an angel or other individual investor

Tax Considerations

- The reality of C-corp double taxation
- Deductibility of flow-through losses
- State income (or franchise/excise) taxation
- Wage taxation/self-employment tax
- Cost of tax reporting
- Hassle factor (payroll tax filings)



Tax Considerations (cont'd)

- Tax is complicated
 - *Generally*, receipt of stock in exchange for contribution to corporation (C or S) is nontaxable (so long as 80% control test is satisfied), provided liabilities not in excess of tax basis of contributed assets (excluding trade receivables and trade payables)
 - *Generally*, receipt of membership interest in exchange for contribution to LLC (or partnership) is nontaxable unless it is a disguised sale, but members who contribute assets encumbered by liabilities recognize gain if allocation of liabilities creates negative capital account
 - Even S-corp subject to double taxation if it distributes E&P left over from C-corp, or sells built-in gain property, or has excess net passive income; if C-corp on cash method makes S election, recognition of income from A/Rs in the following 10 years will trigger built-in gains tax
- In other words, consult an attorney or tax advisor

Tax Considerations (cont'd)

- Some basic tax considerations
 - Deductibility of operating losses in S-corp limited to shareholder's tax basis in stock
 - LLC members may include their share of the LLC's debt in their tax basis for purposes of deducting operating losses, thus potentially allowing larger write-offs
 - Incentive Stock Option (ISO) plans not available to LLCs
 - Employee-member of LLC must pay self-employment taxes on entire share of LLC profits (not just the amount of reasonable compensation)

Shareholder/Operating Agreements

- As a general proposition, equity interests in a company (whether stock, LLC membership, or LP interests) are assets that are freely transferable (subject to securities laws), may be pledged as collateral for a debt, and may be bequeathed by will
- Consider these scenarios in a small company having three owners, all of whom are active in the business:
 - An owner dies, leaving her stock to her husband who is a complete jackass and now is your business partner
 - An owner pledges his LLC interest for a loan, then defaults; now the bank is your partner and wants to liquidate the business
 - An owner leaves the company to work for a competitor; he still is entitled to financial and other information about the company
 - An owner gets divorced and his stock is awarded to his ex-wife; now he works for her

Shareholder/Operating Agreements (cont'd)

- In a closely-held company, each owner typically relies heavily on the abilities and judgment of the others
- All owners of a small business have a common interest in preventing outsiders from becoming partners without consent
- Shareholder agreement (also called buy-sell agreement or stock restriction agreement) is a contract among owners of a company as to limitations on transferability and related contingencies
- Separate document for a corporation, but often incorporated into operating agreement for LLC or into partnership agreement for LP



Shareholder/Operating Agreements (cont'd)

- Typical provisions:
 - Rules for decision-making
 - Prohibition on sale or transfer of interest or pledging interest as collateral without approval of majority of other owners
 - Company and/or other owners have right of repurchase (either for fair market value to be determined at the time or for a value based upon a specific formula) in the event of:
 - **Death of owner and transfer of interest to estate**
 - **Divorce of owner and transfer of interest to ex-spouse**
 - **Bankruptcy of owner and transfer of interest to third party**
 - **Resignation or retirement of owner as employee**
 - Voting rights suspended upon involuntary transfer

The Right Place – Which State(s)?

- Formation (domestication)
 - Corporation: Home state versus Delaware
 - Governance
 - Dispute resolution
 - VC funding
 - LLC: Not so much difference
- Foreign qualification: primarily a tax concern
 - Locations of offices
 - Locations of sales people
 - Other contacts with a state



The Right Time

- Need a limited liability entity at the outset
- May evolve in complexity as business partners, investors, and employee/owners come into picture
- Form of organization can be changed as need arises
 - More tax efficient to change from LLC to corporation than to change from corporation to LLC
 - Don't change without talking to your lawyer and accountant
- Evaluation of your Shareholder Agreements and Partnership Agreements and Operating Agreements



Trademarks and Copyrights

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IP BASICS

The Big 4:

- Copyright
- Trademark
- Patent
- Trade Secrets (not covered)



Copyrights

What is a copyright?

- A bundle of rights protecting an original work of authorship fixed in any tangible medium of expression

U.S. Constitution, Art. 1, Sec. 8, Cl. 8
17 U.S.C. § 101 *et seq.*



Copyrights

What is copyrightable?

- Literary works
- Musical works (incl. words)
- Dramatic works (incl. music)
- Pantomimes and choreographic works
- Pictorial, graphics and sculptural works
- Motion pictures and audiovisual works
- Sound recordings
- Architectural works
- Computer software



Copyrights

What is *NOT* copyrightable?

- Names
- Titles
- Slogans, short phrases
- Domain names
- Facts, ideas, systems, methods
- Recipes (mere listing of ingredients)
- Clothing designs



Copyrights

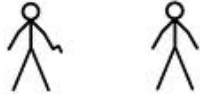
Creation

- Copyright automatically exists as soon as work is created in “fixed form”
- Registration with U.S. Copyright Office is not required, but brings benefits:
 - Ability to bring infringement action
 - Timely registration allows recovery of statutory damages and attorneys fees
 - Prima facie evidence of validity of copyright



Copyrights

- To be protected by copyright, a work must contain at least a certain minimum amount of authorship in the form of original literary, musical, pictorial, or graphic expression.



Copyrights

Computer Program

- Set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result
- Protects that particular expression of the set of statements or instructions, not what the program does



Copyrights

What is in the bundle of rights?

- Reproduce the work in copies or phonorecords
- Prepare derivative works
- Distribute copies or phonorecords
- Perform the work publicly
- Display the work publicly

Trademarks

A trademark is a symbol used by a person in commerce to indicate the source of the goods and to distinguish them from the goods sold or made by others. The symbol can be a word, phrase, design, image, sound, color, or even fragrance.



