

What can a lawyer do for your startup? A lot, and for very little cost

If you're a startup, a relationship with a lawyer is one of the most important you can have. But when and why should you contact a lawyer if you're thinking about starting a company? We asked two attorneys who specialize in technology transactions for their advice.

How much does an attorney cost?

When we tell an entrepreneur to contact a lawyer, red flags go up because of the view that an attorney's fees are expensive. However, according to Brad Gersich, a partner at DLA Piper, it costs hundreds of dollars, not thousands. And most of the fees are deferred until you have financing.

"Up front, all I ask people to pay for is the out-of-pocket costs for filing and courier fees," he said.

The professional services fees that are paid later include all of the documents that cover your legal bases. Later, when the company starts to make money, Gersich bills for the fees that have accrued. The total cost? About \$1,000 to \$1,200.

"We try to be a business partner with you, to help you start to build your product," he said.

Pillsbury Law will also defer the fees until the company has money in the bank, according to counsel Minal Hasan.

"I would say most startup lawyers in Silicon Valley worth their salt do fee deferrals for a certain percentage of their clients," she said.

You have to weigh the costs against the potential problems of not getting an attorney, Hasan said, and a successful founder will understand the importance of an attorney.

"The upside far outweighs the downside. It's worth it to protect your company," she said. "If they don't have the sophistication to understand how important legal issues are and the protection of their intellectual property, they're going to have problems further down the road."

When should you contact an attorney?

When you start developing technology, have cofounders, and are discussing equity split, it's time to contact an attorney. The biggest issue Hasan sees is founder break-ups. When people haven't worked together, have different views, or one of them wants to go back to a regular job, a split can happen. If you don't contact an attorney early, you risk having a co-founder you're no longer on good terms with holding a lot of equity in the company. Then you have to go back to them for approval of anything the company does, which creates a bad situation.

"When the person leaves is when you have the issues. They say, 'You had promised me X.' There's a dispute, and you end up giving them more than you would have if you'd just gotten everything on paper with a lawyer," she said.

Intellectual property is another potential pitfall. You want to create an entity as soon as you start to develop an idea. If you haven't formed an entity, and someone walks away, they own any IP they develop. Once you create an entity, any IP anyone develops stays with the company.

"I've seen it happen where someone walks away, there was no entity in place, they own that IP, and they go off and start a competitive company. It can create an uphill battle in terms of asserting your ownership of that IP," Hasan said.

What else can an attorney do for you?

Besides getting founder and IP agreements on paper early, an attorney will also help you with stock option plans and equity agreements. Don't worry about getting it perfect right away, Gersich said. You can establish reasonable vesting schedules with appropriate protections for terminations without cause. Agreements are often changed later in the process as new contributors and investors join the enterprise. When you're allocating equity between founders, a good starting point is the real or perceived value each person brings to the company.

"You're probably great friends now and looking forward to a long and healthy relationship, but there may be a situation where one of you decides for personal or performance reasons that it's better for one person to continue and the other person not to," Gersich said.

An attorney will also help you create your entity and assign IP to it. They will also explain the differences between types of entities, such as an LLC versus a C-corporation. Gersich starts by asking what kind of business you're building and where you expect your funding to come from.

"You want the best type of entity that's going to give you the liability protection that's fundamental to incorporation. Beyond that, are you setting yourself up for long-term business objectives," he said.

An attorney also helps you set up salary accrual. If a company has been operating for a few months and hasn't made any revenue yet, you want to assign everything a founder or employee has done to the company. This way, if one founder leaves the company, or another company buys you out, all founders will get something out of their months of sweat equity. Salaries have to be paid eventually, but for employees, salaries must be paid in cash, not equity. A common mistake is to misclassify employees as consultants. Calling your full-time CEO a consultant and just giving them equity won't satisfy the IRS.

"The IRS audits a lot of tech startups. If they find out that your full-time CEO is classified as a consultant and you're giving them equity so you can avoid paying cash wages, not only will the company have to pay back wages and withholding on the salary, you're also going to be hit with tax penalties," Hasan said.

A good attorney can help you minimize headaches and hassles from the potential legal pitfalls and disagreements a startup could run into. Since the costs aren't as much as you might think, it's a wise investment to start your company off in a good legal position.