# LEGAL TIPS FOR START-UP FOUNDERS©

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# PROTECTING YOUR IDEA

1. Confidentiality undertakings
2. A mere idea cannot be protected by itself. It should be concretized and materialized
3. You can register:
   - A copyright
   - A trademark
   - A patent
4. Don’t worry a lot about your idea being stolen, a lot of entrepreneurs may have the same idea but few will succeed… Rather bet on your know-how and your unique skills that are the keys to your success!

# INCORPORATING YOUR COMPANY

# Type of company

1. Most common types of companies in Lebanon: joint stock company (SAL) and limited liability company (SARL)
2. The most suitable type of companies for a start-up is the joint stock company (SAL)
3. To benefit from circular 331 of the CBL → company must be incorporated as an SAL (including holdings but excluding offshores)

# Status and limitation of liability

1. The SAL is an independent legal entity
2. Shareholders are not liable on their own patrimony
3. Advantage in comparison with:
   - Establishments
   - Other types of companies

# General information about an SAL

1. Minimum number of shareholders: 3
2. Minimum capital: 30,000,000 LBP
3. Corporate bodies (Board of Directors, General Assemblies, Chairman General Manager, Assistant General Manager)
4. Auditor / supplementary inspector
5. Legal advisor

# Incorporation process

1. Signature of by-laws (notary – stamp duties)
2. Bank account opening (deposit of capital – certificate of deposit)
3. Signature of constitutive documents (minutes of meetings, commercial circular etc.)
4. Registration with the Register of Commerce

Timeline: 48 to 72 hours

# Costs, expenses, fees

1. Incorporation and registration expenses (Notary Public, Register of Commerce, fiscal stamp duty, etc.): approximately 3,000,000LBP
2. Legal fees (incorporation / maintenance)
3. Auditor fees

# OPERATING YOUR COMPANY

# Ministry of Finance - Taxes

1. Registration with the Ministry of Finance (beginning of activities) within 2 months from incorporation
2. Taxes:
   - Corporate tax: 15% of profits
   - Tax on dividends distribution: 10%
3. VAT registration when turnover exceeds LBP150M over 4 consecutive quarters

# Employees

1. Registration of the Company with the NSSF
2. Registration of the employees with the NSSF and payment of the social security contributions on their behalf
3. Usually done by your auditor
4. Employment Agreements (Confidentiality – Non competition – Assignment of IP)

# FUNDRAISING

# Legal documentation in a VC deal

**Agreements:**

- Term sheet
- Shares Subscription Agreement / Convertible Loan Agreement / Loan Agreement
- Shareholders Agreement
- Lock-up Agreement
- Option Agreement
- Management Agreement

**Corporate documents:**

- Minutes of meeting (BOD, EGMs)
- New by-laws
- Commercial circular

# Highlight on Term sheets

1. The negotiation of a VC deal takes weeks or months
2. It starts with a Term Sheet that crystallizes the agreement of the parties on the main points
3. The Term Sheet is a negotiation document
4. Importance of the negotiation of a Term Sheet:
   - Shortens and facilitates the negotiations (fine-tuning)
   - But be aware: You cannot go back by negotiating more advantageous terms (lowers the negotiation leverage)

- **Not-binding as a matter of principle**

→No commitment on either parties to proceed with the transaction

→The Term Sheet merely sets the negotiation framework

→Either they realize that they are unable to agree on main terms → they end the negotiation

→Or they reach an agreement and sign the final documents (SHA, SSA)

- **<u>However, it may contain binding provisions</u>**
- Examples:
  - Undertaking to negotiate in good faith
  - Undertaking of confidentiality (existence of the negotiations - information gathered during the due diligence)
  - Undertaking of exclusivity (negotiate exclusively with each other during a certain period of time – but make sure it is limited in time!)