Creation upon Use In Commerce

Creation

- Trademark rights conferred by use in commerce
- Registration with U.S. Patent and Trademark Office is not required, but brings benefits:
 - Nationwide notice
 - Can achieve incontestable status
 - Additional remedies & statutory penalties for infringement
- Goals:
 - Consumer Protection
 - Incentives to Users

Trademark



What is a trademark or service mark?

- Any word, name, symbol, device, or combination thereof either used or intended to be used by a person to identify and distinguish goods or services from those of others and to indicate their source of origin



Trademark

Levels of Distinctiveness

- Fanciful or Coined
 - Arbitrary
 - Suggestive
-
- Descriptive
 - Generic



Trademark

Fanciful or Coined

- Letters that form a word without meaning, has no relation to the product
- Strongest type of mark
- E.g., KODAK, EXXON

Problem: Can become generic



Trademark

Arbitrary

- One or more words whose common meaning has nothing to do with the goods or services being labeled
- Strong mark
- E.g., PARLIAMENT, CAMEL, used for cigarettes



Trademark

Suggestive

- One or more words that hint at or suggest the nature of a product without actually describing it
- Requires a mental step before association between mark and product is understood



Trademark

Descriptive

- Words that merely describe the product or its components or ingredients
- Very weak; protectible as trademark only if it can establish that term has acquired “secondary meaning”
- E.g., World Book (encyclopedia); 5 Minute Massage

Trademark

Generic

- Words that designate the “genus” of the product or what the product is
- Cannot trademark
- E.g., THERMOS, ASPIRIN, CELLOPHAN



Spectrum of Distinctiveness

Levels of Distinctiveness

- Fanciful or Coined
- Arbitrary
- Suggestive

-
- Descriptive
 - Generic

Capable of Registration
As "Inherently
Distinctive"

Only with "acquired
distinctiveness"

Not Registerable

Secondary Meaning

- Used to be descriptive
- Acquired distinctiveness "as a trademark" when the primary significance of Coca-Cola is now the identifier of the source



Goods and Services

- Not “squatter’s rights”
- Only registerable for the goods and services for which you seek trademark protection



Stylized / Design Trademarks

- “WALMART”
- “WAL*MART”



Use it or lose it!

- Trademark law is dependent upon use of the mark



Patent Basics

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EXPAND YOUR EXPECTATIONS™

Patents

What is a Patent?

- Set of exclusive rights granted to an inventor for a fixed period of time in exchange for the public disclosure of the invention
- Limited property right

U.S. Const. Article I, Section 8
35 U.S.C. § 101 *et seq.*

Exclusive Rights

- Right to exclude others from making, using, selling, offering to sell the invention within the U.S., or importing into the U.S.
- Does not give inventor the right to make, use, sell, offer to sell
 - still bound by regulatory restrictions
 - still subject to other prior patents
 - improvements (only the new stuff)

Types of Patents

- Utility – protects a useful device or method, e.g. the way it works or is used; functional and structural features
- Design – protects the ornamental (non-functional) appearance of an article, e.g. the way it looks
- Plant – protects certain types of asexually reproducible plant varieties

Utility Patent Requirements

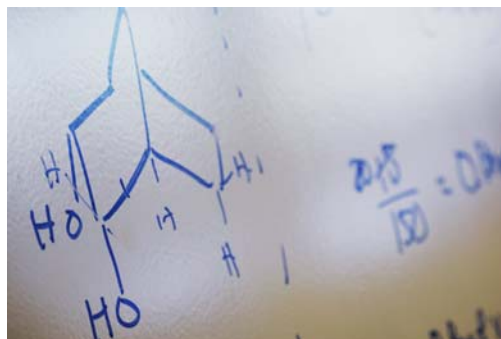
- Patentable Subject Matter
- Utility (must be useful)
- Novelty (no single patent discloses all of the invention)
- Nonobvious to a person of ordinary skill in the art to which the invention pertains (may be shown by combinations)

Utility Patents – Subject Matter

- Machine – concrete thing, consisting of parts or of certain devices and combinations of devices
- Manufacture (Article of Manufacture) – production of articles for use from raw or prepared materials by giving to these materials new forms, qualities, properties or combinations, whether by hand labor or by machinery
- Composition of Matter – composition of two or more substances; chemical compounds; gas, fluid, powder or solid
- Process – act, or a series of acts, performed upon the subject-matter to be transformed and reduced to a different state or thing; methods

Patentable Subject Matter

- CANNOT obtain a patent for:
 - scientific truths, laws of nature
 - mathematical expressions
 - algorithms
 - abstract ideas
 - physical phenomena



Novelty

- Inventor Can Destroy Novelty
 - public use or disclosure of invention
 - prior sales or offers for sale of invention

U.S. – more than 1 year prior to filing
Foreign – absolute novelty bar

Unlike copyrights and trademarks, you must:

- (1) timely file application with the USPTO; and***
- (2) undergo examination and have patent issued***

Ownership

- In U.S., only individuals can apply for a patent (not corporations, similar entities)
- Inventors can assign the patent to any entity
- Each inventor owns full rights to invention without an obligation to the other inventors
- *BOTTOM LINE: Consolidate ownership; get obligation to assign IP rights in employment agreement!*

Provisional Patent Application

- Low cost and quick
- No claims required
- No particular format
- Provides earlier effective filing date, permits use of "patent pending" status
- Not examined; only a place holder
- Does not issue into a patent
- Must file nonprovisional utility application within 1 year

Licensing

- Contract where parties agree to the terms and conditions under which certain rights in the invention/patent are granted (manufacturing, selling, etc.)
- Exclusive or nonexclusive
- Field of use restrictions (industries, markets, uses, etc.)
- Geographical restrictions
- Royalties or other compensation (highly variable)

