



BCIC New Ventures
Corporate Structure and Legal Agreements

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About Fasken Martineau DuMoulin LLP

A Canadian leader in the practice of business law and litigation representing clients nationally and internationally.



We offer customized legal advice in over 30 practice areas, our greatest value to any client is achieved through our commitment to understand their business, culture and people.

Overview

There are two areas we will focus on:

Corporate Structure and Legal Agreements

Corporate Structure

- ⑥ How and where to set up your company
- ⑥ Equity ownership
- ⑥ Attracting and retaining team members
- ⑥ Attracting and closing financing

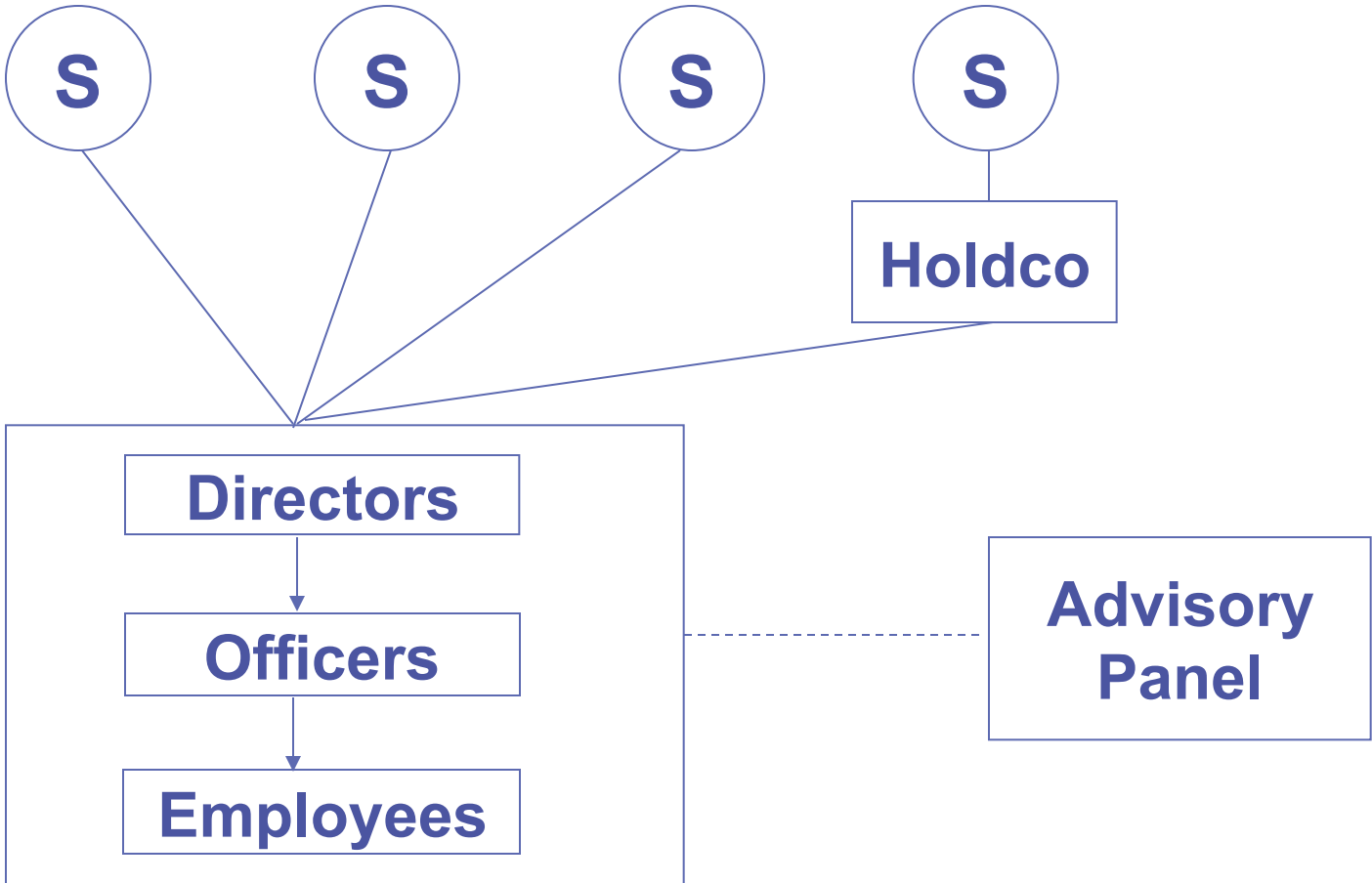
Legal Agreements

- ⑥ Documenting the foundation and development of your venture.
- ⑥ Internally: Shareholders' Agreement, IP Assignment Agreements, Consulting Agreements, Employment Agreements, Reverse Vesting Agreements, etc.
- ⑥ Externally: Term Sheet, Non-Disclosure Agreements, License Agreements, etc.

Options for Association

- ⑥ Proprietorships
- ⑥ Partnerships
- ⑥ Limited Partnerships
- ⑥ Joint Ventures
- ⑥ Companies
 - ⑥ Provincial
 - ⑥ Federal
 - ⑥ International

The Structure



Shareholders

- ⑥ Anybody can be a shareholder
 - ⑥ individuals
