10052103-0003

ISBN 978-1-5438-4748-2

MAYNARD
TREVIÑO

BUSINESS PLANNING
Financing the Start-Up Business and Venture Capital Financing

Fourth Edition

Aspen Casebook Series

MAYNARD
TREVIÑO

BUSINESS PLANNING
Financing the Start-Up Business and Venture Capital Financing

Fourth Edition

Wolters Kluwer

Business Planning

Financing the Start-Up Business and Venture Capital Financing

ASPEN CASEBOOK SERIES

BUSINESS PLANNING

FINANCING THE START-UP BUSINESS AND VENTURE CAPITAL FINANCING

FOURTH EDITION

THERESE H. MAYNARD
PROFESSOR OF LAW
LEONARD COHEN CHAIR FOR LAW AND BUSINESS
FOUNDER, TRANSACTIONAL LAWYERING INSTITUTE
LMU LOYOLA LAW SCHOOL, LOS ANGELES

SHANNON TREVIÑO
DIRECTOR, TRANSACTIONAL LAWYERING INSTITUTE
CLINICAL PROFESSOR OF LAW
PATRICK J. MCDONOUGH DIRECTOR, BUSINESS LAW PRACTICUM
LMU LOYOLA LAW SCHOOL, LOS ANGELES

Wolters Kluwer

Published by Wolters Kluwer in New York.

Wolters Kluwer Legal & Regulatory U.S. serves customers worldwide with CCH, Aspen Publishers, and Kluwer Law International products. (www.WKLegaledu.com)

To contact Customer Service, e-mail customer.service@wolterskluwer.com, call 1-800-234-1660, fax 1-800-901-9075, or mail correspondence to:

Wolters Kluwer
Attn: Order Department
PO Box 990
Frederick, MD 21705

Printed in the United States of America.

1 2 3 4 5 6 7 8 9 0

ISBN 978-1-5438-4748-2

Library of Congress Cataloging-in-Publication Data application is in process.

About Wolters Kluwer Legal & Regulatory U.S.

Wolters Kluwer Legal & Regulatory U.S. delivers expert content and solutions in the areas of law, corporate compliance, health compliance, reimbursement, and legal education. Its practical solutions help customers successfully navigate the demands of a changing environment to drive their daily activities, enhance decision quality and inspire confident outcomes.

Serving customers worldwide, its legal and regulatory portfolio includes products under the Aspen Publishers, CCH Incorporated, Kluwer Law International, ftwilliam.com and MediRegs names. They are regarded as exceptional and trusted resources for general legal and practice-specific knowledge, compliance and risk management, dynamic workflow solutions, and expert commentary.

For Philip, with love.

—TM

To my village—my mother, for instilling in me the value of an education;
my father, for your constant encouragement;
my husband, for your love, patience and precision;
my daughters, for inspiration and motivation;
and my brother, carpe diem.

—ST

Summary of Contents

Contents

Preface

The fourth edition of this casebook continues to be inspired by the legions of law school graduates who sought to practice law as first-year corporate law associates, but who had no idea what it is that corporate lawyers *actually do*. We wrote this casebook for these students in order to bridge the gap between law school and practice as a transactional lawyer, much in the same way that the well-established Trial Advocacy course offered at our law school (as well as at most law schools today) prepares our graduates to "hit the ground running" as first-year litigation associates.

However, this casebook does not bear any resemblance to the traditional form of law school casebook typically used in upper-division law school courses. Indeed, in helping us finalize our manuscript for publication, our research assistants pointed out that our casebook does not include very many cases at all! This was done deliberately because our goal was to write a casebook that would educate law students as to what is expected of them as a first-year corporate law associate—whether they practice as a transactional lawyer on Wall Street or Main Street, in Silicon Valley or a small town.

In order to expose law students to the expectations of senior lawyers supervising the work of first year corporate law associates, this casebook adopts a simulated deal format that is designed to teach law students exactly what it is that transactional lawyers *actually do* in the context of planning a capital rising transaction. While transactional lawyers represent business clients in a wide variety of transactions, this casebook focuses on one type of business transaction that occurs on a daily basis out there in the real world: organizing and financing a new business. Since literally hundreds of thousands of new businesses are formed annually in this country, this type of transaction is likely to be a regular part of the professional life of those law students who plan to practice law in a transactional setting.

By using a simulated deal format, our casebook integrates (i) the teaching of new substantive knowledge about financing a start-up business venture with (ii) the development of the skills that are required for today's law student to be prepared "to hit the ground running" in a transactional practice. In this edition, the simulated client continues to be a software start-up company in the autonomous vehicle industry, a topic that gives instructors ample opportunity to draw analogies from daily news headlines and paves the way for discussions about the intersection of corporate law and the emerging areas of artificial intelligence and machine learning. In this way, law students will gain a real world perspective on the life cycle of a deal, as well as exposure to the kind of problems that typically arise over the course of a deal and frequently jeopardize its successful completion. In addition, use of the simulated deal format provides law students with a meaningful opportunity to identify and reflect on the ethical considerations that face the modern transactional lawyer.

This book is organized in a straightforward way. Chapter 1 introduces the client, which as discussed above is a new technology business that is seeking start-up funding. The primary focus of the materials in this Chapter is to describe the role of the lawyer and the lawyer's relationship with the client in connection with representing an entrepreneurial business of any size—ranging from a small family-owned business to a large high-tech, start-up business. The remaining Chapters of the fourth edition are organized in a manner that tracks the evolution of our client's capital raising transaction. Thus, Chapters 2 and 3 discuss the issues that typically arise when entrepreneurs consider entering into a strategic joint venture with a larger well-established business that will contribute the necessary capital to launch the new business venture. The remaining Chapters of the fourth edition analyze the issues that typically arise in the course of planning and consummating a venture capital financing transaction.

We have tried to organize the casebook so as to present the relevant topics in a sequence that has later materials building on earlier Chapters. By this sequencing and by including a fair amount of explanatory material, our casebook is organized on the fundamental precept that the law student who takes this course is curious about this subject, but has limited familiarity with the business world in general and with the life cycle of a venture capital financing transaction in particular. By introducing the topics traditionally covered in a course on Business Planning in terms that are accessible to the uninitiated law student, we hope to stimulate the law student's curiosity in this subject and to demystify what is often an intimidating and overwhelmingly jargon-laden body of law. Accordingly, the objective is to treat the topics covered in each Chapter in a comprehensive, understandable and yet intellectually challenging manner that combines both the theoretical and practical aspects of the subject matter area. In this way, our casebook combines theory and practice in order to prepare law students for the types of projects and challenges that they will confront in their first few years of a transactional law practice. In addition, by using a simulated deal format, we hope to instill in the law student a sense of the inherent dynamics and fluidity of a capital raising transaction, thus allowing the law student to become an effective junior member of a law firm that represents start-up businesses.

To that end, this book includes a lengthy Appendix that consists of many different types of documents that are typically prepared as part of a financing transaction. These documents are an integral part of the book, as the Chapters make specific references to these agreements and ask students to review these agreements in order to give advice to clients, in a manner similar to what real-world corporate lawyers must do in advising their business clients. Thus, it is hoped that the text will stimulate class discussion of *both* the business and legal considerations involved in planning a capital raising transaction and at the same time provide law students with the opportunity to engage in practical problem-solving skills of the type required to be an effective transactional lawyer.

With this Fourth Edition, we say goodbye to one of the original co-authors of our casebook, Dana Warren, who will now be completely retired from LMU Loyola Law School. This is truly a bittersweet moment as we know Dana will thrive in this next chapter of his life, but we will miss his thoughtful insights and valuable experience. Dana is one of the finest corporate lawyers that we have had the good fortune to work with and this casebook never would have come to fruition without his collaboration. In developing this casebook's innovative approach to teaching law students to be successful transactional lawyers, Dana's contributions are enormous: his depth of knowledge of the venture capital industry and his considerable experience representing entrepreneurs and start-up businesses were invaluable. Equally important, Dana's generosity in sharing deal precedent was crucial to developing the simulated deal format that is the very foundation of our casebook. Finally, and most importantly, Dana has been a tremendous colleague; indeed, his humor, patience, creativity, and elegant writing will continue to influence us.

We hope that you enjoy teaching out of our casebook as much as we do. We would be delighted to hear from you with any criticisms or suggestions. With any luck, we hope to publish a fifth edition of this casebook in a few years and we will do our best to make the next edition better for both students and their professors.

December 2021

Therese H. Maynard
Shannon C. Treviño
LMU Loyola Law School, Los Angeles, California

Acknowledgments and Editorial Note

In our editing of the cases, articles and other materials included in the fourth edition of this casebook, we have omitted most footnotes and case and statutory citations without indication. As to the footnotes that remain, the footnote numbers appear as they do in the original text, with no renumbering to take account of footnotes that we deleted. In addition, the formatting of headings does not necessarily correspond to the text of the original, since we made every effort for consistency of format within our casebook.

We are indebted to many persons for providing the impetus and encouragement to pursue this unusual and innovative casebook. This project never would have been conceived without many generations of law students (taught by Therese Maynard) and young corporate law associates (who sought guidance from Shannon Treviño and our original co-author, Dana Warren), all of whom impressed on us the need to develop a course that would facilitate the young lawyer's ability to understand the life cycle of a typical capital raising transaction for a new business. We owe a debt of gratitude to those many law students who suffered through various drafts of the earlier editions of this casebook as we experimented with our innovative approach to teaching the traditional Business Planning course. We are eternally grateful for your patience, understanding, and feedback. This project is truly the better for having the benefit of your suggestions and guidance. In particular, we wish to extend a special word of gratitude to our colleagues: Professor Emeritus William Fisher of the University of Richmond School of Law and Professor Erika Buell of Duke University School of Law, who were brave enough to teach their respective Business Planning courses using our materials while in draft form. We are grateful to Bill and Erika for their thoughtful and insightful comments.