Enforcement/Infringement

- To infringe a patent claim, all elements of a claim must be present in the accused device or method
- Patent owner is entitled to a claim scope commensurate with the details of the specification and their "reasonable equivalents"
- Patent validity will always be contested:
 - Failure to consider material prior art
 - Concessions made during prosecution (estoppel)
 - Inequitable conduct

Top 10 Patent Points for the Product Development Cycle

Conception and Reduction to Practice

- Write all ideas down with dates of conception; can avert undeserved co-inventorship
- Keep a written record of changes and improvements
- Identify all collaborators with brief description of contribution to the effort; missing co-inventors can cause expense, broken deals, and invalidity
- Manuals, grant proposals, etc., are very helpful; great basis for patent application specification
- Store in a safe place, like in the “cloud”; think Katrina and Rita...

Secrecy

- Secure strong nondisclosure agreements (NDAs) with other parties, but limit the number of NDAs; not everyone is worth it or trustworthy
- Should contain assignment language to avert co-ownership problems with co-inventors; may meet with some resistance, but the alternative is worse with an “unintended partner”
- Term should be for at least enough time to get past a long patent prosecution (assuming no publication at 18 months); typically 3-5 years

Search

- Searching is optional, BUT:
 - Prevents throwing good money out after bad
 - Knowing prior art is critical for drafting persuasive specifications and claims
 - Anticipate possible rejections
 - Trade journals and other technical publications must be considered in rapidly evolving technologies (no patent records); think software, pharma, solar, nanotechnology, etc.

Provisional Applications

- Use provisional applications sparingly and wisely
 - Delays in examination; only a place holder for up to 12 months
 - Added costs
 - Failure to adequately support claims in later nonprovisional application
 - May jeopardize foreign rights if too lean an initial disclosure, because the same 12 month deadline applies
 - Difficult to avoid with Patent Reform Act; file early and often

Filing Strategy

- Develop a strategy for protecting a portfolio of ideas (alternate embodiments, future developments, etc.); build the spider web
- FOCUS: “all eggs in one basket” rarely makes good sense; only one invention per application; restriction requirements and election of species will cause divisionals anyway
- Filing decisions and claim drafting should factor in how products will be marketed; think system vs. method, and how prospective licensees may want one, but not the other

Organization and Priorities

- Patents are business tools
- Treat each idea/application as an asset to be valued in a transaction; how can each asset be monetized?
- Many early stage companies rely almost entirely on IP assets (rather than revenue); even a portfolio of pending applications preserves IP rights for prospective purchasers, and may be important to future investors
- Let licensing and enforcement considerations drive the discussion regarding claims, including which divisionals and CIP's may be desirable

Disclose Prior Art

- Affirmative duty of disclosure of known prior art to the USPTO; only if "material to the examination"
- No "hiding the ball"; full disclosure is part of the deal between you (patent owner), the public (progress of science and the useful arts), and the federal court system (enforcement of your rights)
- Potential invalidity for failure to disclose prior art
- Includes prior art from foreign patent prosecutions which may not have been considered in the U.S.
- Avoids inequitable conduct defense by infringers

Defense

- Patents are a sword, not a shield
 - Patents provide only an exclusionary right; no rights to do anything, only to stop others from doing what's in the patent
 - No relevance to infringement of prior patents; just because you have a patent, you can still be sued for infringement
 - Know competitor's patent portfolio; map out claims for "design around" efforts; think Venn diagrams
 - Possible use of patents as a basis for counterclaims and cross-licensing to settle disputes

International Patents

- U.S. is a signatory to several multinational patent treaties; preserve international rights (national, regional, PCT) before 12 months from initial application
 - But will depend on U.S. non-publication request; if non-publication request is filed, then filing foreign will jeopardize U.S. application
 - Add "outlier" countries that may be important based on market and manufacturing, e.g. Taiwan, and some South American, African, and Middle East countries
 - PCT search results are almost always faster than U.S. examiners
 - Budget carefully and prioritize; can be very expensive

Patent Reform Act (September 2011)

- File early and often
- No more “first to invent”; effective March 2013
- Still have to be an “inventor”; can’t file for others’ inventions
- Self-disclosure buys another year and can avoid some prior art, but ruins international rights in “absolute novelty” countries
- Still a 12-month grace period from your own disclosures, but not disclosures of others
- Post-grant review within 9 months may reduce some litigation?

Top Ten Ways to Reduce the Risk of Employment Litigation

Presented By

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The Countdown Begins at the Beginning

10. Make Sure Your Employment Application Is In Compliance With State and Federal Laws
 - Arrest / convictions
 - Disability
 - Verification of truth / accuracy

9. Set Up A Legal Process For Background Checks
 - Hire an agency!
 - Fair Credit Reporting Act
 - Use of convictions



And once you have employees . . .

8. Create an Employee Handbook with AT LEAST the following:
- At will statement
 - Anti-harassment / discrimination policy
 - Rules for workplace behavior
 - Explanation of benefits
 - Complaint procedure



** DO NOT INCLUDE POLICIES YOU WON'T FOLLOW! **

It's the Little Things That Cost Big Bucks

7. Make sure employees are classified correctly for wage and hour purposes and pay them accordingly.
- Non-exempt employees must keep records of all hours worked and must be paid minimum wage and overtime
 - Exempt employees must meet certain legal tests to be exempt from minimum wage and overtime.



Who Is an Employee?