 - ⑥ companies
 - ⑥ partnerships
- ⑥ As many as you want
 - ⑥ rules change at 50 “people”
 - ⑥ rules on how you find your shareholders
(ie: see a lawyer!)

Shareholders (cont'd)

- ⑥ No liability aside from the initial investment in the shares of the company
 - ⑥ (unless a contract says otherwise - ie: shareholders' agreement, guarantee)
- ⑥ Variety of share classes, rights, restrictions
 - ⑥ common, preferred
 - ⑥ voting, non-voting
 - ⑥ dividends
 - ⑥ participating/non-participating
 - ⑥ anti-dilution, down round protection

Shareholders (cont'd)

- ⑥ Exclusive right to elect directors
- ⑥ Pre-emptive rights
- ⑥ Relationship governed by Articles, Shareholders' Agreements, Subscription Agreement

The Policy Setters

Directors

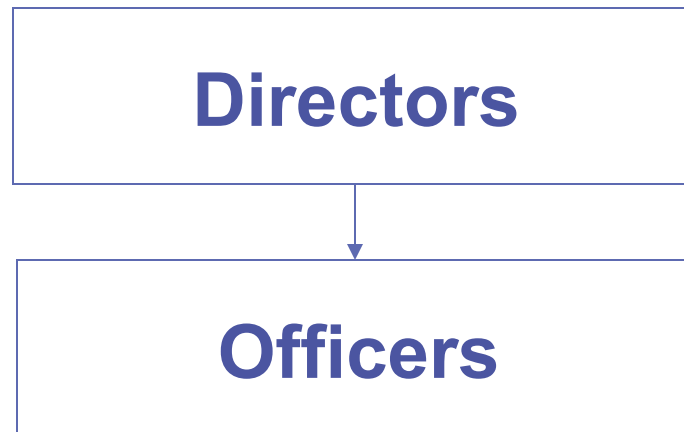
Directors

- ◉ Elected by the shareholders
 - ◉ (but the directors can fill “vacancies” and increase number in certain circumstances)
- ◉ At least one
- ◉ If BC, no residency requirement
- ◉ Qualifications

Directors (cont'd)

- ⑥ Power to manage the affairs of the Company
 - ⑥ (subject to articles, shareholders' agreements, etc.)
 - ⑥ determine policy
- ⑥ Duties to the Company and the “shareholders as a whole” to act fairly and diligently
- ⑥ Potential personal liability
 - ⑥ breaching duties
 - ⑥ taxes, wages
- ⑥ Appoint the Officers