This book was inspired not only by our students, but also by the many fine business lawyers who gave us the benefit of their sage counsel as we sought to develop a casebook that would prepare law students to be ready to "hit the ground running" as young corporate lawyers in a transactional practice. We are particularly grateful for the insightful comments and generous contributions of Josh Armstrong, Mark Bonenfant, Gaurav Mathur and Matthew Crowley. In addition, we appreciate the input of Linnea Warren, who sat through early iterations of the entire course several times and devoted uncounted hours to editing and re-editing the drafts for the second edition.

We also wish to express our deep appreciation to our former students, Katherine Duncan, Arif Sikora, Margaret Karakashian, Sean Montgomery, Ashley Britton and Erika de la Torre, who have provided invaluable research and editorial assistance in connection with preparing the various editions of our casebook.

Finally, we are also grateful to Darren Kelly and Paul Sobel, and likely many others unknown to us, at Aspen Publishers who helped make this casebook into a reality.

We appreciate the permission of the following publishers, authors, and periodicals to reprint excerpts from their publications:

ABA Model Rules of Professional Conduct. Copyright © 2020 by the American Bar Association. Reprinted with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association. Copies of ABA Model Rules of Professional Conduct are available at shopABA.org.

Barlow, Christopher M., C. Michael Chitwood, Howard L. Ellin, P. Michelle Gasaway and Gregg A. Noel, The Year of the SPAC. Copyright © 2021 Skadden Arps, Slate, Meagher & Flom. Available at: https://www.skadden.com/insights/publications/2021/02/skadden-discusses-the-year-of-the-spac.

Beck, Joel, "We're Not Lawyers or Accountants, and Won't Give you Advice." Where's the Value in That? (Or, Why You Shouldn't Do Legal Work For Yourself Online), The Beck Law Firm, LLC BLOG (July 29, 2013). Available at http://www.bdlawblog.com/2013/07/. Reprinted with permission of the author.

Bendremer, Fredric J., Those Delaware LLCs—Another Look: How They Could Work for You, 10 BUS. L. TODAY 43 (May/June 2001). Reprinted with permission of the author.

Bronstein, Felix J., The Lawyer as Director of the Corporate Client in the Wake of Sarbanes-Oxley, 23 JOURNAL OF LAW & COMMERCE 53 (2004). Reprinted with permission of the author.

Campbell, Rutheford B., Jr., The Role of Blue Sky Laws After NSMIA and the JOBS Act, 66 DUKE L.J. (2016). Copyright © 2016 Rutheford B. Campbell, Jr. Reprinted with permission of author.

Cox, James D. & Thomas Lee Hazen, Corporations (2d ed. 2003). Reprinted with permission of the authors.

Dorff, Michael B., Why Public Benefit Corporations?, 42 DEL. J. CORP. L. 77 (2017). Reprinted with permission of the author and the DELAWARE JOURNAL OF CORPORATE LAW.

Fenwick & West, LLP, Guide to Starting A Corporation, Law Firm Memo (2013). Available at http://www.fenwick.com/FenwickDocuments/Legal%20-Guide.pdf. The information in this article does not constitute legal advice by the authors or Fenwick & West LLP.

Freedman, David H., Why the Series A Crunch Might Be a Good Thing, INC. MAGAZINE (Oct. 2013). Available at https://www.inc.com/magazine/201310/david-freedman/why-the-series-a-crunch-might-be-good.html. Reprinted with permission of Mansueto Ventures LLC; permission conveyed through Copyright Clearance Center, Inc.

Freedman, David M. and Matthew R. Nutting, A Brief History of Crowdfunding Including Rewards, Donation, Debt, and Equity Platforms in the USA. Adapted from Equity Crowdfunding for Investors: A Guide to Risks, Rewards, Regulations, Funding Portals, Due Diligence, and Deal Terms. Copyright © 2016-2020 David M. Freedman and Matthew R. Nutting. Available at https://dave40816.wixsite.com/freedman/history-of-crowdfunding.

Gartenberg, Edward, A Review of Fiduciary Duties in California and Delaware Corporations, STATE BAR OF CALIFORNIA, BUSINESS LAW NEWS, Oct. 2006.

Gazur, Wayne M., The Limited Liability Company Experiment: Unlimited Flexibility, Uncertain Role, 58 LAW & CONTEMP. PROBS. 135 (Spring 1995). Copyright © 1995 Wayne M. Gazur. Reprinted with permission of the author and Duke University School of Law.

Gosfield, Gregory, It's a Question of What's Binding: A Look at Letters of Intent, 13 Bus. L. Today 55 (July/August 2004). Copyright © 2004 by the American Bar Association. Reprinted with permission of the American Bar Association; permission conveyed through Copyright Clearance Center, Inc.

Herr, Mitchell E. & Stephen P. Warren, Lawyer Liability: Why the SEC Should Clarify Policy on Its Actions Against Attorneys for Advising Clients, 21 CORP. COUNS. WEEKLY (BNA) 200 (June 28, 2006). Reproduced with permission. Bloomberg Law, Copyright 2021 by The Bureau of National Affairs, Inc. (800-372-1033) http://www.bloombergindustry.com (Available on Bloomberg Law).

Jacob, Valerie Ford, Stuart H. Gelfond, Michael A. Levitt & David A. Kanarek, Key Considerations in Drafting a Registration Rights Agreement from the Company's Perspective, 41 REV. SEC. & COMM. REG. 113 (May 21, 2008). Reprinted with permission.

Keller, Stanley, Securities Enforcement: Searching Google for Meaning — Equity Compensation Pitfalls and a Changed Climate for Lawyer Responsibility, 19 INSIGHTS 2 (August 2005). Copyright © 2017 CCH Incorporated. All Rights Reserved. Reprinted with permission from Wolters Kluwer.

Kleinberger, Daniel, AGENCY, PARTNERSHIPS, AND LLCS: EXAMPLES & EXPLANATIONS (5th ed. 2017). Copyright © 2017 CCH Incorporated, reprinted with permission of Wolters Kluwer.

Kleinberger, Daniel S., Two Decades of "Alternative Entities": From Tax Rationalization Through Alphabet Soup to Contract as Deity, 14 FORDHAM JOURNAL OF CORPORATE AND FINANCIAL LAW 445 (2009). Copyright © 2009 by the FORDHAM JOURNAL OF CORPORATE AND FINANCIAL LAW. Reprinted with the permission of the FORDHAM JOURNAL OF CORPORATE AND FINANCIAL LAW.

Kosuri, Praveen, Beyond Gilson: The Art of Business Lawyering, 19 LEWIS & CLARK L. REV. 463 (2015). Reprinted by permission of the LEWIS & CLARK LAW REVIEW and the author.

Littenberg, Michael R., Emily J. Oldshue, Brittany N. Pifer, Anne-Marie L. Beliveau, and Nellie V. Binder, Taking a Fresh Look at Delaware Public Benefit Corporations – Recent Legal and Market Developments, Ropes & Gray LLP Client Alert (August 14, 2020). Available at https://www.ropesgray.com/en/newsroom/alerts/2020/08/Taking-a-Fresh-Look-at-Delaware-Public-Benefit-Corporations-Recent-Legal-and-Market-Developments. Copyright © 2020.

Litov, Lubomir P., Simone M. Sepe, and Charles K. Whitehead, Lawyers and Fools: Lawyer-Directors in Public Corporations, 102 THE GEORGETOWN LAW JOURNAL 413 (2014). Reprinted with permission of the authors.

Morrison & Foerster LLP, Frequently Asked Questions About Rule 144 and Rule 145. Copyright © 2016 Morrison & Foerster LLP. Available at https://media2.mofo.com/documents/faqrule144_145.pdf.

Manesh, Mohsen, Equity in LLC Law?, 44 FLA. ST. U. L. REV. 93 (2018). Reprinted with permission of FLORIDA STATE UNIVERSITY LAW REVIEW.

Maynard, Therese, Ethics for Business Lawyers Representing Start-Up Companies, 11 WAKE FOREST J. BUS. & INTELL. PROP. L. 401 (2011). Reprinted with permission of WAKE FOREST JOURNAL OF BUSINESS & INTELLECTUAL PROPERTY LAW.

Miller, Sandra K., *What Buy-Out Rights, Fiduciary Duties, and Dissolution Remedies Should Apply in the Case of the Minority Owner of a Limited Liability Company*?, 38 Harv. J. on Legis. 413 (2001); permission conveyed through Copyright Clearance Center, Inc.

Palmiter, Alan R., Corporations: Examples & Explanations (9th ed. 2021). Copyright © 2021 CCH Incorporated, reprinted by permission of Wolters Kluwer.

Palmiter, Alan R., Securities Regulation: Examples & Explanations (7th ed. 2017). Copyright © 2017 CCH Incorporated, reprinted with permission of Wolters Kluwer

Peters, Philip, *The California Corporation: Legal Aspects of Organization and Operation*, Corporate Practice Series, Portfolio No. 31-3rd, pp. A-20 & A-21 (Apr. 2011). Copyright © 2011 by The Bureau of National Affairs, Inc. (800-372-1033), http://www.bna.com. Reprinted with permission.

Robins, Martin B., Recipe for an Overdue Change: Why Corporate Lawyers Sometimes Need to Give Business Advice, 12 BUS. L. TODAY 6 (July/August 2003). Reprinted with permission of the author.

Schurenberg, Eric, *What's an Entrepreneur? The Best Answer Ever*, Inc. Magazine (Jan. 9, 2012). Available at https://www.inc.com/eric-schurenberg/the-best-definition-of-entepreneurship.html. Republished with permission of Mansueto Ventures LLC; permission conveyed through Copyright Clearance Center, Inc.

Smith, Gregory C., START-UP & EMERGING COMPANIES. Copyright © 2020 ALM Media Properties, LLC. Reprinted from the 2020 edition with permission of ALM Media Properties, LLC; permission conveyed through Copyright Clearance Center, Inc.

Smith, Hayden, So You Owe Thousands of Dollars in Delaware Franchise Tax? Cooley Go(April 12, 2021). Copyright © 2021 Cooley LLP and Cooley (UK) LLP. All rights reserved. Available at https://www.cooleygo.com/so-you-owe-thousands-in-delaware-franchise-tax/. Reprinted with permission.