6. Understand the difference between employees and independent contractors – obligations to employees:
 - Withhold taxes
 - Covered / protected by MANY employment laws (Title VII, FMLA, ADEA, ADA)
 - Workers' compensation
 - Unemployment benefits

5. Temporary employees are still YOUR employees for the purpose of many employment laws like harassment, discrimination, and retaliation



Key Lessons to Learn

4. Respond quickly and appropriately to employee complaints about possible employment law violations and understand they have a legally protected right to complain.
 - Discrimination / Harassment
 - Wages
 - Safety Issues



Key Lessons to Learn

3. Do not wait for the straw that broke the camel's back before taking action – Investigate!

- Prompt
- Thorough
- Appropriate Remedial Action
- Confidential



Don't Be Penny Wise and Pound Foolish

2. Train your managers on employment laws and leadership skills

- Recognize harassment, discrimination, request for accommodation
- Know reporting / action is required
- Document discipline
- Be accurate in performance evaluations

1. Develop a relationship with an EMPLOYMENT lawyer.



Questions



BAKER DONELSON
BEARMAN, CALDWELL & BERKOWITZ, P.C.

Top Ten Ways to Reduce the Risk of Employment Litigation

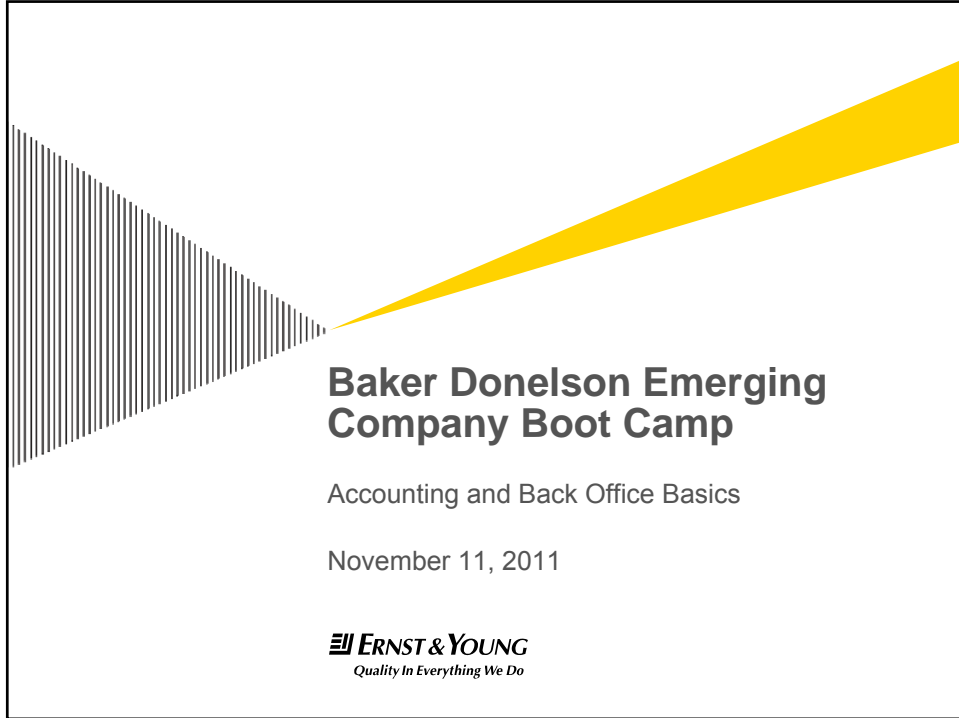
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**Baker Donelson Emerging
Company Boot Camp**

Accounting and Back Office Basics

November 11, 2011

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Agenda

- ▶ Accounting sets the foundation
- ▶ Accounting information systems
- ▶ Accounting polices and procedures
- ▶ Internal controls
- ▶ Financial statements and reporting
- ▶ Tax responsibilities
- ▶ Questions

Accounting sets the foundation

- ▶ Accurate accounting is critical to understanding your business
 - ▶ Track and report results
 - ▶ Outside parties want to understand your financial results
 - ▶ Manage your business decisions
 - ▶ What works and what doesn't
 - ▶ Develop budgets and project future results
 - ▶ Accurate historical information sets the foundation to budget for the future

Accounting information systems

- ▶ Accounting software
 - ▶ Quickbooks/ Peachtree/Other industry specific applications
 - ▶ Choose an application that will be able to meet your near term growth plans
 - ▶ Must consider system maintenance
 - ▶ Internal resource or outsource to vendor
 - ▶ Accounting staff/employees need to be proficient in the application
 - ▶ Training and education

Accounting policies and procedures

- ▶ Accounting policies
 - ▶ There are different accounting policies for different businesses
 - ▶ Oilfield related services
 - ▶ Health care services
 - ▶ Manufacturing
 - ▶ Distribution
 - ▶ Construction or contractors
 - ▶ Not-for-profit
 - ▶ Other services – professional, insurance, etc
 - ▶ AICPA Accounting Guides
 - ▶ Available for many specific industries
 - ▶ Provides guidance on proper accounting for industry specific matters

Accounting policies and procedures

- ▶ Accounting procedures
 - ▶ Employees
 - ▶ Accounting director or controller with sufficient knowledge
 - ▶ Determine the appropriate support staff
 - ▶ Accounts payable, accounts receivable, payroll, other areas such as revenue if complex
 - ▶ Payroll can be outsourced (e.g., ADP)
 - ▶ Closing of the books
 - ▶ Typically done monthly
 - ▶ Develop a schedule
 - ▶ Document responsibilities

Internal controls

- ▶ Safeguarding business assets and helps ensure accurate financial reporting
 - ▶ Entity level controls
 - ▶ Management tone
 - ▶ Segregation of duties
 - ▶ High level controls that lay a foundation
 - ▶ Management review of results
 - ▶ Transaction level controls
 - ▶ Bank reconciliations
 - ▶ General ledger account reconciliations
 - ▶ Check signing authorizations
 - ▶ Information systems controls