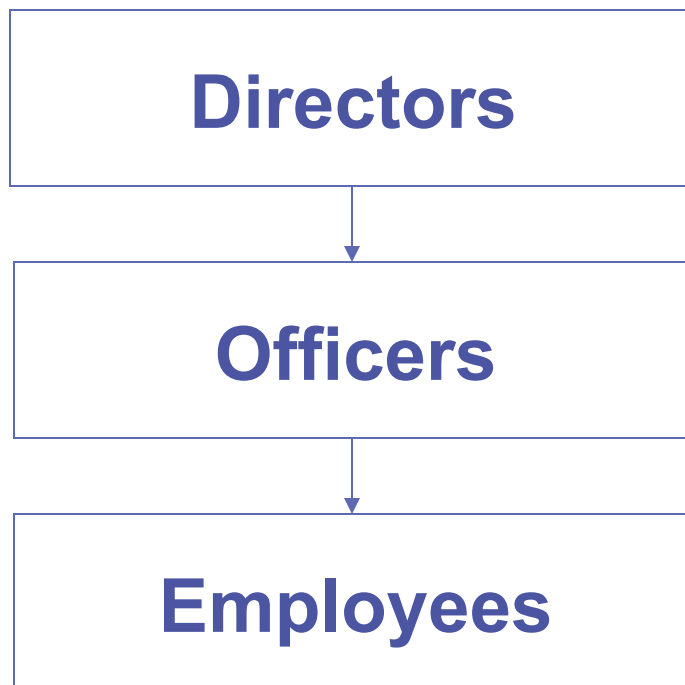
The Instructors



Officers

- ⦿ Appointed by the Directors
- ⦿ As many as you want, any titles at all:
 - ⦿ President, Chairman, CEO, COO, CTO, VP, Secretary, etc.
- ⦿ In charge of day-to-day affairs of the Company

The Doers



Employees

- ⑥ Master-Servant Relationship
- ⑥ Entitlements
- ⑥ Indefinite vs. Fixed-term
- ⑥ Statutory Obligations

Employment Agreement

- ④ Employment Agreement
 - ④ confidentiality
 - ④ assignment of intellectual property
 - ④ non-competition
 - ④ non-solicitation

Consultants

- ⦿ Not employees – not entitled to benefits or other statutory entitlements
- ⦿ Generally allowed to contract with other companies at same time
- ⦿ Use of own equipment
- ⦿ Onus on consultant to withhold, collect and pay tax

Consulting Agreement

- ④ confidentiality
- ④ assignment of intellectual property
- ④ non-competition
- ④ non-solicitation

Risk of CRA Re-Designation

- ⦿ CRA will look at the substance of the relationship – not simply how the company and individual have designated it!

Compensation

- ⦿ cash
- ⦿ shares
- ⦿ options

The Advisors

Advisory Panel

Advisory Panel

- ④ Non-Director Experts
 - ④ focused on the field in question
- ④ Advise the Board
- ④ Option-based Compensation

Other Issues

- ⑥ Conflicts of Interest
 - ⑥ within the structure - ie: your role as Shareholder v. Director
 - ⑥ within other companies - ie: director of this Company and director of contracting company
 - ⑥ between the Company and the educational institution - ie: technology transfer/pricing/time
 - ⑥ between investor and inventor
- ⑥ Public v. Private

Initial Corporate Structuring

Incorporation – U.S. v. Canada v. Offshore; Canada because:

- ⑥ Financing Issues - Investors don't like offshore companies.
- ⑥ Government grants – In most cases, only available to Canadian companies.
- ⑥ Taxation and Employment issues - Are simpler if you are building the company here.

B.C. (BCBCA) v. Federal (CBCA):

- ⑥ Either BC Business Corporations Act (BCBCA) or Canada Business Corporations Act (CBCA) are fine and both are investor friendly.

Initial Corporate Structuring – cont'd

Create a structure with:

- ⑥ Unlimited number of common shares.
- ⑥ Unlimited number of “blank-cheque” preferred shares.

Financiers dictate financing terms:

- ⑥ Debt vs. equity, price, preferences, terms of SHAG, etc.

If you can, avoid:

- ⑥ Issuing secured debt.
- ⑥ Using shareholders' loans.
- ⑥ Using multiple share classes.
- ⑥ Incorporating offshore.

Founders' Shares

What are Founders' Shares?:

- ⦿ Large block of shares issued at a low price to position the Founders.
- ⦿ To recognize their “sweat equity” contribution.

What class of shares should they be?:

- ⦿ Common shares.

At what price should they be issued?:

- ⦿ Nominal - \$0.0001 to \$0.01 per share.

Founders' Shares – cont'd

To whom should they be issued?