Werner, Peter, Primer on Convertible Debt, Cooley LLP (via Cooley GO). Copyright © 2017 Cooley LLP and Cooley (UK) LLP. All rights reserved. Available at https://www.cooleygo.com/convertible-debt. Reprinted with permission.

Wry, Charles A., Jr., Tax Considerations in Choosing the Form of Organization for a New Business, Morse, Barnes-Brown, Pendleton, PC, Law Firm Memo (January 25, 2018), available at: http://www.morse.law/news/business-entity. Reprinted with permission.

Business Planning

Financing the Start-Up Business and Venture Capital Financing

Chapter 1

Introduction to Business Planning

Imagine yourself, a newly licensed lawyer, pursuing a career as a transactional lawyer. It is your first day at work as a first-year associate with a corporate law firm that specializes in representing start-up businesses. As you settle into your new office, a senior partner enters to ask you to help her prepare to meet a new client the next day. After describing the client and the nature of the financing transaction that the client proposes to enter into, the senior lawyer presents you with a document and then tells you, "Look over this agreement and let me know first thing in the morning what issues I should be worried about when I meet with the client tomorrow."

This is a fairly typical assignment to be delegated to a first-year corporate law associate. If you are like many first-year associates, however, your initial reaction may be one of utter panic, followed closely by bewilderment as to *exactly* what the senior lawyer expects you to *do* when you review the agreement that she has just left on your desk. Moreover, if your law school is like most across the country, you may be thinking, "Nothing that I learned in law school prepared me for this kind of legal work! What am I going to *do* now?"

This casebook has been deliberately constructed to give you a practical, hands-on learning experience that will leave you well prepared to tackle this kind of assignment. We hope that, rather than experiencing the typical wave of panic, you will feel confident that you have the substantive knowledge, the critical thinking skills, and some amount of experience to immediately engage with the problem. Moreover, you will be familiar with the expectations of the senior lawyers who will be supervising your work so that you will be in a position to understand both the needs of the client and the senior lawyer who is relying on you to help her diligently represent this new start-up business. In other words, this casebook is designed to prepare law students to be ready to "hit the ground running" as transactional lawyers.

To accomplish this teaching objective, this casebook departs from the traditional law school casebook by adopting a "simulated deal" format to the study of the subject matter covered in the traditional Business Planning course. Over the years, it has been our experience that the use of a "simulated deal" format provides law students with the opportunity to bring their understanding of relevant legal materials to bear upon the problems that typically arise in the course of completing a particular business financing transaction. In this way, the law student develops some feel for the process of exercising judgment and reaching a decision in order to advise the client regarding the best way to structure a particular transaction. By participating in a simulated deal, law students will learn the necessary skills to engage in a financing transaction, regardless of the size of the transaction (whether it is a $10,000 or a $100 million deal) or the types of parties involved (a large venture capital firm, a small business, or a major Web 3.0 start-up business).

In addition, the use of a simulated deal format exposes law students to the real-world expectations of experienced senior lawyers who will be evaluating the work product of a first-year associate working in the corporate law department of a law firm—whether on Wall Street or Main Street. Finally, we have found that the simulated deal format provides the law student with a more realistic view of the lawyer's work as a corporate lawyer practicing in a transactional setting, thereby providing the student with a meaningful opportunity to bridge the gap between law school and practice as a transactional lawyer.

A. *WHAT IS "BUSINESS PLANNING"?*

Business planning is an essential process for most, if not all, businesses. It begins with the very inception of a business idea. Many business ideas never reach beyond this stage for numerous reasons: lack of marketability, funding, entrepreneurial energy, etc. However, those ideas formed by entrepreneurs with the necessary gumption to forge ahead must *plan out* their business. In planning the business, an entrepreneur must figure out what type of company will be created (e.g., corporation, limited liability company (LLC), partnership), generate a business plan, locate financing, contemplate how the idea will develop and grow into a successful business, etc. As the idea evolves into a viable business model, its needs will change, perhaps to include venture capital financing, a capital restructuring, or maybe even an initial public offering (IPO) or acquisition by a larger company. During this entire process, from idea to exit, the entrepreneur will need legal assistance to help him or her on this journey.

This casebook is designed to familiarize you both with the business planning and the lifecycle involved in a typical financing transaction for a start-up business and the transactional lawyer's role in that process. Since business planning, in this context, covers such a broad range of issues, it requires the corporate associate to have a broad range of knowledge of fundamental corporate law issues. Over the years, the description for a typical Business Planning course has emphasized the "interdisciplinary" (or "cross-disciplinary") nature of this upper-division course. In other words, the traditional Business Planning course required law students to synthesize the substantive knowledge that they had acquired from previous courses in order to analyze problems and make recommendations to business clients regarding the best way to structure a particular business transaction. This integration of multiple bodies of substantive legal expertise led many law schools to impose certain prerequisites, most often introductory courses on Corporations or Business Associations, Securities Regulation, and Federal Income Taxation. Accordingly, the focus of the doctrinal materials contained in the traditional Business Planning casebook reflects that the students would need to *expand* their basic understanding of corporate, tax, and securities materials beyond the core principles that students are exposed to as part of these introductory courses.

This casebook carries forward certain attributes of this pedagogical approach to teaching Business Planning. By compiling the necessary background material in the subsequent chapters of this casebook, students are provided with a road map that will help them identify and analyze the relevant legal and business issues that typically arise in connection with planning a capital-raising transaction for a start-up business. This approach allows the law student to concentrate on *synthesizing* the various areas of substantive legal knowledge in order to formulate a sound and well-reasoned recommendation in the context of planning and structuring a particular financing transaction. In the process, students also will learn *new* substantive legal doctrines that are typically not covered in other courses in the traditional law school curriculum.

As such, students will be asked to go beyond the material covered in the core prerequisite for this course, and also will be exposed to new materials regarding capital-raising transactions, including the use of venture capital financing, a topic that is often the subject of a freestanding, upper-division course in many law schools today. However, we deliberately eschew any emphasis on tax issues. This was very much a conscious choice on our part, borne out of our conviction that this approach best reflects the real world of practice. Rather than ask law students to master the minutiae of tax law, we prefer the more realistic approach that identifies tax issues, without trying to offer the breadth of materials (as part of our casebook) that are necessary in order to resolve *all* relevant tax issues that may potentially arise as part of planning a capital-raising transaction. We believe that this approach best comports with the real-world practice of modern corporate lawyers, who, in our collective experience, issue-spot on tax questions, but consult with a knowledgeable tax practitioner for definitive advice in the course of structuring a particular business transaction.

The organizational approach we adopt in our casebook also reflects our view that the modern corporate lawyer serving as a transaction planner really is something of a "jack of all trades." This observation is based on the fact that the modern corporate lawyer giving advice on the best way to structure a particular capital-raising transaction usually must have a foundational knowledge of intellectual property, employee benefits, executive compensation, and tax matters, as well as a thorough mastery of agency, partnership, LLC, general corporate, contract, and federal securities law. (The breadth of issues that typically confront the lawyer as the planner of a capital-raising transaction is reflected in the table of contents for this casebook.) Reflecting the view that the modern corporate lawyer is "a jack of all trades," the only prerequisite for this class is the basic, introductory course, Business Associations or Corporations, which is offered at all law schools. Thus, the topics to be covered in each chapter of this casebook assume that students have completed a Corporations course. Accordingly, the materials included in the various chapters of the casebook provide ample coverage of all the relevant topics so that students will be able to master the doctrinal material needed to analyze the issues that surface in the course of the simulated deal without the need to do any additional research on their own.

As part of our simulated deal format, you will assume the role of counsel to a start-up business seeking capital and will be required to handle a series of increasingly complex matters typical in the representation of an early-stage business. By using a simulated deal format, you will be expected to analyze *both* the legal and the business considerations that must be taken into account in planning the structure, and negotiating the terms, of a typical capital-raising transaction involving venture capital investors. In the process, you will gain a meaningful sense for the role of the lawyer in the deal-making process, including the ethical dilemmas that are common—and unique—to the practice of law in a transactional (rather than litigation) setting.

This casebook will integrate (i) the acquisition of new substantive knowledge about financing a start-up business (including the use of venture capital) with (ii) the development of the skills that are required for you to hit the ground running as a first-year associate in a transactional practice. Thus, our focus was to design a curricular approach that meets two objectives: first, the materials in the casebook must teach students to *think* like a transactional lawyer; and second, the materials must teach students to *perform* as a deal lawyer.

In addition, the reading materials in connection with several of the chapters (as well as many of the *Homework Assignments* contained in Appendix A) will often ask you to review relevant documents. For administrative convenience, all of these documents are collected in one place—Appendix B. Through the use of the materials contained in Appendices A and B, you will be exposed to the type of projects that junior corporate associates typically are asked to complete, such as reviewing documents, comparing documents to term sheets, and drafting documents such as articles of incorporation or LLC operating agreements. By the end of the semester, you will have completed a "deal," and, in the process, you will have synthesized the learning of new substantive doctrinal material with the development of the skills that you need when you graduate and start practicing as a transactional lawyer.

Although this casebook adopts a practical approach to teaching Business Planning, the materials in this casebook also challenge law students to think about the role of corporate lawyers in the business community at large. We ask you to consider the ethical issues as they arise at various points in completing this particular financing transaction. Although we deliberately eschew a strictly theoretical approach to the materials that make up our casebook, at the same time we ask you to consider the role of corporate lawyers in the modern world of business transactions. As made clear in the materials contained in the various chapters of this casebook, we firmly believe that corporate lawyers have an opportunity to be an important influence (and also an ethical compass) as the business community continues to reflect upon the wave of corporate scandals of the new millennium. The format that we have adopted in this casebook is designed to encourage you to contemplate important public policy questions that are peculiar to the lawyer serving as a transaction planner: *Why* structure a particular deal in this particular way? Is this the *best way* to structure a particular deal from a larger public policy perspective? The classroom setting encourages discussion of these important questions—a luxury that often is not allowed for the busy practitioner laboring under the considerable pressures of the modern practice of law. In this way, we also hope to make the intellectual richness of practice as a transactional lawyer come alive for the law student.