Financial statements and reporting

- ▶ Basic financial statements
 - ▶ Balance sheet
 - ▶ Income statement
 - ▶ Cash flow statement
 - ▶ Financial statements summarize the information maintained in the general ledger
- ▶ Well presented financial statements include financial statement footnotes
 - ▶ Accounting policies
 - ▶ Significant account details
 - ▶ Other quantitative and qualitative information

Financial statements and reporting

- ▶ Users of the financial statements (bankers, potential investors) will expect well presented financial statements and accounting records
- ▶ Management must understand the financial statements and be able to explain to other users of the statements
- ▶ Your outside CPA can provide critical support
 - ▶ Bookkeeping
 - ▶ Income tax and other tax reporting
 - ▶ Accounting matters consultation
- ▶ Audited financial statements
 - ▶ Often required by lenders or investors
 - ▶ Independence considerations for CPA performing the audit

Tax responsibilities

- ▶ Income tax filings (both federal and state)
- ▶ Payroll taxes
 - ▶ Amounts withheld from employees and employer portion must be submitted timely – avoid severe penalties
 - ▶ Outsourced payroll provider assists with payroll tax filings
- ▶ Sales/Use taxes
 - ▶ Understand the types of sales and purchases that your business incurs that are subject to tax
 - ▶ Various jurisdictions collect tax
 - ▶ Outside CPA can assist

Questions

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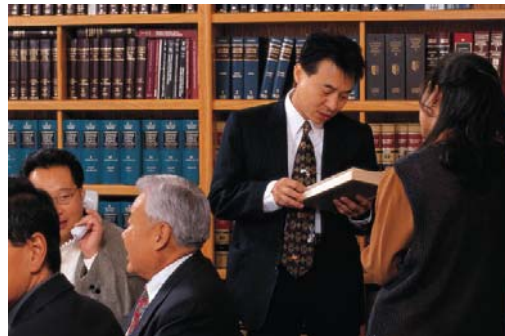
A Relationship that Counts Outside General Counsel

David C. Rieveschl
drieveschl@bakerdonelson.com

EXPAND YOUR EXPECTATIONS™

Role of Outside General Counsel

- Understand the business.
- Attend senior management or board meetings.
- Spot issues in advance.
- Proactive suggestions based on experience (strategic planning).
- Reactive suggestions based on experience (lawsuits, investigations, etc.).



Role of Outside General Counsel

- Be part of the team to provide legal point of view.
- Understand the role is to serve the client, but that it's the client's business, not yours.
- Have access to all areas of legal specialty.
- Doing appropriate work while referring the rest.
- Be a trusted advisor.



Effective Use of Outside General Counsel

- Find somebody interested in you and your business.
- Arrive at appropriate compensation structure.
- "Train" yourself to include outside general counsel in strategic discussions as appropriate (like other professionals).
- Make sure you are on the same page with respect to whether something is billable or not.



Effective Use of Outside General Counsel

- When something is “billable,” make sure scope is defined up front as well as proposed costs. This can often lead to strategic use of counsel, keeping work that can be done by others out of the scope.
- Create and keep tabs on a budget and have waypoints when “targets” are reached.
- Develop a trusted relationship that surpasses that of a mere technician. In fact, many outside General Counsel manage work they don’t do.



A Relationship that Counts

Outside General Counsel

Contract Basics for Entrepreneurs

Chris Sloan

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csloan@bakerdonelson.com

EXPAND YOUR EXPECTATIONS™

Overview

- What is a Contract?
- The Importance of Written Contracts
- Contract Fundamentals
- Common Contract Types
- Negotiating with Customers
- Other Common Contract Issues

What is a Contract?

- A promise supported by consideration
 - Sometimes described as a “bargained-for exchange”
- Example
 - Chris offers David \$100 to buy David’s pet honey badger
 - David agrees
 - Chris and David have a contract
- “Consideration” can be almost anything of value
 - Money
 - An action
 - An obligation to pay money or do something in the future

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The Importance of Written Contracts

- Oral contracts can be enforceable (except when they aren’t)
- Proof is the problem
 - Old legal saying: “If it’s not in writing, it didn’t happen.”
- Written agreements provide proof and clarity.
- “Written” does not mean formal.
 - e.g. An email exchange can create a contract.

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Contract Fundamentals

- Contracts serve three main purposes:
 1. Documenting the deal
 2. Risk allocation
 3. Legal compliance (not as common as you might think)
- Get it ALL in the contract
 - People turn over
 - “Understandings” are forgotten
- Use the Law of Common Sense
 - “Magic language” is rare

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Customer Contracts

- KISS: KeeP It Simple Stupid
- Long and (needlessly) complicated is rarely better
- Simple can speed up sales cycle
 - People understand plain English
 - Understanding = Acceptance = LESS LAWYER TIME = MORE \$\$
- A few tips:
 - Don't repeat
 - Don't use lots of words when fewer will work fine
 - Use active voice
 - Be choosy about what clauses really add value

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Clauses You Should Care About

- Included/excluded products/services
- Payment terms and remedies for failure to pay
- Disclaimers and Limitations of Liability
- Dispute Resolution
- Assignment
- Indemnification
- Term and Termination
- IP

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Other Common Contract Types

- NDA
- Software Development Agreement
- Software License or SAAS Agreement
- Terms of Use
- Hosting Agreement
- Employment Agreement

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Nondisclosure Agreements

- Use if you are disclosing trade secrets or other confidential info
- Clearly define scope
 - Be careful of labeling requirements
 - Common exceptions
- Trade secrets
 - Specifically include in scope
 - Specifically exclude from expiration

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What About Vendor Contracts?

