

# An ounce of legal prevention

**The right advice at the outset saves you money in the long run**



Brock H. Smith

You're a startup. You have a great idea, tons of ambition and the ability to function on very little sleep. Yet your bank account is almost empty. In your quest to preserve cash, you limit yourself to the most critical expenses: equipment purchases, research and development costs and, if you're lucky, founder salaries.

This strategy works well in many ways, but many founders fail to understand the value of the right legal advice. They either proceed without it or write their own contracts, often using templates found on the Internet. Yet foregoing legal advice can turn out badly for you and your business, causing complications and higher legal costs down the road.

### **Incorporation and corporate maintenance**

In British Columbia, you can incorporate a company yourself via a self-guided procedure posted on a governmental website. Yet without understanding the various options presented to you during incorporation, you can end up with deficient governing documents. For example, you may underestimate the number of shares needed for yourself, your employees and your investors, setting the maximum number too low. Or you may adopt the government-prescribed form of articles (rules of conduct) for your company, finding only later that this form lacks the flexibility you need for effective management.

Governmental websites can assist with incorporation and certain ongoing reporting requirements, but they don't guide you on how to fulfil ongoing corporate maintenance obligations, such as the requirement to hold annual general meetings (AGMs) or have your shareholders and directors complete the AGM business by way of written resolutions. Without comprehending why you need these documents or knowing how to meet these

ongoing obligations, you'll have incomplete corporate records.

As these problems persist, they'll grow bigger and their ultimate cost to you higher. And the cost can be more than the legal fees required for their correction. A potential investor or joint-venture partner reviewing your corporate records in due diligence will quickly discover these deficiencies and may get cold feet about continuing a business relationship with you if he or she believes you can't manage basic corporate requirements.

### **Founders' relationships**

At first, co-founders have a collective drive to move forward as a team. Over time, however, working relationships can develop cracks. You need a shareholders' agreement that establishes a process for resolving disputes or smoothing the transition of one or more co-founders out of the company. Lacking such a critical agreement at the outset may mean that the cracks in these relationships may grow to the point that the whole project collapses.

### **Intellectual property protection**

You need proper legal agreements to document ownership of your company's intellectual property and restrict its use and disclosure, or you may find that someone else owns the property or has disclosed it to your competitors. Either way, this will be a deal-killer for a financing or buy-out transaction. Proper agreements with your employees and independent contractors will assure that your company owns all the work they've developed and that they are free of restrictions on their ability to work for your company, such as any non-competition obligations they might otherwise have owed to former employers.

Also, have your potential business partners sign non-disclosure agreements (NDAs) before you release any confidential company information. Beware,

though: an NDA isn't a "one-size-fits-all" document. The form of agreement that restricts disclosure of company secrets by an employee or contractor differs from the one needed for a potential business partner.

### **Corporate finance**

Many founders think they grasp the complex rules and regulations of corporate finance and believe they can manage their own financing transactions. Unfortunately, in many cases their knowledge is incomplete, outdated or just plain wrong.

Canadian securities regulation has changed dramatically over the past years, particularly with respect to the nature and availability of exemptions from prospectus and registration requirements. Founders using outdated or homemade documents often find that the transactions by which their companies issued shares to family and friends and other early-stage investors contain significant deficiencies that are difficult or even impossible to correct. Most often, you won't identify these problems until you're in the midst of a significant transaction and need a solution in short order.

### **Strategy**

Good legal counsel from the start can give your business the foundations and protections it needs to move forward. The right legal adviser will work with you to identify the specific issues you face and develop a plan to create the correct documents within a realistic budget. ■

*Brock H. Smith is a partner in the technology & intellectual property group at Clark Wilson LLP, where he provides strategic legal advice to technology and emerging growth companies of all sizes. He concentrates on asset acquisition and management, technology commercialization, outsourcing arrangements and financing. Reach him at 604-643-3186, bhs@cwilson.com.*