- ⑥ Founders and senior officers.
- ⑥ Not to employees or outside investors.

Common mistakes in allocating Founders' shares:

- ⑥ Not setting aside enough Founders' shares at time of incorporation: 4.0M – 8.0M.
- ⑥ Not considering future additions to the management team: 15% - 25%?
- ⑥ Not vesting the Founders' shares: 2 - 4 years, or providing for “reverse-vesting”.
- ⑥ Issuing them to the wrong people.

Preparing a Financing Plan

Determine a “Road-Map” for financing:

The company determines its developmental “milestones”:

- ④ What they are.
- ④ By when they will be met.
- ④ How much funding is needed to meet them.

The milestones are integrated with the budget and a timeline to determine how many tranches of financing will be needed and when.

This info is used to prepare a sample capital structure table - a “road map” for the financing trail (e.g. – to raise \$5.0M).

Sources of Financing – Debt/Grants

Non-equity financing might come from:

- ⑥ **Government grants/credits/refunds:**

- ⑥ NRC/IRAP, SRED.

- ⑥ Telefilm Canada and other industry specific organizations.

- ⑥ Environmental/“green” grants.

- ⑥ **Quasi-governmental organizations like:**

- ⑥ BCIC, BDC

Sources of Financing - Equity

Initial (equity) seed financing may come from:

- ⑥ The “Founders”.
- ⑥ Their “Friends and Family”.

Follow on rounds (pre-public) from:

- ⑥ Angels.
- ⑥ Venture Capitalists.
- ⑥ Investment bankers (both private and institutional).
- ⑥ Underwriters (i.e. brokers).
- ⑥ **Public financing - Initial Public Offering.**
- ⑥ **Strategic Partners.**

Sources of Equity Financing – Revisited

⦿ Categories of Financiers:

⦿ Founders:	Variable
⦿ Friends and Family:	\$50K – \$150K
⦿ Angels:	\$250K - \$500K
⦿ Venture Capitalists:	\$1.0M - \$3.0M
⦿ Underwriters:	\$1.0M - \$5.0M
⦿ Strategic Partners:	Variable

- ⦿ **Match potential investors with your Financing Plan to maximize chance to secure investment.**

BC Venture Capital Programs

- ⑥ 30% refundable tax credit for BC resident investors
- ⑥ Very popular, often drives the deal
- ⑥ Company needs to register as an 'eligible business corporation' and request an allocation of tax credits
- ⑥ They run out every year



Break

Securities Legislation

Requirement:

⦿ If you distribute a security, you must:

⦿ file a prospectus

OR

⦿ Rely on exemption from prospectus requirement

Exemptions

- ② Family, Friends and Business Associates
- ② Accredited Investor
- ② Private Issuer
- ② \$150,000
- ② Start-Up Crowdfunding
- ② Offering Memorandum
- ② Employee, Director, Officer & Consultant Exemption

Family, Friends & Business Associates Exemption

Can sell securities in any amount without any disclosure to:

- ◉ Director, senior officer or control person
- ◉ Family member of a director, senior officer or control person

Family, Friends & Business Associates Exemption (cont'd)

- ④ Close personal friend or close business associate of a director, senior officer or control person
- ④ No limit on number of purchasers or amount that can be raised

“close personal friend” or “close business associate”

- ④ Has known the director, senior officer or control person for a “sufficient period of time”
- ④ Is in a position to assess the capabilities and trustworthiness of the director, senior officer or control person

Accredited Investor Exemption

- ④ “accredited investors” can purchase any securities in any amount at any time
- ④ No limit on number of purchasers or amount that can be raised

“Accredited Investor”

- ④ financial institutions
- ④ registered advisers or dealers
- ④ pension funds
- ④ mutual funds selling only under a prospectus or to accredited investors or persons buying at least \$150,000 of securities
- ④ corporations, limited partnerships, trusts or estates having net assets of at least \$5 million
- ④ individuals who have at least \$1 million in financial assets before taxes. (In calculating an individual's financial assets, any outstanding loans incurred to acquire those assets must be deducted.)
- ④ individuals whose net income before taxes exceeds \$200,000 (or \$300,000 combined income with spouse) in each of the two most recent years and who reasonably expects to exceed that net income in the current year
- ④ individuals who have at least \$5 million in net assets

Private Issuer Exemption

Can sell securities in any amount without any disclosure to:

- ⑥ directors, officers, employees or control persons of the issuer
- ⑥ family members (spouse, parent, grandparent, sister, brother or child) of the directors, senior officers or control persons
- ⑥ close personal friends or close business associates of the directors, senior officers or control persons
- ⑥ current security holders
- ⑥ family members of the selling security holder
- ⑥ accredited investors

What is a Private Issuer?