- Vendors usually push their own paper (but not always)
- Most vendors will negotiate to some degree
 - Your mileage will vary according to leverage and vendor
- Vendor contracts can be long, complicated, and/or tricky
 - Some are very poorly drafted
 - Some are confusingly organized
- Vendor forms can be full of traps and outs
- READ VERY CAREFULLY
 - Critical thinking is important
 - Use common sense – your instincts are often right

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Software Agreements

- IP ownership is often misunderstood
- To own it, you MUST have an express assignment
 - Usually NOT a work made for hire
- If you are doing the work, make payment a precondition for transfer of IP ownership
- Detailed functional specs and implementations plan are always better
 - #1 source of disputes = in-scope vs. out-of-scope
- All payments tied to objective milestones
- For SAAS, address SLA and credits for failures (if important to ops)

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EXPAND YOUR EXPECTATIONS™

Introduction of Topics

- A. What are Louisiana tax incentives?
 - 1. General definition
 - 2. Benefit of Louisiana tax incentives
- B. When should an emerging company in Louisiana start planning for Louisiana tax incentives?
- C. Why should an emerging company concern itself with Louisiana tax incentives?
- D. How does a business qualify for Louisiana tax incentives?
- E. A sampling of the more prominent Louisiana tax incentives
 - 1. How they are earned
 - 2. How much can be earned
 - 3. How to benefit from them
 - 4. Special rules to consider
 - 5. How to apply for them

What are Louisiana Tax Incentives?

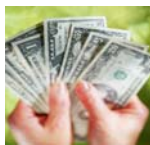
- Relief from payment of tax that your business and/or its owners would otherwise owe
- Designed to encourage some activity, generally a trade or business activity



What is the Benefit of Louisiana Tax Incentives?



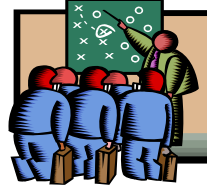
Your business and/or its owners will not have to pay tax otherwise owed



Tax incentives such as tax credits put extra cash in your pocket

When should an Emerging Company in Louisiana Start Planning for Louisiana Tax Incentives?

As early on as possible



- Louisiana tax incentives can impact the financing of your business, in terms of the timing of the financing, the amount of financing available and the kind of financing that your business is able to obtain
- Louisiana tax incentives can impact the organizational structure of your business

Why should an Emerging Company Concern itself with Louisiana Tax Incentives?



Some are lucrative and you could be leaving a significant amount of money on the table



Louisiana tax incentives can make a business more attractive to equity investors and lenders and in some cases serve as the direct source of their returns

How does a Business Qualify for Louisiana Tax Incentives?

- Engaging in the particular business activity that the Louisiana tax incentives were designed to encourage
- Generally, a two-part application process
 - pre-certification
 - final certification



A Sampling of the more Prominent Louisiana Tax Incentives



Angel Investor Tax Credit

Research and Development Tax Credit



Louisiana Entertainment Incentives

- Louisiana Motion Picture Investor Tax Credit
- Digital Interactive Media and Software Tax Credit
- Musical and Theatrical Production Tax Credit
- Sound Recording Tax Credit

Technology Commercialization Credit and Jobs Credit



The Investor Ready Entrepreneur

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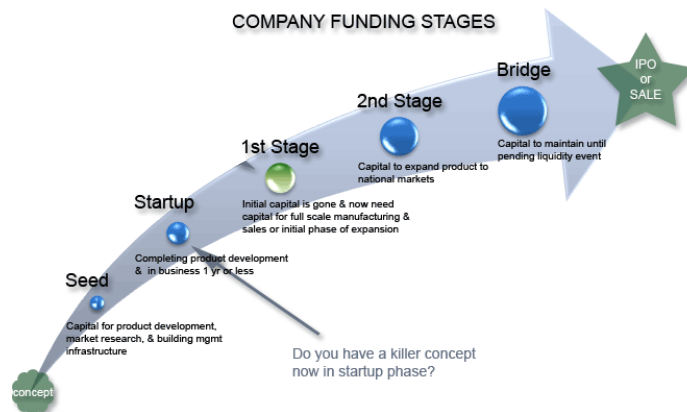
SouthCoast
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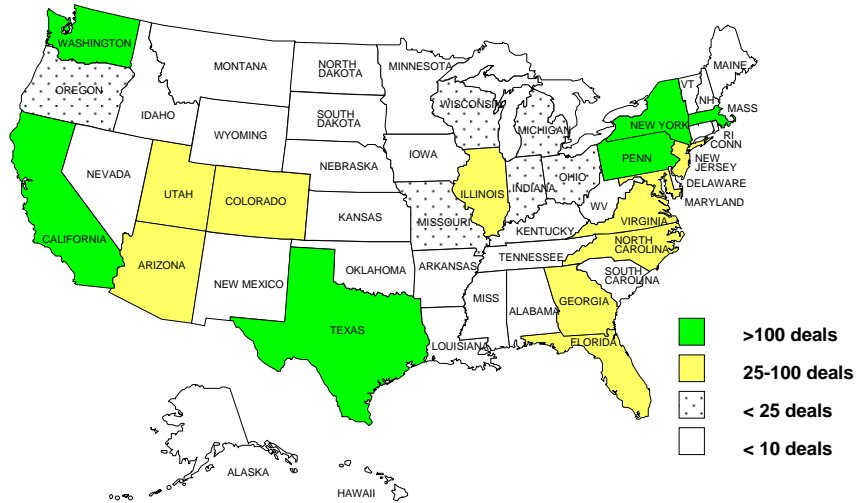
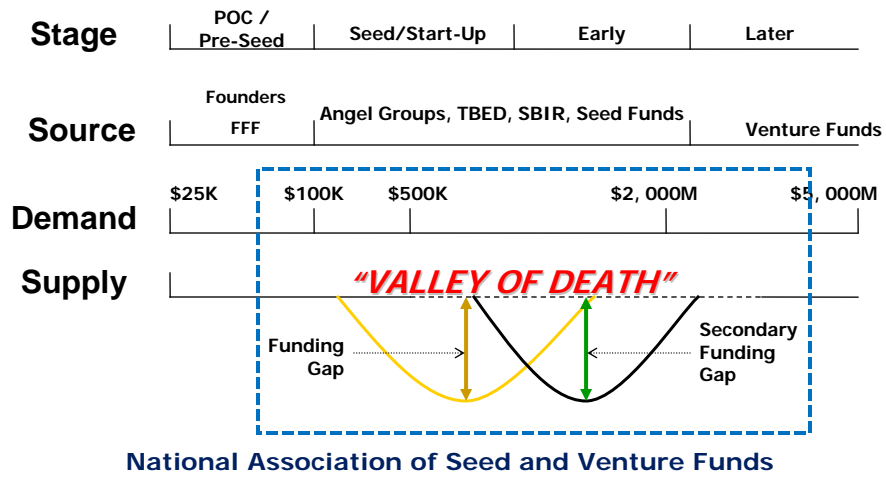
Introductions