B. MEET OUR NEW CLIENTS

The transaction that is the focus of this casebook is based on the deal files of practicing lawyers in the real world. In this way, the deal is authentic in that it is representative of the type of capital-raising transactions that lawyers are routinely asked to complete on behalf of their business clients. In addition, the *Homework Assignments* emphasize the drafting and analytical skills necessary to be successful as an entry-level associate in a transactional practice. We have prepared the materials in our casebook on the assumption that the professor will assume the role of the senior, experienced corporate lawyer who relies on the students—serving in the role of junior associates working under the partner's supervision—for assistance in completing this capital-raising transaction.

The memo (set forth below) introduces the law student to a new, capital-seeking client with whom the senior partner recently met. As we progress through the various *Homework Assignments* in Appendix A, new information, circumstances, and objectives will be presented as the client moves ahead and its financing goals evolve. It bears emphasizing that this is typical of the life cycle of business transactions in the real world of practice. As reflected in the memo below, the facts and circumstances surrounding this new client matter are inherently fluid. This fluidity—both as to the source of funding and as to the form of business entity to be used—is fairly typical in connection with taking on a new client who proposes to start up a new business. As a pedagogical matter, this fluidity also allows us to engage in a more in-depth discussion of the factors involved in the choice of entity decision (the use of the LLC, often to be formed with a strategic partner), and gives us the freedom to consider the different financing alternatives that are typically available to a new business (including the possibility of obtaining funding from a venture capitalist). By addressing the range of options typically available to finance a new business, the materials in this casebook are designed to be relevant, enlightening, and helpful in preparing law students for practice as entry-level corporate lawyers—and that is true whether they expect to be doing the more complex transactions at a big firm on Wall Street (or in Silicon Valley), or to be representing local entrepreneurs at a small law firm on Main Street.

To: **Associate**
From: **Partner**
Re: **New Client**

I met yesterday with the founders of a new business. Our firm, Maynard & Treviño, LLP, has been retained in connection with the formation of the business and to serve as its primary outside counsel. The founders think they want to name the company "Safecar." I would like you to be Safecar's main contact person at the firm. As Safecar has not yet been formed, one of the first issues to address will be entity selection.

Safecar's founders are developing software technology that promises to solve a critical obstacle in the development of autonomous (driverless) vehicles. The software interprets data from light detection and ranging (LiDAR) sensors installed on self-driving vehicles and triggers braking, acceleration, or steering action by the appropriate vehicle components, all in a manner designed to distinguish and prioritize the safety of humans over inanimate objects. The software uses sophisticated deep learning algorithms to quickly process sensor data and adapt to changing environments. The ability to generate the algorithms to make split-second decisions when human safety is at risk is critical. The software is significantly more accurate than anything else currently available on the market.

The founders of the company and developers of the software are Ana Flores and Alex Lee, who met while students and post-doctoral fellows at Caltech. While still at Caltech, Ana conceived the idea for Safecar and completed early work on the software concept as part of her thesis. Since graduating, Ana has continued developing the software. Alex completed his studies about a year before Ana defended her thesis and left to work for a major automobile manufacturer in Detroit. However, after six months on the job, Alex was disappointed with his level of responsibility and autonomy and, after discussing it with Ana, returned to California to perfect Safecar's software program. Ana and Alex have been working out of a garage at the home of Ana's uncle and rely occasionally on resources provided by a local accelerator for start-ups. (The term "accelerator" refers to an organization that provides education, coaching, and mentoring to—and often invests in—select early-stage start-up businesses in exchange for an equity ownership stake in the companies. Accelerators will be discussed again in Chapter 8.)

Ana and Alex are still in the development phase with their technology. They envision that if they go it alone—that is, they do not seek financial support from investors—it will take them another 12 to 18 months to get the software ready for initial (or beta) testing with a LiDAR sensor from an original equipment manufacturer (OEM). It will then take an additional 18 to 24 months to beta-test the product and make necessary fixes and improvements. Alternatively, they estimate that if they take in approximately $500,000 from investors, they can cut the time to get to the beta-testing phase in half. Further, if they can obtain several million dollars more, they can cut in half the time to get through beta testing and have the product ready to market.

Ana and Alex told me they believe that, if they choose to pursue this course, the initial $500,000 could be raised from family and friends, but that the several million dollars will need to be raised from professional investors or a strategic partner.

Based on conversations Ana and Alex have already had, they believe the $500,000 could come from a group of seven investors: (a) Ana's parents; (b) Alex's mentor, a former entrepreneur turned investor; (c) Alex's family doctor and his spouse; (d) Ana's elderly aunt; and (e) Alex's college roommate (who, according to Ana, says that he just "inherited a bundle"). Ana and Alex report that they, as well as all of these potential investors, are concerned about exposing their personal assets through their involvement with the business. In addition, several of the potential investors asked about being able to take tax deductions based on Safecar's expected early losses.

Ana and Alex made it clear that they are nervous about the decision of taking on friends and family as investors. If they do it, they want to be scrupulously fair, but they also want to be sure that there is no issue about their ability to be in charge of the management of Safecar.

In addition, and what prompted their call to our firm, Ana and Alex have been contacted by Drift, Inc. (Drift), a leading auto parts supplier of sensors and other vehicle components. They said that Drift was feeling them out regarding a joint venture to provide the funding necessary to finish the development of Safecar's technology and then to produce, market, and distribute an off-the-shelf system for incorporation into autonomous vehicles. As you probably know, part of Drift's growth has come through making investments in new, disruptive technologies, including through funding joint venture relationships and acquisitions. Ana and Alex are interested in the idea and have scheduled a preliminary meeting with Drift next week. More details should become clear then.

As to our firm's role, in addition to our entity selection analysis, we need to be prepared for the first steps on that potential joint venture transaction.

I read this morning that several members of Congress recently introduced legislation that would apply universal standards to driverless vehicles and clarify certain negligence and product liability principles as they relate specifically to this evolving area of autonomous vehicles. In addition, the departments of motor vehicles in several states are moving ahead with proposed regulatory changes. You probably also read about the recent fatal crash of a car with selfless-driving capability. We obviously need to stay on top of these issues.

I will be in touch with you later regarding the matters that arise in serving this new relationship. Thank you for your help!

As the materials in the next section make abundantly clear, starting a new business can mean many things. It can mean starting a law firm, starting a landscaping business, arranging a joint venture between two large, established Fortune 500 businesses, or even the purchase of an ailing business out of bankruptcy and helping to recapitalize and restructure the bankrupt business. This casebook does not propose to cover all of these various possible scenarios. Instead, we will focus on the types of financing transactions that are typically used by start-up businesses. However, it bears mentioning that many of the business considerations and legal issues that we will study in the remaining chapters are equally relevant to *all* of the different types of financing transactions described above and are not limited to the two types of financing transactions that we will cover in this casebook—namely, the investment in a new business (such as Safecar) by a strategic investor through a joint venture and the use of outside professional venture capital investor(s) to fund the business operations of a start-up firm, such as our new client. As you go through the remaining materials in this casebook, you will be asked to consider how to address the business and legal issues raised by these materials in the context of representing our new client, Safecar, and its founders, Ana and Alex.

C. WHAT IS AN ENTREPRENEUR?

Our new clients, Ana and Alex, describe themselves as "entrepreneurs," which leads to the obvious question: *What is an entrepreneur?* Credit for coining the word "entrepreneur" is generally given to Jean-Baptiste Say, a nineteenth-century French economist and businessman. In his *Treatise on Political Economy*, he described an entrepreneur as "one who undertakes an enterprise, especially a contractor, acting as intermediatory between capital and labour."[1] The word derives from the French "*entre*" (to enter) and "*prendre*" (to take). In general terms, an entrepreneur is an individual who takes financial risks by undertaking (i.e., entering into) a new business venture; thus, the term is often synonymous with *founder*. More commonly today, in business school terms, the term *entrepreneur* is used to describe someone who creates value by offering a new product or service, or by carving out a niche in the market that may not currently exist. So, generally speaking, entrepreneurs will identify a market opportunity and then exploit it by organizing the resources necessary to affect an outcome that changes existing interactions within a particular sector of an industry, or perhaps even the entire industry.

While much has been written about entrepreneurs, one author has pared it down to the following classic—and simple—definition that also explains why the process of entrepreneurship

> . . . is so hard. . . . Here it is: *Entrepreneurship is the pursuit of opportunity without regard to resources currently controlled.* [This definition] was conceived [some] 37 years ago by [a Harvard Business School professor,] Howard Stevenson. [More recently, Professor] Stevenson [talked] about his classic definition. . . . Back in 1983 [when he first articulated his definition, Professor Stevenson observed that] people tended to define entrepreneurship almost as a personality disorder, a kind of risk addiction. "But that didn't fit the entrepreneurs I knew," he said. "I never met an entrepreneur who got up in the morning saying 'What's the most risk in today's economy, and how can I get some?' Most entrepreneurs I know are looking to lay risk off—on investors, partners, lenders, and anyone else." As for personality, he said, "The entrepreneurs I know are all different types. They're as likely to be wallflowers as to be the wild man of Borneo. . . . They see an opportunity and don't feel constrained from pursuing it because they lack resources . . . [Entrepreneurs] are *used* to making do without resources."
>
> The perception of opportunity in the absence of resources helps explain much of what differentiates entrepreneurial leadership from that of corporate administrators: The emphasis on team rather than hierarchy, fast decisions rather than deliberation, and equity rather than cash compensation.

Eric Schurenberg, *What's an Entrepreneur? The Best Answer Ever*, INC. MAGAZINE (Jan. 9, 2012), *available at:* https://www.inc.com/eric-schurenberg/the-best-definition-of-entepreneurship.html.

