

# High Tech Counsel Corner

In this edition, we discuss problems resulting from the beneficence of friends and family (next issue we will discuss similar issues with employees and contractors). One of the greatest challenges faced by entrepreneurs in starting a company is obtaining adequate funding. This often creates tremendous pressure to take money from whoever offers it.

A common mistake made is taking money from outside sources without fully understanding the legal and business implications. Friends and family may offer to invest in the new business or lend money. These people are willing to help you out, so what is the problem?

If you take money from someone and give them an interest in the business, you are selling a security. Securities take many forms, including stock, limited partnership interests, limited liability company interests, and debt instruments (such as promissory notes). Every offer and sale of securities is subject to compliance with federal securities laws and applicable state securities ("blue sky") laws. Compliance with blue sky laws can be particularly complicated because you must comply with the laws of each state in which an offer or sale of securities is made, and the requirements for compliance differ from state to state.

Compliance failures typically come to light when the business seeks additional funding from another source, like an angel investor, venture capital firm, bank, or state development agency, or when you sell your company. At that point, the manner in which you previously obtained your funding comes under scrutiny. Buyers, banks and professional investors will not put their money into a company that has exposure for failing to comply with securities laws until the violations are resolved. Resolving these issues is often not a simple task.

We have worked with many clients to clean-up situations like these which could have been avoided with proper planning. The fixes are often painful and problematic, and may include fines as well as being required to offer back to the original investors their investment money plus interest.

Whenever you are considering obtaining funding for your company, we encourage you to seek advice from knowledgeable legal counsel about the requirements of federal and state securities laws. Curing problems in these areas after the fact can often be a bitter (and very expensive) pill to swallow.



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