- ⑥ is not a reporting issuer, mutual fund or pooled fund
- ⑥ has less than 50 security holders, excluding employees and former employees
- ⑥ has restrictions on the transfer of its securities in its articles, memorandum, bylaws or its shareholders agreement
- ⑥ has sold its securities only to the persons in the list in the last slide

Loss of “Private Issuer” Status

- ◉ If you lose your Private Issuer status, you do not automatically “go public”
- ◉ You can still rely on the previously-mentioned exemptions
- ◉ Certain regulatory filings are now required

\$150,000 Exemption

- ◉ Under the \$150,000 exemption, a company can sell securities to **non-individual** investors without providing any disclosure to the purchaser, provided the purchaser buys at least \$150,000 worth of securities.

Start-Up Crowdfunding Exemption

- ⦿ Can raise up to \$250,000, twice a year
- ⦿ Investors can invest up to \$1,500 each
- ⦿ Need to publish an offering document online that sets out certain information
- ⦿ Need to raise money within 90 days of publishing that document
- ⦿ Need to hit minimum goal before any money is released from trust

Offering Memorandum Exemption

Issuer can sell securities to anyone in B.C. in any amount if Issuer:

- ④ Delivers an offering memorandum in the prescribed form
- ④ Obtains a signed Risk Acknowledgement from the purchaser

Risk Acknowledgement/Liability

- ◉ Clear, blunt statement of risks of investing in exempt market securities
- ◉ Issuer must give a copy of the signed Risk Acknowledgement to purchaser prior to making investment

If the offering memorandum contains a misrepresentation, the purchaser has:

- ◉ A right of action for rescission
- ◉ A right of action for damages

Employee, Director, Officer & Consultant Exemption

- ⑥ The sale cannot be based on a promise of continued employment, appointment or engagement.
- ⑥ Narrow definition of consultant.

Legal Agreements – Raising Money

- ④ Non-Disclosure Agreement
- ④ Term Sheet
- ④ Subscription Agreement/Convertible Debt/SAFE

Non-Disclosure Agreement

- ⑥ Mutual or One-Way
- ⑥ All information designated confidential, or only what is marked confidential
- ⑥ Length of time information must be kept confidential

Term Sheet

- ⑥ Type of security being offered (shares, units, convertible debt, SAFE, other)
- ⑥ Valuation (pre-money and post-money, non-diluted vs. partially diluted vs. fully diluted)
- ⑥ Use of proceeds
- ⑥ Investors' rights
- ⑥ Other

Subscription Agreement

- ⑥ Agreement setting out the terms and conditions upon which an investor buys securities – usually shares
- ⑥ Representations and warranties about the company and the shares being purchased – may require that the company make certain disclosures about its affairs and existing liabilities in a disclosure schedule
- ⑥ Indemnification

Convertible Debt

- ⑥ Debt investment that can be converted into equity, usually upon a future financing of at least a specific size
- ⑥ Repayment requirement at end of term
- ⑥ General security agreement
- ⑥ Inter-lender agreement
- ⑥ Usually not eligible for EBC tax credits

SAFE

- ⑥ Simple Agreement for Future Equity
- ⑥ Not debt – no interest, no maturity date
- ⑥ Company does not have to settle on a valuation
- ⑥ Eligible for EBC tax credits

Stock Options

What are stock options?:

- ⑥ The right to purchase a number of shares at a predetermined price.
- ⑥ Used to incent the team building the Company.

How many should be issued?:

- ⑥ 10% - 30% of issued share capital.

At what price should they be issued?:

- ⑥ Last round of financing or higher.