---

1. As quoted in Tim Hindle, GUIDE TO MANAGEMENT AND GURUS 77 (2008).

At least one prominent theorist has viewed the entrepreneur as an innovator and has popularized the use of the phrase "creative destruction" to describe the role of the entrepreneur in changing "business norms."[2] Many observers point to Apple, Inc. as an example of entrepreneurship that launched "a Schumpeterian 'gale' of creation destruction" within the computer industry.[3] As a practical matter, very few new businesses have the potential to launch such a "gale of creation-destruction" sufficient to revolutionize an entire industry—or even rearrange world economic order—in the way that modern giants such as Wal-Mart, Microsoft, and Amazon have done or are now doing. It is much more likely that an entrepreneur will launch a new business that will effect incremental change within an existing market.

Given that it has been reported that "[m]ore than a thousand new businesses are born every hour of every working day in the United States,"[4] it is clear that entrepreneurs are an important part of the U.S. economy. These new businesses transform the way that we work and live, providing services or products from software and delivery services to smart gadgets, biotechnology, and altered reality.

While our new client, Safecar, is a technology-based start-up business, entrepreneurship is not limited to Silicon Valley–based, high-tech start-ups. Entrepreneurship extends to all industries that comprise the U.S. (indeed, the global) economy, such as gourmet ice cream, fast-food restaurants, and drug packaging, to name but a few. Indeed, the well-known, high-profile "serial entrepreneur," Wayne Huizenga, launched new businesses in several, completely unrelated industries, starting with Waste Management (garbage disposal); then Blockbuster (video sales); then still later AutoNation (automobile sales), not to mention that along the way, he was the original owner of the Florida Marlins.[5]

Another, more recent example of a leader of "creative destruction" is Elon Musk, the well-known founder, chief executive officer (CEO), and chief technology officer of SpaceX, CEO of Tesla, and co-founder of PayPal, among other endeavors.

---

2. *See* Joseph Schumpeter, Capitalism, Socialism, and Democracy. In this book, first published in 1942, Schumpeter popularized the term "creative destruction," which he used to describe the process of transformation that accompanies radical innovations introduced by entrepreneurs.

3. William D. Bygrave & Andrew Zacharakis, The Portable MBA In Entrepreneurship 2 (John Wiley & Sons, 4th ed. 2010).

4. *Id.* at 1.

5. There are many notable examples of entrepreneurs who start new businesses that become wildly successful, leaving the entrepreneur a very wealthy person. However, rather than retire and rest on their laurels (and personal wealth), the "serial entrepreneur" goes off and does it all over again. According to the *Wall Street Journal*,

> Call them serial-preneurs. While some entrepreneurs struggle their whole lives to bring one idea or product to market, there's another breed: those who do it once, twice or three times more, disproving the notion of beginner's luck. In some cases, the brands and people are household names, such as Steve Jobs with Apple, Pixar, and NeXT. But the ranks are also populated with lesser-known entrepreneurs who fly under the radar, hitting one start-up home run after another.

Gwendolyn Bounds, Kelly K. Spors, & Raymund Flandez, *The Secrets of Serial Success: How Some Entrepreneurs Manage to Score Big Again and Again and . . .*, Wall St. J., Aug. 20, 2007, at R1.

The recipient of various innovator and entrepreneur recognition awards, Musk and his companies have disrupted financial payment systems and, some believe, will revolutionize transportation on land and in space.

Why do you suppose investors "embrace" an entrepreneur such as Elon Musk, even if some of his ideas and approaches are controversial and take years to become profitable?

Why do other investors take a chance on successful entrepreneurs who venture into different industries? Arguably one of the most well-known serial entrepreneurs, Richard Branson, went from founding a mail-order record business to branching into numerous other ventures—some successful and others not—over the span of several decades. Branson's businesses have included record stores (Virgin Records), a music label (also Virgin Records), an airline (Virgin Atlantic), and, most recently, a space tourism company (Virgin Galactic).

Within the technology and software industries, "disruption" continues to play an important role. As one report notes, "[i]mportant technologies can come in any field or emerge from any scientific discipline, but they share four characteristics: high rate of technology change, broad potential scope of impact, large economic value that could be affected, and substantial potential for disruptive economic impact." *See* James Manyika, Michael Chui, Jacques Bughin, Richard Dobbs, Peter Bisson, and Alex Marrs, Disruptive technologies: Advances that will transform life, business, and the global economy, McKinsey & Company, May 2013, *available at:* http://www.mckinsey.com/business-functions/business-technology/our-insights/disruptive-technologies.

This casebook does not propose to *teach* entrepreneurship; it focuses instead on the *role of the lawyer* in the process of organizing and financing a new business to be launched by an entrepreneur. Having said that, it bears emphasizing that, to be effective as a transaction planner, the deal lawyer must have some basic understanding of the *entrepreneurial process*. This section briefly describes the functions, activities, and actions generally associated with an entrepreneur perceiving an opportunity and creating a new business to pursue this opportunity.[6]

The Entrepreneurial Process. Here, we are referring to the personal, sociological, and environmental factors that typically guide the founder in making the decision to launch a new business enterprise. While there are many descriptions of this decision-making process, the following general description offers a succinct summary of this process.

Ideas for new businesses can come from a wide variety of sources. New businesses can be the direct outgrowth of an existing business. Or the idea for a new business may grow out of the brainstorming of a few individuals sitting around a

---

6. For those law students who are interested in a more in-depth examination of the *entrepreneurial process*, we strongly recommend The Portable MBA In Entrepreneurship, *supra* note 3, which is self-described as providing "complete coverage of what leading business schools teach about entrepreneurship." For additional information on entrepreneurship generally, the Ewing Marion Kauffman Foundation, *available at:* http://www.kauffman.org/, is an excellent resource.

kitchen table. No matter where the idea for a new business originates, the idea has to be translated into a viable business concept. This process usually entails defining why the new business idea has merit. On the one hand, the new business idea may involve developing a new product to fill an unmet need in the marketplace. On the other hand, the new business idea may involve producing a product that is either better or cheaper than that of an existing competitor. In either case, the new business idea is viable only if it can be shown that people (i.e., customers) are willing to pay for the product (or service) that is reflected in the new business idea.

To move the new business idea to a viable business model usually involves some form of investigation to assess the validity and merits of the new idea. Depending on the nature of the business idea, investigation usually involves some form of feasibility study (or marketing study) or perhaps retaining consultants to help evaluate various aspects of the proposed new business model. At some point, however, the entrepreneur must make the "go/no-go" decision. That is to say, at some point in this business development process, the decision must be made whether the new idea is sufficiently viable to proceed with creating a new business; or alternatively, the project must be abandoned because the business idea is just not viable.

Business Plan. Once the decision is made to proceed with creating a new business, the next step typically involves preparing a business plan, which is an outline (or a blueprint) as to how the new business will be created. If a feasibility study was done as part of the investigative process, then such a study will often provide much of the information needed to draft the business plan. Issues that are typically addressed in even the simplest of business plans include the following:

- **Organizing a legal entity to operate the new business**
  - What form of business entity is to be used?
  - Has the business entity been created?
  - What will be the governance structure for the new business entity?
- **Identifying the potential market and method for accessing this market**
  - How will the business make money?
  - Why will the business make money?
  - If the new business is to produce a product, what are its attributes?
  - If there is an existing competitor, how does the new product differ from those of the competitor?
  - Who are the prospective customers for the new product or service?
- **Raising financing to launch the new business**
  - What are the available sources of financing?
  - How much equity ownership are the founders willing to give up in order to obtain the necessary financing?
  - How will the business attract the necessary investors?
  - If the business plan requires it, are the necessary credit sources in place?
- **Hiring management or other staff to run the business operations**
  - Who will manage the company once the business is up and running?
  - *Note:* It is important that the qualifications and experience of the management team are described with sufficient specificity to convince the reader that they will be successful in managing this new business.

- **Identifying the facility (or facilities) where the new business is to operate**
  - Is there an advantage to being in a certain location?
  - Are there environmental concerns with respect to operating in a certain facility?
- **Business strategy**—Any good business plan should address the following key strategic planning questions:
  - Where are we now?
  - Where do we want to be?
  - How do we get there?
- **Financial information**—This section should include the projected revenues, costs, and returns for the proposed new business.
  - This section should take all of the information provided above and convert this information into a financial projection or outcome.
  - This section is scrutinized carefully by most prospective investors. Therefore, the value and persuasiveness of the numbers in this section depend heavily on how accurately it represents the economic assumptions that were made in the previous sections of the plan. Very often, entrepreneurs will present projections that are based on a worst-case scenario at one end of the spectrum and a best-case scenario at the other end of the spectrum.
- **Executive summary**—This section is a self-contained summary that makes a compelling case for why the new business venture will be successful. While the executive summary is customarily placed at the beginning of the business plan, it is usually the last section to be drafted as a practical matter.

At this point, it bears emphasizing that the preparation of a compelling business plan generally constitutes the essential foundation for the successful launch of a new business of any size or scope. Indeed, the most important way that the entrepreneur convinces *any* prospective investor (of any size or sophistication) to invest in his or her "new idea" is to prepare a compelling business plan. While lawyers typically are not involved in the actual writing of a business plan, it is important for lawyers to have some sense of this process in order for the lawyer to effectively represent the participants in the new start-up business—and that is true regardless of whether the lawyer is representing the founders or the prospective investors. The information that is typically contained in a business plan directed toward venture capital investors and the process typically involved in creating a business plan and preparing a company for venture capital investment is described in more detail as part of the materials in Chapter 8.

