

# **Brown Forum for Enterprise**

## ***Building the Team***

**February 17, 2005**

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The logo for the Brown Forum for Enterprise features a series of black dots of varying sizes arranged in a curved path that starts from the left and arcs upwards towards the right. The text "Brown Forum for Enterprise" is written in a red, serif font above the dots.

# Brown Forum for Enterprise

**Moderator: Dimitry Herman, Esq.**  
**Partner**  
**Hinckley, Allen & Snyder LLP**

**Keynote Speaker:**  
**Terry Feeley**  
**Director**  
**New Ventures of Rite Solutions**

**Panelists: Ze'ev Shaked**  
**President & CEO**  
**Spherics Inc.**

**Leslie M. Gray**  
**Director**  
**Morgan Group LLC**

**Robert W. Jevon**  
**Partner**  
**Boston Millenia Partners**

## Building the Team

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## Stages of Development

	Seed Stage	Series A	Series B and later
Skill Set	<ul style="list-style-type: none"> <li>● Pres/Treas/Sec</li> <li>● Scientific/Technical</li> <li>● Board of Directors</li> <li>● Board of Advisors</li> <li>● Lawyers/Accountants</li> </ul>	<ul style="list-style-type: none"> <li>● CEO</li> <li>● CTO</li> <li>● Product Development</li> <li>● CFO/controller</li> <li>● Board of Directors</li> <li>● Board of Advisors</li> <li>● Lawyers/Accountants</li> </ul>	<ul style="list-style-type: none"> <li>● President/CEO</li> <li>● CTO</li> <li>● COO</li> <li>● Marketing/Sales Team</li> <li>● CFO</li> <li>● Board of Directors</li> <li>● Board of Advisors</li> <li>● Lawyers/Accountants</li> </ul>
Legal/Business Issues	<ul style="list-style-type: none"> <li>● Confidentiality/IP Assignment/Noncompete</li> <li>● Equity Incentives</li> <li>● Profit Sharing</li> <li>● Employee vs. Contractor</li> </ul>	<ul style="list-style-type: none"> <li>● Confidentiality/IP Assignment/Noncompete</li> <li>● Equity Incentives</li> <li>● Increase in option pool</li> <li>● Employment Agmts</li> <li>● Indemnity Agmts</li> <li>● D&amp;O Insurance</li> <li>● Key man Insurance</li> </ul>	<ul style="list-style-type: none"> <li>● Confidentiality/IP Assignment/Noncompete</li> <li>● Equity Incentives</li> <li>● Employment Agmts</li> <li>● Indemnity Agmts</li> <li>● D&amp;O Insurance</li> <li>● Key man Insurance</li> </ul>

# Employee Noncompete Agreements

## Where appropriate

- Key employees in any industry
- Protection of IP in tech industry
- Protection of Good Will in sales and service industries
- Consultants and contractors
- Directors and advisors of Company

# Consideration

- Disclose Agreement in oral discussions and offer letter prior to hire

# Examples of confidential information

- General/Software Industry
- The Confidential Information includes, but is not limited to, **source code, object code, operational and functional features and limitations of the Company's software**, the Company's **research and development plans and activities**, the Company's manufacturing and production plans and activities, the **prices, terms and conditions of the Company's contracts with its customers**, the identities, needs and requirements of the Company's customers, the Company's pricing policies and price lists, the Company's **business plans and strategies**, the Company's **marketing plans and strategies, personnel information**, and **financial information** regarding the Company.

# Assignment of IP

- Cannot always rely on “work for hire” if dealing with contractors, consultants and agents
  - A work prepared by an “employee” within the scope of his or her employment;
  - a work specially ordered or commissioned for use as a
    - *contribution to a collective work,*
    - as a part of a motion picture or other audiovisual work,
    - as a translation,
    - as a supplementary work,
    - as a **compilation,**
    - as an instructional text,
    - as a test,
    - as answer material for a test,
    - or as an atlas,
    - **if the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire**

# Terms of Assignment

- Unconditional and irrevocable assignment
- Broad description of what rights are assigned
  - Entire right, title and interest
  - Company should have rights to modify, make derivative works, etc.
  - Employee obligated to keep records, disclose, assist with IP protection efforts
  - Exclusion for prior inventions

# Noncompete and Non-solicitation

- In general
  - non-competition clause
  - nonsolicitation/anti piracy clause – customers and employees
  - other flavors:
    - forfeiture of benefits, like severance for competition clause;
    - pay company to exercise right to compete

# Equity and Cash Incentives

- Restricted Stock
- Incentive Stock Options (ISOs)
- Non-qualified stock options
- Phantom stock arrangements
- Profit sharing plans

# Cap Table Planning

Sample Cap Table	Formation	%	Option Pool	%	Series A	%	Series B	%	Pro-rata value
Common Stock	100,000	100%	100,000	77%	100,000	29%	100,000	15%	\$ 2,283,539
Option Pool			30,000	23%	50,000	14%	60,000	9%	\$ 1,370,124
Series A Preferred Stock					195,000	57%	195,000	30%	\$ 4,452,902
Series B Preferred Stock							301,875	46%	\$ 6,893,435
<b>Total</b>	<b>100,000</b>	<b>100%</b>	<b>130,000</b>	<b>100%</b>	<b>345,000</b>	<b>100%</b>	<b>656,875</b>	<b>100%</b>	<b>\$ 15,000,000</b>
"Pre-Money" valuation					\$2,000,000		\$ 8,000,000		
Price per share	\$0.01		\$0.01		\$ 15.38		\$ 23.19		
Total Investment					\$3,000,000		7,000,000		
Total value of Company	<b>\$1,000.00</b>		<b>\$1,300.00</b>		<b>\$5,000,000</b>		<b>15,000,000</b>		

# Restricted Stock

- Can be voting or non-voting stock
- Can be paid for with cash or promissory note
- Reverse vesting – subject to “risk of forfeiture”
- “83b election” within 30 days of purchase can lead to favorable tax consequences

# Incentive Stock Options (ISOs)

- Issuable only to employees
- Exercise price must equal FMV at time of grant
- Must be issued pursuant to a qualified plan adopted by shareholders
- If all rules met, no taxable event upon exercise of option
- Company does not get a tax deduction
- Capital gains tax at disposition of stock acquired through option

## Non-qualified stock options (“non-quals”)

- Can be issued to employees, consultants, directors
- More flexibility than ISOs with exercise price, term of option and other limitations
- Does not require to be issued under qualified plan
- Optionee is taxed upon exercise of option at ordinary income rates on difference between exercise price and FMV at that time
- Company gets a tax deduction and withholding obligations apply
- Capital gains tax at disposition of stock acquired through option

# Vesting of Stock and Options

- Typically 3-4 years
- 1 year “cliff” – 25%
- 3 years – 75% quarterly
- Typically not subject to repurchase at termination
- Performance based vesting raises potential accounting issues

# Questions and Answers

Hinckley, Allen & Snyder LLP, one of New England's leading law firms with offices in Boston, MA, Providence, RI, and Concord, NH, provides a full range of legal services to individuals and businesses in a wide range of industries throughout the Northeast and beyond.

Our team of over 100 lawyers provides expert legal counsel and in-depth industry knowledge in such specialties as venture capital, intellectual property (including patent prosecution and licensing), state and federal taxation, securities law, health care law, construction law, corporate law, real estate law, labor and employment law and commercial litigation.

Hinckley, Allen & Snyder has been providing clients with world-class service and pragmatic business advice for nearly a century. For more information about us, please visit [www.haslaw.com](http://www.haslaw.com).