Show others you can be **clear** and **concise**
in 15 seconds or less



- Revenue
- Reduction in Overhead
- Equity for services
- Research Grants – NIH, SBIR/STTR
- Specialty Loans – SBDC, Self-Help, Local
- Licensing
- Partnerships/Strategic Investors
- Banks/Loans – guaranteed by you or others
- Angel, VC Funding



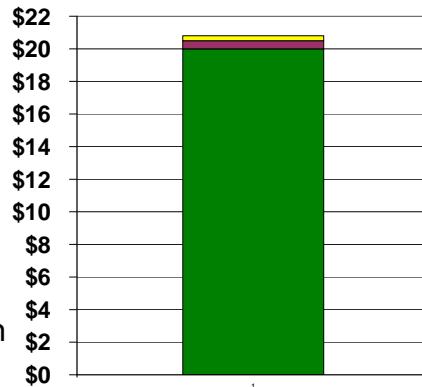


Sources of Start-up Funding

Venture Capital ~\$.3 billion
 State Funds ~\$.5 billion
 Angel Investors ~\$20 billion

Angels: 90% of outside equity for start-ups?

Friends & Family ~\$60 billion



Sources: MoneyTree, NASVF, multiple studies on informal capital

Companies Backed by Angels

AMBIT[®]
Broadband

bitpipe

YAHOO!

amazon.com

COSTCO
.COM

ALCOA

redhat.

CISCO



Google

green dot

Regeneration[™]
TECHNOLOGIES, INC.

Ask[™]
.com

PayPal[®]

A really great angel helps an entrepreneur:

1. See around the corner
2. Gain a sober second opinion
3. Network with people who can help build the business
4. By being an ambassador
5. Gain credibility in a field

- ▣ Individuals
- ▣ Private Groups
- ▣ Networks
- ▣ Funds

- ❑ Investment Return
 - Funds are invested only after an extensive due diligence indicates a good chance of target return / time.
- ❑ Economic Development
 - There is a strong sense of satisfaction from aiding entrepreneurs and the local economy. All investments are typically within a limited geographic area.
- ❑ Tax Incentives
 - Investment in angel funds may qualify for state tax credits.
 - ❑ Most states have some type of tax credit for angel investing.
 - ❑ Louisiana Digital Interactive Media Tax Credit Program
- ❑ Social
 - Members enjoy meeting and working together. Participation in the screening, due diligence or monitoring teams is an enjoyable, educational and rewarding experience.

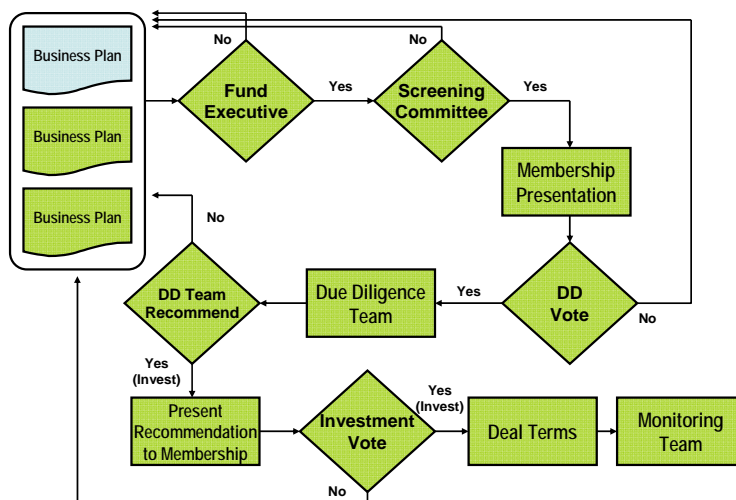
- ❑ Angel investing is VERY risky
 - 1 or 2 of every 10 investments brings most of return
 - Hard to tell which companies will return
- ❑ Current return estimates for portfolios:
 - Annual IRR of 27% - 2.6X in 3.5 years*
- ❑ If business gets VC funding later, angel investment is often diluted
- ❑ Some really great angels therefore looking for 10 to 30X potential
 - Wide variety of expectations, depending on mix of motivations to be an angel
- ❑ Correct valuation is critical

*Source: Rob Willbank, Willamette University, November, 2007 paper

- ❑ Management team
- ❑ Is the plan Clear, Concise, Compelling?
- ❑ Can you communicate it?
- ❑ Does it grab attention or capture the imagination?
- ❑ Is your idea truly unique? (this is rare)
- ❑ Is it high growth - scalable?
- ❑ Is there a way out?