NOTES AND QUESTIONS

1. ***Management Conflicts.*** As a general rule, entrepreneurs are highly independent, which (as we shall see in the materials in later chapters of this casebook) often can cause problems when their business ventures succeed. At the outset, the entrepreneur is usually able to personally manage most (if not all) aspects of the new business. But this is usually not sustainable once the business has grown beyond a certain size. Management conflicts will often arise in those situations where the

entrepreneur fails to realize that running a large, stable business is very different from running a small, growing business. This type of management conflict is very often resolved by the entrepreneur leaving—either voluntarily or involuntarily—and often starting a new business venture. Indeed, according to one study, "Four out of five entrepreneurs . . . are forced to step down from the CEO's post." Noam Wasserman, *The Founder's Dilemma*, 86 Harv. Bus. Rev. 103 (Feb. 2008). To offer but one high-profile example, consider the case of Apple Computer, where one of the founders, Steve Wozniak, left to pursue other interests, while the other founder, Steve Jobs, was ultimately forced out, to be replaced with a more experienced CEO from a much larger company (although Steve Jobs did return many years later to resume leadership of the company). In later chapters of this casebook, we study the types of management conflicts that are likely to surface as a start-up business grows and matures into a larger business with a very different set of management concerns, and we examine various ways to resolve these conflicts.

2. ***Will the New Business Succeed?*** For those lawyers who represent entrepreneurs, it bears emphasizing that entrepreneurship is often difficult and quite risky, resulting (not surprisingly) in many new ventures failing. Statistics show that approximately 20 percent of all new businesses fail within the first year and roughly 50 percent are out of business by the end of the fifth year. *See* Bureau of Labor Statistics, Business Employment Dynamics, Entrepreneurship and the U.S. Economy (based on data showing the survival rates of new businesses between 1994 and 2015), *available at:* https://www.bls.gov/bdm/entrepreneurship/entrepreneurship.htm (last accessed May 6, 2021); *see also* Paul Gompers et al., *Performance Persistence in Entrepreneurship and Venture Capital*, 96 Journal of Financial Economics 18 (2010) ("[F]irst time entrepreneurs have only an 18% chance of succeeding. . . ."). The reasons for the high mortality rate are numerous and varied, including lack of commitment and perseverance on the part of the entrepreneur who started the business; employee problems; lack of funding and/or difficulty in obtaining sufficient financial resources; family problems related to the time and energy required to launch a new business; and finally, managerial incompetence that leads to difficulty in executing the business plan to achieve success with the new product or service.

Potential investors in the entrepreneur's new start-up business are also well acquainted with these statistics. Hence, it pays for the entrepreneur to evaluate the prospects of the proposed new business venture from the perspective of a potential investor, such as a bank or a venture capitalist. Professional investors, including venture capitalists, know that the success of a new business generally depends on three crucial components: the opportunity, the entrepreneur (including the management team), and the resources needed to start and grow the business. We have already described the strong entrepreneurial and management skills necessary to launch a new business. The remaining materials in this section explore the other two components in more detail: the opportunity and the resources.

3. ***The Opportunity***. The founders of Safecar, Ana and Alex, believe that they have developed software that has solved a major obstacle to the development of safe self-driving vehicles. But as any professional investor worth his or her salt will tell you, ideas are a dime a dozen. What is important is not the idea by itself. Instead, what separates merely another "new idea" from the field of "new ideas"

that are regularly pitched to prospective investors is evidence that the entrepreneur can develop the idea, implement it, and build a successful business based on this new idea. Naturally, these questions lead to a discussion of the all-important topic: developing a business plan that will persuade prospective investors that the entrepreneur's new idea really does present the potential for a successful business opportunity.

4. ***When Does an "Idea" Become an "Opportunity"?*** One time-honored maxim—at least from the perspective of the professional investor—is that the crucial components for entrepreneurial success are a superb entrepreneur (backed by a solid management team) and an excellent market opportunity. The preceding materials described the process of preparing a solid business plan that allows the entrepreneur to communicate his or her idea to the prospective investor. The next step on the entrepreneur's journey is to convince the would-be investor that the entrepreneur's new idea constitutes a high-potential opportunity. The criteria to be used by the prospective investor to decide whether to finance the new start-up business, while overlapping, will vary somewhat depending on the business objectives and the profile of the prospective investor. Thus, the criteria used by a bank in deciding whether to make a loan to launch a new business will typically be different than the criteria used by the venture capitalist in deciding whether to finance a start-up business. The nature of these criteria—and the inherent differences—is explored in more detail in Chapter 8.

5. ***Resources Necessary to Start a New Business.*** As part of the process of preparing a business plan, the entrepreneur must determine the amount of capital that the business needs to get started. This determination turns on an accurate assessment of the minimum set of essential resources required to open the business and to make it grow. Assuming a thoughtful and thorough business plan is in place, the entrepreneur should be able to determine—either on his or her own or with the assistance of a professional advisor—how much start-up capital is required to get the business to a point where it will generate a positive cash flow.[7]

As we discuss in more detail in Chapter 8, there are essentially two types of start-up capital: debt and equity. The key difference is that with debt, the founders do not have to give up any ownership interest in the business, although they do have to pay interest and will be required to pay back the borrowed funds to the investor. In the case of equity, the founder must be prepared to give up some portion of the ownership of the business to the investor in exchange for the necessary capital to launch the new business.

---

7. Not every new business requires multimillion-dollar funding to get started. In fact, many large, well-known companies have been started with far less capital. Sara Blakely founded Spanx in her Georgia apartment while working as a door-to-door fax machine salesperson. *See How Spanx got started: Sara Blakely on how she came up with the idea for Spanx footless pantyhose* (video transcript of interview with Sara Blakely), *available at:* https://www.inc.com/sara-blakely/how-sara-blakley-started-spanx.html (accessed May 6, 2021). In 2012, Forbes reported that Sara Blakely became the youngest self-made female billionaire at the age of 41. *See* Clare O'Conner, *Undercover Billionaire: Sara Blakely Joins The Rich List Thanks To Spanx* (Mar. 7, 2012), *available at:* https://www.forbes.com/sites/clareoconnor/2012/03/07/undercover-billionaire-sara-blakely-joins-the-rich-list-thanks-to-spanx/ (accessed May 6, 2021).

As a practical matter, most entrepreneurs do not have much flexibility in their choice of financing. The vast majority of small businesses are financed by the entrepreneurs leveraging their own savings and labor, such as taking out a home equity loan to fund the new business. More often than not, the entrepreneur will also work in the business financed by his or her own personal savings, building what is popularly referred to as *sweat equity* (i.e., an ownership interest in the business that is earned in lieu of wages). Very often, additional capital to grow the business will later be obtained from a wealthy investor—sometimes referred to as an *angel investor*—who invests some personal funds in exchange for an equity interest in the business, which usually occurs when the business reaches the stage where it is actually selling goods and/or services. At this point, the business may also be able to obtain a bank line of credit secured by its inventory and/or accounts receivable. If the business is growing quickly in a large market, the business may be able to raise financing from venture capital investors. Further expansion of the business may then come in the form of a public offering of the company's stock (known as an IPO—initial public offering).

The truth of the matter, however, is that the vast majority of new businesses will never qualify for an IPO, for reasons that will become clear as we go through the remaining materials in this casebook. Nevertheless, all of these new businesses need to find some source of equity capital. In many cases, after they have exhausted their personal savings (the *Go-It-Alone* approach to financing the new business), entrepreneurs will very often seek financing from family, friends, and business acquaintances (the *Friends and Family* alternative). And, of the hundreds of thousands of new businesses that are launched every year, only a small percentage will be able to obtain the necessary funding from venture capitalists. However, in the case of *all* of these different possible financing scenarios, it bears emphasizing that entrepreneurs "often find themselves with *all* of their personal net worth tied up in the same business that provides *all* their income. That is 'double jeopardy,' because if their business fails, entrepreneurs lose *both* their savings and their means of support"[8] for themselves and their families.

In the remaining chapters, we will analyze the issues and challenges that typically face the lawyer in planning a capital-raising transaction in all three of these very common real-world financing alternatives, which we will refer to in shorthand form as the *Go-It-Alone* option; the *Friends and Family* financing; and the *Venture Capital* deal.

D. THINKING LIKE A "DEAL LAWYER" VS. THINKING LIKE A "BUSINESS LITIGATOR"

Notwithstanding the business-oriented materials that comprise most of the last section of this chapter, it bears emphasizing that this casebook is *not* a business-oriented text that examines the business-related steps involved in starting up

8. Bygrave & Zacharakis, *supra* note 3, at 21 (emphasis added).

a new business enterprise. Rather, this casebook focuses on the *role of the lawyer* who is retained by the entrepreneur for legal assistance in organizing and launching a new business enterprise/venture. This approach emphasizes the role of the lawyer as *transaction planner*—a very different professional perspective than the business lawyer serving as litigation counsel. To be most effective as a transaction planner, the lawyer must understand the client's business objectives—in order to plan the financing transaction to preserve maximum flexibility for the new business in the future. That is, so that the business will be well positioned to take advantage of future opportunities.

In the last section, we described the essential traits of entrepreneurs who propose to start a new business. While it is important for the business lawyer to understand the essential attributes of entrepreneurs in order to provide effective legal representation, it is equally important that the business lawyer explore the principal motivating force of the founders/entrepreneurs in establishing their new business venture. In other words, it is important that the lawyer retained by a new business enterprise understand what the *real goals* of the founders are. These goals can potentially encompass a broad range, including the following:

- Do the founders plan to take the company public?
- Do the founders plan to sell the business within a specific (or target) time frame (say, five years)?
- Do the founders plan to merge the new business with another company and continue to operate the business, sharing management control with managers of the acquiring company?
- Do the founders plan to form a joint venture with a larger company, perhaps a competitor in the industry?
- Do the founders intend to run a privately owned company as a "cash cow"?

While these questions may seem to pose business-related issues, experienced counsel understand that the answers to these questions will have a dramatic impact on the nature of the legal advice and ultimately will help the lawyer steer the new business in a direction that will enable it to achieve the desired business objectives. From the lawyer's perspective, the issues that are of the highest priority for counsel to address in the context of representing a start-up business will be dictated in large part by the goals of the owner-managers. This idea has been expressed by experienced corporate lawyers as follows:

Lee R. Petillon & Robert Joe Hull

Representing Start-Up Companies

§2.1 (2006)

2.1 Goals of the Founders

For example, many legal, financial, and business decisions would be made in a certain way if the goal [of the owner-managers] were to go public within three years, as compared with staying private indefinitely. . . . On the other hand, if the founders' goal is to be acquired by a large company, perhaps a strong research and development effort or expanding market share is more important than building up earnings per share. . . .