# Most common forms of investment

**Loan :**

- Investor does not become a shareholder
- Investment is considered as a debt (payment of interest + depending on the loan’s terms, Investor can request to be reimbursed at a certain maturity date)
- Upon liquidation, Investor (as a third party) gets paid before the shareholders

**Equity (Capital increase):**

- Investor becomes a shareholder - bears the risks of the business like any other shareholder
- Investment is considered as a contribution in capital (apport en capital) → no interest – no maturity date
- Investor gets paid upon liquidation after the payment of all the company's debts

**Convertible loan :**

- Hybrid type
- Investor is initially a creditor <u>but</u> has the right to request the conversion of the loan into shares (becomes a shareholder)

# What is a cap table

Table summarizing the capital structure of the Company

- Names of shareholders
- Type of shares they hold
- Number of shares
- Percentage of participation

# What it looks like*

* Without taking into consideration the security share to 3rd board member

| | | Pre-Investment | | Post-Investment | |
|---|---|---|---|---|---|
| | Type of shares | Nb. of shares | Percentage | Nb. of shares | Percentage |
| Founder 1 | Common | 10,000 | 50% | 10,000 | 42% |
| Founder 2 | Common | 10,000 | 50% | 10,000 | 42% |
| Investor | Preferred | 0 | 0% | 3,809 | 16% |
| Total | | 20,000 | 100% | 23,809 | 100% |

# Preferred shares v/s Common shares

1. Preferred shares = shares that have higher claims on the Company's assets and profits than those of the common shares.
2. They enjoy a combination of features or privileges such as:
   - the right to receive dividends in priority to common shares
   - the right to receive the proceeds of the Company's liquidation also in priority to common shares, etc.

3. In some foreign systems, preferred shares do not benefit from voting rights
4. In Lebanon, this feature applies only to banks (Law 308/2001)
5. Preferred shares issued by companies under the Code of Commerce enjoy voting rights

# Pre-money valuation v/s Post-money valuation

1. Pre-money = valuation of the Company prior to the investment
2. Post-money = pre-money + investment

# Basic calculations

1. % of shares that the Investor will get = investment / post-money x 100
2. Number of shares to be issued to the Investor: formula (based on the % of shares and the initial number of shares in the Company)
3. Issue price = investment / number of shares

# Nominal price v/s Issue price

1. Nominal price = value of one share upon the incorporation of the Company = minimum 1000LBP as per Code of commerce
2. Issue price = nominal price + premium

# Stock Options (ESOP)

Pool of options for future employees → employees will have the option to **buy** shares at a certain price (preferential price) called the strike price.

ESOP are intimately linked to the pre-money valuation

*"The price per share is based upon a* ***fully-diluted pre-money valuation*** *of $5M* (including conversion of all currently outstanding convertible notes, warrants (if any) and existing employee stock option plans if any)"

# Stock Options (ESOP)

**Fully diluted** = means that the number of shares to be issued to the Investor will be calculated on the basis of the initial number of shares in the Company ± the shares allocated to the ESOP plan even if such shares are not issued yet

# Cap table excluding ESOP*

* Figures are rounded up

| | | Pre-Investment | | Post-Investment | |
|---|---|---|---|---|---|
| | Type of shares | Nb. of shares | Percentage | Nb. of shares | Percentage |
| **Founder 1** | Common | 10,000 | 50% | 10,000 | 42% |
| **Founder 2** | Common | 10,000 | 50% | 10,000 | 42% |
| **Investor** | Preferred | 0 | 0% | 3,809 | 16% |
| **Total** | | 20,000 | 100% | 23,809 | 100% |

# Cap table including ESOP*

* Figures are rounded up

| | | Pre-Investment | | Post-Investment | |
|---|---|---|---|---|---|
| | Type of shares | Nb. of shares | Percentage | Nb. of shares | Percentage |
| Founder 1 | Common | 10,000 | 40% | 10,000 | 34% |
| Founder 2 | Common | 10,000 | 40% | 10,000 | 34% |
| ESOP | Common (issued) | 0 | 0% | 0 | 0% |
| | Common (unissued) | 5,000 | 20% | 5,000 | 16% |
| Investor | Preferred | 0 | 0% | 4,761 | 16% |
| Total | | 25,000 | 100% | 29,761 | 100% |

