

# Legal Due Diligence for Emerging Growth Companies



Presented by:

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Jonathan S. Storper is a Partner with Hanson Bridgett. He has over nineteen years of experience counseling corporations, partnerships, limited liability companies and nonprofit entities in connection with business and intellectual property transactions, corporate finance, including initial public offerings, and general corporate law.

# Preliminary Matters

- NDAs

# People

- References
- Beyond References
- Third Party Background Checks

# References

- Who for?
- Who to ask?
- What to ask?
- Most important question of all for each reference

# Beyond References

- Litigation Searches
- Bankruptcy Searches
- UCC/Judgment/Lien Searches
- Criminal Record Searches
- Credit Reports
- Administrative Agencies/Actions
- Verifying degrees/credentials/certifications
- Permission/authorization needed for each

# Third Party Background Checks

- VentureOne searches
- Lexis/Nexis
- Anything else?

# Ownership/Capital Structure

- **Type of Ownership**
- **Corp Documents**
- **Public Records**
- **Shareholders**
- **Shareholder Agreements**
- **Securities**
- **Employee Benefits and Executive Compensation**
- **Other**



# Type of Ownership

- Common
- Preferred
- Warrants
- Membership Interest (LLC)
- Convertible Note
- Partnership interest

# Corp Documents

- Articles and Bylaws
- Minutes of the Board
- Stock Journal

# Public Records

- Public Records
- Documents filed with SEC or other regulatory agency (Dept. of Corporations)

# Shareholders

- **Schedule of stock outstanding by type and percent ownership**
- **Schedule of option and warrant holders**
- **Royalty agreements**
- **Copies of warrants and options**
- **Outstanding stock subscriptions receivable**
- **Form of stock certificate for each class of stock**
- **Stock transfer documentation**
- **Trust agreements**
- **Powers of attorney**
- **Stock Escrow agreements**
- **Proxies and voting trust agreements**

# Shareholder Agreements

- **Founders stock purchase agreements**
- **Common Stock purchase agreements**
- **Preferred stock purchase agreements**
- **Voting rights agreements**
- **Co-sale agreements**
- **Redemption agreements**
- **Buy-sell agreements**
- **Registration rights agreements**
- **Preemptive rights agreement**

# Shareholder Agreements Cont.

- **Restrictive covenants**
- **Operating agreements/partnership agreements**
- **Other contracts, arrangements, or public or private documents or commitment for the stock of the Company**
- **Any debt arrangements, guarantees or indemnification between officers, directors, shareholder and the Company**
- **Convertible debt instruments**

# Securities

- Exemption under federal and state Blue Sky laws or
- Permit/qualification

# Employee Benefits and Executive Compensation

- Equity compensation
- Severance agreements
- Change in control arrangements
- Qualified plans, funding obligations
- Bonus and incentive plans
- 409A compliance
- Securities law compliance



## Other

- Litigation search

# Ideas

- **What Intellectual Property is involved?**
- **Is the IP protected?**
- **Who owns the IP?**
- **Are there any IP risks?**
- **What is the probability of the IP risks resulting in loss?**
- **What is the estimated magnitude of such loss?**

# What Intellectual Property is involved?

- Patents
- Trademarks
- Copyrights
- Trade Secrets
- Licensing

## Patents, Trademarks and Copyrights

Type of Protection	Utility Patent	Design Patent	Trademark- Service Mark	Copyright
What is Protected?	Functional features of process, machine, manufacture or composition of matter.	Ornamental designs for article of manufacture.	Words, names, symbols, devices, sounds, smells, trade dress, or product shape.	Works fixed in tangible medium of expression, e.g., literary, musical, pictorial and motion picture works.
Criteria for Protection	New, useful and "non-obvious"	New, useful and "non-obvious"	Used to identify and distinguish goods or services	Originality and creativity
How obtain Rights?	Granted only by Federal Gov't. (U.S. Patent & Trademark Office)	Granted only by Federal Gov't. (U.S. Patent & Trademark Office)	Common Law: Adoption & Use (Sometimes secondary meaning required)  Federal or State Registration: Application and compliance with statutes.	Federal rights automatic upon creation.  To maximize rights: Publication with notice and Registration of claim with Register of Copyrights.
Life Time?	20 years from date of application* (if maintenance fees paid, 3½, 7½ and 11½ years after the Grant)	14 years from Date of Federal Grant	Common Law: As long as properly used as a mark.  Federal Reg.: 10 years (If formalities complied with) Renewable for 10-year periods.	Post 1/1/78 works: Life of author plus 70 years.
Test for Infringement?	Making, using or selling in U.S. devices embodying the claimed invention?	Designs look alike to eye of ordinary observer?	Likelihood of confusion, mistake or deception?	Substantial portion copied? Similarity?

\* If patent was in force or issued from an application filed before June 8, 1995, it is the greater of 17 years from the date issued or 20 years from the date of filing.

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# Employment

# Key Employment Contracts

- Employee offer letters/other employee employment contracts - at will language?
- Union contracts/labor agreements

- Employee Proprietary Information Agreements
- Other procedures to protect trade secrets
- Enforceable non-compete agreements (both directions)



# Wage and Hour Compliance

- Independent contractor/employee
- Exempt/non-exempt

- Immigration law compliance
- Anti-discrimination and anti-harassment law compliance

- Hiring: disability discrimination law compliance
- Hiring: compliance with background check laws

## Additional compliance issues

- Electronic communications policies
- OSHA/Workers' compensation
- Required postings

# Product Liability Review and Analysis

# Identify the Subject Products

- Completed Products
- Products in Development

# Consider Possible Grounds for Liability

- Design Defect
- Manufacturing Defect
- Warnings and Instructions
- Regulatory
- Marketing, Advertising & Packaging
- Licensing

# Regulations, Voluntary Industry Standards, Trade Associations & Competitors

- Compliance Review
- Reporting



## Review Facilities and Processes - Consider Geography

- **Research, Development & Design**
- **Manufacture & Sale**
- **Quality Control & Assurance**
- **Testing**
- **Commitment to Safety**
- **Customers**

# Documentation, Product Literature & Data Management

- Research
- Design
- Manufacture
- Instructions for Assembly
- Instructions for Use
- Warnings/Prompts
- Labels
- Advertising/Marketing
- Packaging
- Sale
- Licensing
- Post Sale Issues

# Product Hazard Analysis

- Analysis of reasonably foreseeable uses and misuses
- Identification of Risks
- Useful Life
- Product Safety
- Testing & Review

# Maintenance/Repair/Warranty

# Review Contracts

- Terms of sale & distribution
- Appropriate warnings & communication with end users
- Limitations of liability and indemnity
- Warranties

# Claims History and Management

# Insurance

- Review
- Procurement

# Customers

- Relations and Communications
- Notices, Corrective Actions & Recalls
- Privacy