- ❑ Different angel groups have varied criteria for investment.
 - Make sure you find criteria that match your opportunity.
- ❑ Typical - South Coast
 - Prefers to be the first institutional investor in seed to early stage ventures seeking value added capital to achieve an acquisition, licensing, or public offering exit within five years.
- ❑ Criteria – Looking for companies that:
 - Are headquartered within Louisiana
 - Are seeking investment of \$1 million or less
 - Are in a technology sector
 - Can match at least 50% of requested funding (from principals or other previous/current investors)
 - Are seeking to close their first round of investment with a professional group
 - Have a personal referral from a member of South Coast Angels or another angel group

- How much is needed?
- Use of funds - with timeframe
 - Alternatives
- Time to *cash flow positive*
- Overly optimistic sales projections lead to:
 - Worst case → perceived as unsophisticated, unrealistic
 - Best case → missed milestones, disappointed investors
- Understand realistic exit issues



- Angel funds will tell you their criteria for investment
 - Address those criteria
- Must be concise
 - 100+ page business plans will **NOT** be read
- Provide a range of financial outcomes (low to high)
- Make the plan realistic and believable
- Know the dynamics – what affects your plan?
- Addressable market – know it from the bottom up
- Positioning and competition – where and who?
- Backup plan – Survival is the key
- Exit plan – Where do you get off the train?

- Acts as a first-line filter
- Reviews business plans:
 - Completeness
 - Against general criteria
- Coordinates all presentations to screening committee and membership presentation
- Coordinates due diligence process

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*The Night Before the Big Meeting Frank
Receives a Visit from the PowerPoint Fairy.*

Clear – Concise – Compelling

- It starts with your executive summary
- You have one chance to make your first impression
- Introduce yourself
- State the problem, pain or opportunity - This sets the context for everything else you present
- Test your opening statement - Do friends, family, and others understand the opportunity?

- ▣ Initial Presentation
- ▣ 5-6 people
- ▣ 15 minute presentation
- ▣ 15 minutes of questions
- ▣ One of three or four presentations
- ▣ Requires approval of screening committee to make it to membership meeting

- ▣ YOU MADE IT THROUGH SCREENING
- ▣ Present to full membership
- ▣ 15 minute presentation
- ▣ 15-30 minutes of questions
- ▣ Probably the only presentation
- ▣ Requires approval of membership to go to due diligence

- Non-exclusive list
 - Management Team
 - Marketing
 - Uniqueness
 - Competition / Barrier to Entry
 - Intellectual Property
 - Market
 - Valuation
 - Potential
 - Failure Risk
 - Existing Investors
 - Exit Strategy

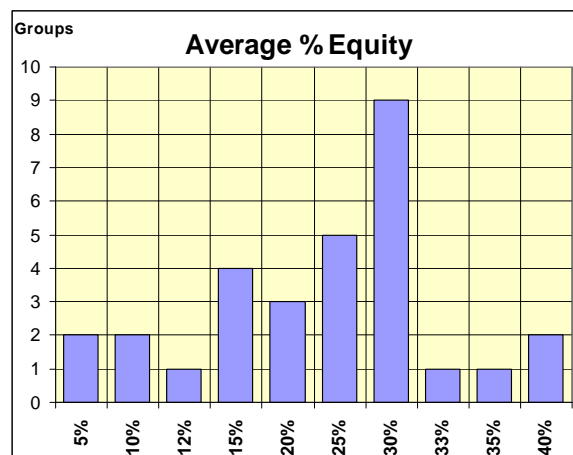
Management Team	0-30%
Size of Opportunity	0-25%
Product or Service	0-10%
Sales Channels	0-10%
Stage of Business	0-10%
Size of this round	0 - 5%
Need for more funding	0 - 5%
Quality of plan	0 - 5%

WHY ARE DEALS TURNED DOWN ?

- ▣ Quality of Management
- ▣ Unprepared for presentations
- ▣ Size of Opportunity
- ▣ Rate of Market Growth
- ▣ Product Quality
- ▣ Competition
- ▣ Barriers to Entry
- ▣ Stage of Development

- ▣ Funds likely have template – individuals may or not
- ▣ Negotiations will determine ultimate structure
- ▣ The stronger the critical factors (mgt team, proven market, etc.) the stronger the negotiating position
- ▣ Remember that investors think early about exit strategy, and it's *not* likely an IPO
- ▣ Familiarize yourself with deal structure concepts **before** approaching investors – *Preparation* is key to negotiating successfully

- *Moving toward "vanilla" term sheets with:*
- Preferred stock
- Liquidation preference
- Board & information rights
- Anti-dilution
- Participation rights



39 groups reporting (Caution: source data is incomplete & unverified)

- Read how angel groups work
 - (*Cutting-Edge Practices in American Angel Investing* J. May & E. O'Halloran, U of VA)
- Look on the website of your local group
- Network with those familiar with the process
- Know what to expect
- Be open and honest with investors
- Remain patient

- Start-up funding terms are unique
- Study these terms
 - Read *Term Sheets & Valuation* (A. Wilmerding - \$15)
 - Talk to your advisors
 - Consult with experience entrepreneurs
- Stay flexible on terms, especially valuation
- Understand common practice (your region and business vertical)



- Kauffman Foundation
 - eVenturing.com
 - angelcapitaleducation.org
- Angel Investor News
- Inc Magazine (and Web site)
- Books
 - *Term Sheets & Valuation – A Line by Line Look at the Intricacies of Venture Capital Term Sheets & Valuation*, A. Wilmerding (2003) \$10 from www.amazon.com
- Top level entrepreneurial support orgs

The Investor Ready Entrepreneur



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