At the outset, the founders, owners and managers are usually the same persons. However, as outside passive investors such as angel investors or venture capitalists invest in the company, there may be differing views as to the proper direction of the company. Thus, if the founders are looking to go public and continue to operate [the business] independently, whereas the major outside investors are planning for the company to be acquired, the lawyer should ensure that the investors are fully informed in the investors' disclosure document as to the true goals of management, so as to avoid misleading the outside investors.

Unless the lawyer takes the time to understand the short-term and long-term objectives of the founders/owners/managers, he or she will at best be rendering legal advice in a vacuum, and at worst may, by commission or omission, lead his or her client down the wrong path, with adverse legal and business consequences.

The lawyer may be hesitant to request his or her clients to take valuable time to formulate and review the basic direction of the company and the founders. Most founders, however, recognize that the lawyer who is interested in better understanding their business is trying to be a more perceptive, knowledgeable, and effective counsel, and will accordingly take the time to orient the lawyer to the details of the company's business.

Another recent article (also written by an experienced corporate lawyer) describes ten mistakes commonly made by lawyers representing start-up companies. The author contends that all of these common mistakes are easy for counsel to avoid. We will analyze all of these potential pitfalls in the remaining chapters of this casebook, so we have provided (in brackets) a cross-reference to the relevant chapters where we consider the following common legal mistakes:

- **Mistake No. 1**: Not properly licensing technology patented by others [*see* Chapter 7]
- **Mistake No. 2**: Incautiously hiring former employees of a competitor [*see* Chapters 5 and 7]
- **Mistake No. 3**: Not conducting a timely trademark search [*see* Chapter 7]
- **Mistake No. 4**: Not properly maintaining organizational records [*see* Chapter 5]
- **Mistake No. 5**: Selling securities to nonaccredited investors [*see* Chapter 4]
- **Mistake No. 6**: [Failing to make a timely] Section 83(b) election [*see* Chapter 6]
- **Mistake No. 7**: Not adopting an appropriate employee stock option plan [*see* Chapter 6]
- **Mistake No. 8**: Failing to institute a trade secret protection program [*see* Chapter 7]
- **Mistake No. 9**: Failing to obtain good title to intellectual property [*see* Chapter 7]
- **Mistake No. 10**: Creating a "cheap stock" problem [*see* Chapters 4 and 6]

James J. Greenberger, *Top Ten Legal Mistakes of Early Stage Tech Companies*, 10 Bus. L. Today 3 (Jan.-Feb. 2001).

Since the goals and objectives of a new business are evolving constantly, it is wise for counsel to meet regularly with his or her clients to learn about recent developments affecting the company's business. The founders will usually appreciate the lawyer's desire to keep abreast of the company's opportunities and risks, and this type of ongoing dialogue will also allow the lawyer to be more effective in his or her representation of the business over time.

E. ATTRIBUTES OF A GREAT BUSINESS LAWYER

There has been much discussion (and even scholarly debate) about the characteristics that make one corporate lawyer better than the next. Most observers would agree a substantive understanding of the relevant law is a necessary baseline, but only the tip of the iceberg of what characterizes a "good" corporate lawyer. The following excerpt identifies important attributes that separate "great business lawyers from ordinary ones."

Praveen Kosuri

Beyond Gilson: The Art of Business Lawyering

19 Lewis & Clark L. Rev. 463, 475–481 (2015)

1. Great Business Lawyers Understand Business

It seems self-evident that a business lawyer should understand business; however, it is far from the norm. In fact, that is why it is a differentiating characteristic of great business lawyers.[58] There is a saying on Wall Street that deal lawyers do weddings, not marriages. The suggestion is that lawyers focus on the transaction and not the long-term impact of the transaction on the businesses involved. Businesses prefer it when their lawyers not only understand their business and strategy but also are interested in their long-term success. It seems self-evident that in order to do that well, a lawyer must know certain things: What does the client do? How does it make money? Who are its main competitors? What economic factors is it most sensitive to? Understanding what one's client does, how it does it, and how it makes money are fundamental to problem solving.

Without knowing a client's goals (both short- and long-term) and strategy, it is virtually impossible to give relevant or meaningful advice. A great business lawyer is unafraid to ask his client questions about its business and industry. Understanding the drivers of the business will help the lawyer better assess the parameters of available solutions. Additionally, being able to see problems through the lens of business is one of the most important features of a great business lawyer. Problems manifest

58. Once upon a time, I was an investment banker. As a banker, my team would routinely work with company counsel on deals—sometimes asset dispositions, sometimes securities offerings. In numerous instances, I was shocked at how few of those lawyers could actually describe their clients' businesses or explain how their clients made money. Too often the task of writing a company overview section in a securities offering would fall to the bankers after the lawyers' failed attempt.

in the context of a business and understanding that context means understanding the client's business. Relatedly, a business lawyer should speak his client's language. If there are industry terms or terms of art used by a client, a great business lawyer will learn and understand them. By the same token, great business lawyers can read and understand financial statements. Accounting is the language of business. The ability to engage with basic financial documents is essential for any business lawyer. A great business lawyer uses the information to better understand his client's business. Understanding business arms the transactional lawyer with the ability to provide better and more valuable advice to his client. It also makes it more likely that the client will not switch lawyers simply based on cost. In other words, business lawyers that plan marriages are more likely to be around for future events.

2. Great Business Lawyers Are Loyal to Their Client

Though most businesses are entities and most business lawyers represent the entity, determining who the lawyer truly represents is not always straight forward, particularly when the lawyer has relationships with executives, directors, and in-house lawyers. Great business lawyers know how to navigate this web of personalities and competing interests without sacrificing their client. In fact, great business lawyers will use their relationships with other constituencies to further [their] client's interests.[61]. . .

The decision on whose interest to prioritize is not always so clear for business lawyers. In today's competitive legal market, clients hire lawyers, not firms. As such, the person(s) making the hiring decision is competing for the lawyer's allegiance. If it is a general counsel, she may be at a different company next year. A lawyer might be tempted to preference the general counsel over the company in certain scenarios hoping to continue to get work from her. The great business lawyer will navigate the potential conflicts, pick a client, and advocate for that person or entity wholeheartedly. Usually the result is respect and enhanced reputation which may lead to additional business in the future.

3. Great Business Lawyers Understand People

In addition to understanding the business, a lawyer must understand just as much about the people in the business: Who owns the company? Who runs the company? What motivates them? What are their short and long term goals? What is their risk tolerance? Regardless of the size of the business, these are questions that every lawyer representing a business client should know the answers to. They are the same questions that other business advisors ask in order to do their jobs well. Though business lawyers often represent entities, no business acts without people. What [Martin] Lipton displayed as complete allegiance to his client started with a complete understanding of the people and personalities involved in any transaction. If problem solving is the ultimate goal of the great business lawyer, diagnosing the problem is primarily derived from hearing the client's story. That story is

61. Landon Thomas Jr., *Counselor for All Reasons: Martin Lipton Wears Many Hats (Some Say Too Many at Once)*, N.Y. Times, July 28, 2005, at C1.

delivered through people.[64] The first set of people for the great business lawyer to understand are the principals in the business. If a lawyer is representing a start-up venture, these may be the founders. What is their story? Why did they start this business over all the others they could have started? What have been the biggest challenges and successes? What are they good at? Conversely, what are they less good at? If the client is an established company the business lawyer must know and understand the executives and board members. There may be in-house counsel, other outside advisors, investors, or bankers. The goal is for the business lawyer to get to know the person(s) with whom they are interacting and ultimately to whom they need to deliver advice. In addition to providing the great business lawyer with a much richer appreciation of his client, it allows him to deliver better advice.

The client's principals and advisors are two sets of people but there are many others. In a transaction there is often a counterparty. Who are they? What motivates them? What other information can a business lawyer learn about the other side? Over time, a great business lawyer may have encountered certain actors before and stored knowledge about them. Learning to pay attention to the traits and predilections of all the people one encounters in any transaction is a valuable trait for the great business lawyer. Business is transacted by people and great business lawyers understand how to utilize psychology and manage personalities. This is true whether one is engaged in [a mergers and acquisitions (M&A)] deal for a Fortune 500 company or negotiating with a city agency to get a necessary approval. Great business lawyers know how to get people to do things that ultimately further their clients' interests.

4. Great Business Lawyers Become Part of Their Client's Team

Clients that are engaged in a transaction or some other form of business often act through teams. Usually the composition of the team is a selection of internal employees. Outside advisors such as consultants, bankers, accountants, or lawyers are rarely viewed as part of the team. That creates a barrier between the client and the advisor. Getting a client to treat the business lawyer like an actual team member facilitates communication which leads to better and more-candid advice. The lawyer's role is to be an advisor. When the lawyer is viewed as an outside party, clients do not treat him with the same trust and familiarity as one of their own. Great business lawyers integrate themselves into the client team and break down that barrier.[65] Fully integrating into the team also better aligns incentives which allows the business lawyer to fully prioritize his client's success.

---

64. Jerome Groopman, How Doctors Think 11–27 (2007) (describing how medical doctors diagnose most ailments by learning the patient's story, not by conducting tests—in the story lies the information a doctor needs to make a diagnosis).

65. Richard J. Phillips, Sr., famous (or infamous) for his representation of the Major League Baseball Umpires union in 1999, was outside general counsel to a struggling freight forwarding company. The company, Pilot Air Freight, was made up of a number of franchisees. As it emerged from bankruptcy, the franchisees rallied behind Phillips to be their next CEO even though he was outside counsel. He turned a $3 million annual loss into a $4 million profit in his first year. *See* Douglas Martin, *Richie Phillips, Union Leader Who Helped and Hurt Umpires, Dies at 72*, N.Y. Times, June 6, 2013, at B18; Mark B. Solomon, *Richie Phillips Dies; Took Controversial Stand for Baseball Umpires, Then Became Transport Success*, DC Velocity (June 7, 2013), *available at:* http://www.dcvelocity.com/articles/20130607-richie-phillips-dies/.