Stock Options – cont'd

Companies must plan for growth and make a notional allocation of their options.

Allocate stock options by category:

- ⑥ Senior Management: 35% - 50%
- ⑥ Remaining Employees: 25% - 35%
- ⑥ Board of Directors: 13% - 20%
- ⑥ Board of Advisors: 2% - 5%
- ⑥ Contingency: 10% - 15%

Companies should:

- ⑥ Integrate Stock Option Plan with their HR Plan.
- ⑥ Vest all options over 2 – 4 years.

Capitalization Table Founders Organize Company

	No. of Shares	Price	Funds Raised
Founders (3)	6,000,000	\$0.0001	\$600
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Total:	6,000,000		\$600

FOUNDERS' OWNERSHIP INTEREST: 100%

Capitalization Table

\$100,000 Friends & Family Round

	No. of Shares	Price	Funds Raised
Founders	6,000,000	\$0.0001	\$600
Family and Friends	400,000	\$0.25	\$100,000
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Total:	6,400,000		\$100,600

PRE-MONEY VALUE: \$ 1,500,000
 POST-MONEY VALUE: \$ 1,600,000

FOUNDERS' OWNERSHIP INTEREST: \$ 1,500,000 (93.75%)



Capitalization Table Stock Option Plan Added

	No. of Shares	Price	Funds Raised
Founders	6,000,000	\$0.0001	\$600
Family and Friends	400,000	\$0.25	\$100,000
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Total:	6,400,000		\$100,600
Option Plan	1,500,000	n/a	n/a

PRE-MONEY VALUE: \$ 1,600,000
 POST-MONEY VALUE: \$ 1,600,000

FOUNDERS' OWNERSHIP INTEREST (NON-DILUTED BASIS): \$ 1,500,000 (93.75%)



Capitalization Table \$420,000 Angel Round

	No. of Shares	Price	Funds Raised
Founders	6,000,000	\$0.0001	\$600
Family and Friends	400,000	\$0.25	\$100,000
Angels	1,200,000	\$0.35	\$420,000
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Total:	7,600,000		\$520,600
Option Plan	1,500,000	n/a	n/a

PRE-MONEY VALUE: \$ 2,240,000
 POST-MONEY VALUE: \$ 2,660,000

FOUNDERS' OWNERSHIP INTEREST (NON-DILUTED BASIS): \$2,100,000 (79%)



Capitalization Table \$1,500,000 Series A Round

	No. of Shares	Price	Funds Raised
Founders	6,000,000	\$0.0001	\$600
Family and Friends	400,000	\$0.25	\$100,000
Angels	1,200,000	\$0.35	\$420,000
Series A Round VC	3,000,000	\$0.50	\$1,500,000
Type of Investor (?)	?	?	?
Subtotal:	10,600,000		\$2,020,600
Option Plan	1,500,000	n/a	n/a
New Options	500,000	n/a	n/a
Total (Fully Diluted Basis):	12,600,000	n/a	n/a

PRE-MONEY VALUE: \$ 4,800,000
 POST-MONEY VALUE: \$ 6,300,000

FOUNDERS' OWNERSHIP INTEREST (FULLY DILUTED BASIS): \$3,000,000 (47.6%)



Capitalization Table

\$5,000,000 Series B Round

	No. of Shares	Price	Funds Raised
Founders	6,000,000	\$0.0001	\$600
Family and Friends	400,000	\$0.25	\$100,000
Angels	1,200,000	\$0.35	\$420,000
Series A Round VC	3,000,000	\$0.50	\$1,500,000
Series B Round VC	5,000,000	\$1.00	\$5,000,000
Subtotal:	15,600,000	n/a	\$7,020,600
Option Plan	2,000,000	n/a	n/a
Total (Fully Diluted Basis):	17,600,000	n/a	n/a

PRE-MONEY VALUE: \$ 12,600,000
 POST-MONEY VALUE: \$ 17,600,000

FOUNDERS' OWNERSHIP INTEREST (FULLY DILUTED BASIS): \$ 6,000,000 (34.1%)

Legal Agreements - Commercial

- ④ Licensing Agreements
- ④ Sales/Services Agreements



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