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LEGAL PRACTITIONERS

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Unique Value Proposition of a Lawyer *For Your Startup*

Private Capital Insights

Summary: Engaging a lawyer does not guarantee a startup's success, just as marketing, technical recruitment, or fundraising does not. The lawyer's value lies in reducing transactional costs by applying cumulative deal experience to identify key legal (and commercial) risks and advise on what is industry standard, what is not, and where it makes commercial sense to push or concede. This is knowledge founders typically do not have, which makes early engagement imperative.

As a founder solving an identified friction point, we understand that the primary focus is on getting the product to the market and ramping up adoption. It is fairly typical to spend attention on product development, pitches to investors, marketing, and a host of others. The necessity of legal support – exactly *what* it is for, and *when* it matters – is often deferred.

Key value proposition

In an interesting article published here, Professor Schwarcz identified several ways lawyers add 'value' to transactions. Through careful structuring and advise, a skilled startup lawyer may help: prevent the risk of (very costly) future litigation, reduce regulation and transaction costs, lend reputation to the client and probably create economies of scope by applying accumulated deal experience in across multiple similar transactions.

'Transaction costs simply mean the aggregate costs a party incurs to consummate a transaction (other than the price of contract's subject matter). In the context of start-ups, it is the cost of finding an investor, accounting and legal due diligence, drafting the key commercial and financing contracts, and litigating in the event of breach.

A pre-seed term sheet may probably be a founder's first, but the lead investor's hundred. A skilled start-up lawyer helps to reduce transactional cost by counselling you on what is fairly industry standard, what to push for and what to resist.

Each principal stage of a start-up lifecycle is considered, and we look at how a start-up lawyer adds immense value to you and the business:

Formation

After validation, the next key milestone is to incorporate the company. The incorporation process is a fairly straight-forward one. Most start-ups incorporate as a limited liability company and you *probably* do not need a lawyer to incorporate a company. The only exception is where offshore incorporation is considered for tax and other purposes, which we will consider in our next post. Even at that, later stage restructuring may achieve whatever objective you seek.

We also see founders adopting a googled/template Founder's Agreement to structure their relation vis-à-vis the company. A cost-benefit analysis may be made, but it is our view that this is not absolutely necessary to engage a lawyer at that stage.

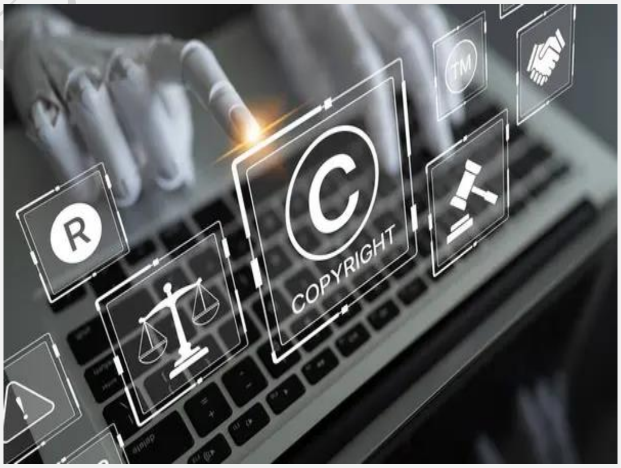
Execution

While a case may be made that a lawyer's input is not needed at the formation stage, however, execution calls for more circumspection. Early operation phase may require building innovative products that require intellectual property protection (i.e., trademarks, patents, etc.).

Patent registration can be legally and technically complex, with patent offices' recommending the use of intellectual property attorneys. Therefore, the value of the lawyer is immense here.

Similarly, regulation may require licensing of the business' operations and/or ongoing compliance. What the lawyer brings to bear here is explaining the scope of regulation and helping you structure your operation either to fall within or outside the scope of regulatory perimeter, the key consideration being the client's goals.

In a fiercely competitive market for talent, employees would be recruited and an Employee Stock Option Plan (or similar incentive arrangement) would be put in place to hire and retain talents. Partnerships may be entered with established players to expand distribution, and key clients contracts may be agreed on the other party's standard contracting terms.



To summarise, the lawyer's value is less about drafting documents and more about judgment such as understanding where risk is acceptable, where it is not, and how today's operational decisions may affect future fundraising, partnerships, or exits.

Financing to Exit

This is where the lawyer's input is absolutely necessary. From the term sheet down to the documentation, you need the support of the skilled counsel to explain the contracts and the key mathematics behind them. Consider this seemingly innocuous provision in the term sheet:

> *If the Company issues any additional shares (including, but not limited to, all classes of shares, warrants, rights to subscribe for shares and securities convertible into any share class) for a consideration per share that is less than the subscription price per preference share (as adjusted for any change of nominal values of shares, e.g. share splits and similar events), the subscription price (as adjusted for share splits, consolidations of shares and similar events) of the preference shares issued subject to this Investment shall be adjusted on a full ratchet basis. The adjustment will be made through the issuance of additional preference shares to the holders of preference shares at par value, so that the ownership of the Investors after the dilutive issuance shall be set equal to the ownership that the Investors would have had if the subscription price paid by the Investors (based on the Investment amount added for the avoidance of doubt the amount paid to subscribe for the anti-dilution shares) had been the same as the price of the dilutive issuance*

How does this strike you? do you understand if this is market standard or not? What possibly carve-outs or alternatives can you introduce to protect founders? And how would the investor respond to your proposals? Remember, this is one of many and this is where the lawyer skills and judgment come in.

Choosing the right lawyers

A dentist is a doctor, so is a psychiatrist. But if your niece suffers mental health crisis, you know whom you run to. The same is true of lawyers you engage as a founder. The market for private capital lawyering is complex and may be intimidating for the uninitiated. So, hiring a cousin with conveyancing or DUI specialism on your pre-seed round may likely be lethal. There would be opportunities to engage him, but certainly not when the stakes are this up.

The International Element

As a Nigerian or UK based start-up, it may be the case that you have restructured to a US hold-co to attract US facing VC firms. Alternatively, you may have entities in multiple jurisdictions for tax efficiency and other purposes. In that circumstance, an international counsel may therefore be required to consider the implication of these arrangements on any contemplated deal.

Managing Costs

One key question is the likely costs to incur. In a market where the lower scale of hourly rate is around $300, the costs could be steep where resources are constrained. A way of dealing with this is to negotiate a fixed fee. Another alternative is to allocate equity (or options) to your lawyers as a consideration for their services. It all depends on the existing relationship, and the advice is to always develop one with your lawyers at the earliest opportunity.

A word of caution

The stack of factors that determines the success or otherwise of a venture is wide. In fact, legal support does not a guarantee that your business would succeed. Same argument can be made for almost every value addition to the business – advertisement/marketing, funding, etc. The value the lawyer brings to bear is the ability to identify potential risks and protect you to the fullest extent permitted under the law.

Conclusion

The market for private capital is a very niche field. If you ever want to raise capital in that market, it would be in your interest to have an excellent lawyer at your corner at the earliest stage.

For more information, please contact us at +2349029752441 or send us an email at **info@ahl-legal.com.**