# Dividends distribution

1. Profits of the Company will be distributed among the shareholders
2. In principle: distribution pro-rata
3. However, Investor might have a priority to receive a certain percentage of his investment from the dividends (certain guarantee for the Investor)

# Dividends distribution: Non cumulative v/s Cumulative

1. **Non-cumulative:** if the Company does not declare dividends for a particular fiscal year, the right to receive the dividends extinguishes for such year
2. **Cumulative:** the right to receive the dividend is carried forward until it is paid

# Liquidation preference

Applies in case of a “Liquidation Event” at a lower valuation

- Liquidation, dissolution, winding up
- Consolidation, merger, acquisition, sale, transfer, disposition of assets

It is all about how/in which order of priority the liquidation proceeds will be distributed among the shareholders

# Liquidation preference: 3 types

1. **Non-participating:** proceeds to be distributed to the preferred shareholders. Thereafter, the balance pro-rata to common shareholders.
2. **Fully-participating:** proceeds to be distributed to the preferred shareholders. Thereafter, the balance pro-rata to both preferred and common shareholders.
3. **Partially-participating:** proceeds to be distributed to the preferred shareholders. Thereafter, the balance pro-rata to both preferred and common shareholders.

   However, preferred shareholders stop "participating" when they receive a certain amount.

# Anti-dilution

1. Applies in case of a down round (dilution resulting from issuance of stock at a lower price than the price paid by Investor)
2. Adjustment mechanism in favor of the Investor that is being diluted

# Anti-dilution: 2 types

1. **Full ratchet**: Investor requires that the new price (paid by new investor) applies to him retroactively
2. **Weighted average**: Investor will require that an average issue price applies to him

# Reps & Warranties - Indemnification

1. Founders and Company give certain guarantees in respect of some matters (financial situation, status of employees, tax exposure, licenses, no lawsuits etc.)
2. In case it appears after the investment that one or several warranties are not true, Investor can ask for indemnification

# Composition of the Board

1. The Board composition usually reflects the balance of forces as reflected in the Cap table
   - Founders’ representatives
   - Investors’ representatives
   - Independent members
2. One of the Founders to be elected as Chairman
3. Majority on the Board is a majority of seats whereas majority in the Assemblies is a majority of voting rights (majority of shares)

# Reserved Matters or Matters requiring consent

Matters that cannot be resolved by the Company's bodies (Board/Assemblies) unless with the prior approval of:

- A shareholder (ex: the Investor)
- A certain majority of shareholders, etc.

# Preferential right / Preemption right

1. **Preferential right:** right of a shareholder to subscribe to a capital increase in priority over a third party: (art 112 Code of Commerce)
   - to avoid being diluted in terms of percentage
   - to avoid the entry of third parties
2. **Preemption right:** in case a shareholder wants to sell his stake in the Company, the other shareholders will have priority to acquire the sale shares → to avoid the entry of third parties

# Drag-Along / Tag-Along

1. **Drag- Along**: Right of a shareholder, upon receiving an offer to sell the Company, to “DRAG” the other shareholders into the sale = to force them to sell their shares also (objective: to ensure that 100% of the Company is sold)
2. **Tag- Along**: Right of a shareholder, upon other shareholders selling their shares in the Company, to be “TAGGED” to the sale = to join the sale and sell his own shares also.

# Redemption Rights

1. Right of the Investor to force the Company to repurchase the Investor's shares

2. Reason: limited life of a fund → after the expiry of the fund's life, the fund needs to be liquidated → if the fund cannot exit → Redemption Rights

Always remember to seek legal advice before it is too late…

HAPPY FUNDRAISING ☺