5. Great Business Lawyers Are Creative

Though grounded in technical expertise, great business lawyers are incredibly creative. Strict interpretation of the law and an adherence to organization and process sometimes make clients think their lawyers are rigid and narrow-minded. Many lawyers are. Great business lawyers, however, do not let their lawyerly training confine their thinking. They resist practice by template, seek to understand the problem and all of its parameters, and propose creative solutions. They draw on their entire experience, not merely their legal experience.

Examples of creative business lawyering are present in all kinds of transactions. Lawyers create unique structures for all types of transactions and deals. Maximizing liability protection, minimizing tax leakage, ensuring sound governance, and accommodating efficient exit options may all be features in a corporate structure designed by a great business lawyer. Understanding the features of different business entities, their underlying infrastructure, and how they can be manipulated provides the great business lawyer with a toolkit to be creative. One of the most famous creative-lawyering solutions was Martin Lipton's creation of the poison pill. In the face of increased hostile takeover activity in the early 1980s, Lipton sought a defensive strategy that would empower target companies. Drawing from his knowledge and understanding of securities laws, corporate governance, and the process of unsolicited offers, Lipton devised a solution called "the Warrant Dividend Plan" that would allow target companies to issue a security before or after an unsolicited offer that would buy the board of the target more time to respond to the offer while maintaining control over the process.[67] It would later become known as the "poison pill" and be used by countless business lawyers as a takeover defense strategy.[68] The best business lawyers are in fact strategists. Their objective is to help the client get from point *A* to point *B*. The journey may be wrought with obstacles and land mines, but the great business lawyer is able to chart a path forward and ultimately deliver the client to its destination.

6. Great Business Lawyers Solve Problems

Though scholars have parsed different aspects of being a business lawyer and tried to empirically prove the value that lawyers provide, almost all transactional scholars agree that being a business lawyer is fundamentally about helping business clients solve problems and make decisions. In many ways, problem solving is embedded in each of the characteristics that differentiate great business lawyers from average ones. Problem solving is what the best business lawyers get paid to do. Too often lawyers, even really good lawyers, abdicate their advisory role when it comes to "business decisions." The false dichotomy between "legal" and business decisions (presented as problems) has permeated the dialogue between lawyers and clients to such an extent that they presume it is valid. To a client, every problem is a business problem requiring a business decision. Clients look to their advisors to provide the best solutions to make those problems go away. The best solution may

---

67. Martin Lipton, *Pills, Polls, and Professors Redux*, 69 U. Chi. L. Rev. 1037, 1043–44 (2002).

68. *Id.* at 1044.

or may not be rooted in the law; the business lawyer's job, at the end of the day, is to provide the best solution to his client's problem. Lawyers who only present problems without solutions are quick to be labeled "deal killers" or "obstructionists" or "speed bumps." They are also likely to be out a client unless they present solutions to the problems they identify.

Part of effective problem solving is figuring out what the problem is and its constraints. Clients often come to lawyers with ill-structured problems. For example, in a start-up context a young company may call its lawyer stating that it wants to grant equity to a new employee in lieu of cash compensation. The great business lawyer will continue to ask questions to better define the problem. Is their desire to issue equity to the employee about attracting long-term talent to the company, managing cash flow, meeting a competing offer from another company, or compensating the new employee for a major contribution to the business that could affect its trajectory? Does the company want the employee to share in the unlimited upside of a liquidity event or governance of the company? This first series of questions is meant to help the lawyer diagnose the problem. The lawyer must then establish the parameters of the universe of solutions. When does the company anticipate earning revenue, how much, what is the expected growth rate of revenues, how many employees does the company currently have and anticipate having, does the employee have the ability to pay taxes if incurred, and does the company plan on paying taxes for the employee?[72]

Once the business lawyer defines and constrains the problem he can finally begin to create potential solutions. As part of problem definition, a business lawyer may have to educate himself about new areas of law or other subject matter in order to come up with the best solution. Great business lawyers are great at teaching themselves new material all the time. They learn what they need to learn in order to solve a client's problem. It is not unlike a patient going to the doctor and stating that his foot hurts and he wants the doctor to amputate it. No doctor would let patients diagnose themselves. Doctors would conduct their own interviews and make their own diagnoses before researching and deciding on potential treatments. It is no different for business lawyers, yet many business lawyers will rely on the client to present its own solution to an ill-structured problem and simply execute that solution.

7. Great Business Lawyers Add Value to Their Clients

. . . . Whether a lawyer represents Fortune 500 companies, privately owned family businesses, or start-up ventures, he must always be thinking about how he will add value to that client. Technical lawyering is foundational for business lawyers and expected by clients. It is a commoditized service. Premium service lies in being a trusted advisor to a client in the fullest sense of the word. That advice, like the advice from any other business advisor, needs to add value to the client's business. Too often lawyers are viewed by clients merely as cost centers. Instead, lawyers

72. The list of questions is merely for demonstration. The inquiry could go much further and be more complex.

should work to get clients to view them as assets that will pay a return based on the investment. Lawyers should seek to provide a positive return on assets. This can be done in many ways—helping the client make a decision, preventing the client from making a bad decision, or offering unique solutions to difficult problems. Fundamentally, it's about getting things done and advancing the client toward its goals. There is a notion that other advisors are better equipped to deal with problems outside of the lawyer's sphere. Yet lawyers fear those same advisors encroaching on their turf.

When one thinks about a lawyer's training, it is at its core about critical and analytical thought. That thought need not be relegated to applying securities law or drafting the best indemnity clause. It is equally valuable in helping clients solve problems that confront their business whether that problem has a solution rooted in the law or elsewhere. But the universe of value-added functions goes well beyond transaction cost engineering and minimizing regulatory costs.[77] Valuation of companies is not a science. There are different methods that one can use to determine the value of an enterprise;[78] however, at the end of the day a business is worth what someone is willing to pay for it. It is no different for legal services. . . . Clients pay for what they perceive as value. Great business lawyers provide it.

NOTES AND QUESTIONS

1. ***"Legal" and "Business" Advice.*** The article above discusses the role of the lawyer in helping clients make appropriate business decisions. In representing any type of client, but especially clients forming new ventures, the line between "business" and "legal" advice can and does get blurred. Lawyers must be cognizant of their role, and context matters—business advice or recommendations made by a legal advisor in a boardroom, for instance, can be viewed in hindsight as an improper "changing of hats" absent appropriate explanation of all relevant facts and the legal risks. We will return to this topic again later in this chapter, as well as in Chapter 4 as part of reviewing a high-profile Securities and Exchange Commission (SEC) enforcement proceeding.

2. ***Lawyers "Breaking the Deal."*** The article above also addresses the important role a lawyer plays in completing a business transaction. Consider the following observations penned by well-known corporate law scholars:

> One of the interesting and significant aspects of the process of drafting [business agreements] has to do with the concern often expressed by experienced lawyers that their efforts might "spoil the deal." One of the most important functions of the [transactional] lawyer is to look beyond the days of heady optimism and mutual good will that [generally] characterize the initiation of a business venture. . . . [Thus, in drafting business agreements,

---

77. Stephen T. Furnari, *Start-Ups: Providing Value with Non-Legal Advice*, GPSOLO Mag., Jan./Feb. 2008, at 30, 31–32.

78. *See generally* Aswath Damodaran, Damodaran on Valuation (2d ed. 2006).

> the lawyer must anticipate that, as the business grows, the needs of the parties will change, as well as the nature of the business problems to be encountered over time. This means that it is quite foreseeable that the parties to the agreement will confront issues of business strategy and the like on which they cannot agree. It is at this point—when these issues and problems later surface—that the rules set forth in the relevant agreement become vitally important. However, as every experienced corporate lawyer well knows, at the time that the agreement was originally being prepared,] [t]here are choices about how these rules should be drafted and many lawyers consider that they should explain those choices to their clients. But this gets tricky, for if the [parties] start worrying too much about the problems that might arise [in the future] and become excessively concerned about the difficulty of solving them, they may become overly anxious and walk away from a [business] venture that would have been good for them. . . .
>
> Some lawyers think it is their responsibility not only to try to raise all the significant issues with which their clients may be confronted in the future but also to be sure that the clients understand those issues. Others will tend to pay less attention to such matters, fearing, as suggested, that it is too easy for the parties, because of their unfamiliarity with the law, or with business, to exaggerate the significance of the problems and, consequently, to forgo a business opportunity that the lawyer thinks they ought not to forgo. This kind of lawyer may express the idea by saying that he did not want to "spoil the deal." Other lawyers will tend more often to think that if raising issues and pointing to problems kills a deal then it deserves to die. Obviously there are no formulas to tell the lawyer how to act with respect to this basic issue of client-handling strategy. No two deals, no two sets of clients, and no two lawyers are alike. There is no widely agreed upon "correct" approach.

William A. Klein, John C. Coffee, and Frank Partnoy, Business Organization and Finance 66-67 (11th ed. 2010).

Query: What do you think is the proper role for the lawyer to adopt in connection with drafting business agreements on behalf of the lawyer's clients? What do you think is the proper role for you in connection with representing the founders, Ana and Alex, in connection with the launch of their new business, Safecar?

3. ***Lawyers as Problem Solvers.*** The author in the excerpt above emphasizes the creative, problem-solving role that is a defining characteristic of the most successful lawyers. As you approach the materials in the remainder of this book, consider the various issues that might arise for your future clients and the tools and strategies you may employ to resolve those matters without "spoiling the deal" or serving as an obstacle to your client. All of these decisions, of course, need to be made within the applicable framework of ethical rules to which one is subject as a lawyer. In the next section, we cover the obligations most commonly triggered as part of representing new businesses.