

Lawyered – Episode 93
Start-Up Law ft. Mark Asfar

[00:03] HUSEIN: This is Episode 93 of Lawyered. I'm Husein Panju. And on this week's episode, we speak with startup lawyer, Mark Asfar, about the fast pace of legal issues involving startups and emerging growth companies. First step, we'll learn about a new court of appeal case that provide some new instruction about the reasonable expectations of founders. This case known as the Pereira Decision, suggests that business realities in context may trump the plain wording of vesting agreements, and may impact the legal drafting of similar forms of contracts.

[00:36] We'll also chatted about some special considerations that startup lawyers are turning their minds to regarding artificial intelligence products, including the use of AI in the legal workplace. And later on, we'll always think about a growing trend of the use of representations and warranties insurance, and how this tool can provide some greater protection for buyers and sellers.

[00:57] And finally, in our, Ask Me Anything segment, we will respond to questions submitted by our listeners on a range of topics, including equity distributions, corporate structuring and how startup lawyers can help bring some order to chaos. All that and a lot more is coming up in just a bit. This is Lawyered.

[Music Break]

[01:22] Hey, everybody, and welcome to another episode of Lawyered. I appreciate you tuning in for another episode. We don't have to chat about in terms of housekeeping updates, but I want to just call out what happened on our previous episode. Last episode, that was episode 92, we had a really fantastic conversation with Rebecca Durcan. Rebecca is one of the foremost leaders in the area of professional regulatory law, which was the topic of last episode. And again, the area that I practice in as part of my day to day.

[01:53] I sometimes feel like I work in a very hyper niche area, like a lawyer who represents a regulator. And sometimes I feel like the only people who kind of know what I'm talking about when I would discuss my job, are my direct colleagues or former direct colleagues. So it felt really neat, frankly, to talk with someone who practice in this area as well, their bread and butter. And even if you're not practicing in this area yourself, there's a lot of helpful takeaways, this is by far one of my favorite episodes in recent memory on the show.

[02:27] We talked about a few topics, one was about Bill 21. Not that built when you want that you may be thinking of from Quebec, this is a different Bill 21, that's the British Columbia new bill that would seemingly overhaul the way that legal professionals are regulated in the province. And there's probably some discussions about whether that would result in a more or

Lawyered – Episode 93
Start-Up Law ft. Mark Asfar

less independent regulator. We also spoke about a new Supreme Court case that speaks about Charter values, as opposed to just Charter rights. That's going to be a really impactful case, that's going to impact pretty much anyone dealing with public law broadly, in terms of focusing on the intention and the spirit behind the rights rather than the rights of themselves.

[03:10] But my favorite topic that we spoke about was what record describe as trauma-informed regulation. And this is, for lack of better term, it's a global trend that some regulators are using to invoke and inject some more empathy and kindness into the regulatory process. So, Rebecca spoke about a few examples in the episode, but it really comes down to appreciate the humanity within the registrant base that regulators are required to oversee.

[03:43] I recorded the episode a few weeks ago, and what's really sticking with me is this concept that, like a fierce advocacy and empathy are not mutually exclusive, and there is room for both. And that there's an obligation, especially for public sector bodies to be cognizant of the needs of the registrant base, whether they're accessibility needs or education aspects, or many other ones, to make sure that they feel supported in order to carry out their public interest mandate. And frankly, even if you don't work in regulatory law, again, a really helpful reflection in terms of what it means to be effective advocate. So, I highly recommend this episode. It's episode 92 in our archive about professional mandatory law with a guest, Rebecca Durcan.

[04:34] Today's episode is another one that I think you're really going to enjoy. It's been a completely different area. This is about startups and the variety of legal issues that are associated with that. As you probably know, Canada has been the birthplace for many successful startups, large and small. And as you're surely this is one of the areas of law that often straddles the line between providing legal advice and business advice.

[04:59] Again, a bunch of helpful takeaways in this episode that are going to apply to lawyers, whether they're practicums or not, or even non-lawyers who are just interested in business operations and how to, you know, keep your head above water when things are moving at a very high pace. So much enjoy this episode. And with that, here's our interview with our guests Mark Asfar.

[Music Break]

[05:23] Mark is an associate in Dentons' corporate and venture technology and emerging growth companies groups in the Ottawa office. And his legal practice focuses on capital markets, mergers and acquisitions, corporate finance, corporate reorganizations, and corporate governance matters. Practically Mark works with new startups who are looking to get set up and established as well as more mature companies that are seeking to raise money from

Lawyered – Episode 93
Start-Up Law ft. Mark Asfar

investors or to exit by acquisition. And prior to joining Dentons, Mark was in-house as general counsel at a professional engineering and architecture firm, where he was responsible for advising the board of directors on corporate governance and shareholder transactions and also oversaw the company's commercial legal matters.

[06:07] And before that, he got his start at a boutique business law firm in the Ottawa region, where he was introduced to the world of startups while also working in traditional and small enterprises and emerging industry clients including the areas of cannabis and crypto. And when he's thinking about the law, Mark also enjoys exploring Ottawa with his wife and dog, or exploring his hobby of tinkering with technology, including building computers and mechanical keyboards, the latter being a pandemic past time. So, Mark, thanks for joining us on the show today.

[06:35] MARK: Thanks so much, Husein, thanks for having me.

[06:37] HUSEIN: Of course it was really great to have you on. For people who don't know, Mark and I have been friends for I think it's been about 15 years or so if my math is correct.

[06:47] MARK: Is that the count? My goodness.

[06:51] HUSEIN: Yeah. We both went to Queen's University. We're part of the Queen's debating union. And it's been a real treat to watch your career unfold alongside mine on separate but related tracks, both in the legal fields. So, it really means a lot that you're on the show. I know you are also a big supporter of the show when I first started, so thanks again for coming full circle on this journey with me.

[07:11] MARK: Yeah. Longtime listener first time speaker and yeah, really glad we could do this. I mean, aren't all great friendships cemented by arguing with each other chronically over the years?

[07:23] HUSEIN: Exactly, it that and also calling in personal favors, like years after the fact and here we are. One thing I want to chat about is that you're a bit of an outlier that you are your lawyer who practices in Ottawa, and while there are many that do that, you're from the GTA originally. Tell us what brought you to Ottawa, what keeps you there as well?

[07:46] MARK: Yeah, you're spot on. I'm actually originally from Mississauga, born and raised, but have been in Ottawa since the start of my legal career professionally, and I love it. You

Lawyered – Episode 93
Start-Up Law ft. Mark Asfar

know, if there's one thing I want to be able to make a strong stand for while I'm on the podcast today, is that Ottawa is a great place to be. We get the bad rap of the city that fun forgot. It's quite a widespread cliché. And I can assure you it is not the case. It's actually a really great city.

[08:14] I chose to come here, because I visited Ottawa several times, when I was in the university and every time I came, I thought, what a really beautiful city, Ottawa has got these great historic buildings, it's got these beautiful streets, it's got nature, got parks, and a lot of really great restaurants. Every time I was in town, I had a meal that I would not forget. And so that drew me in and was really appealing, and was helped by the fact that I of course, met my wife who wanted to be a public servant, and to do good and try to advance the nation.

[08:44] So between her incredible career leading us here and me just really liking the city, seemed like an easy win. And I have to say, I don't regret it. It's a fun place. Lots of cool things going on in the city all the time, very walkable, very drivable. Everything in the city is miraculously a 10-to-12-minute drive. I can't explain it, but it sure beats Toronto traffic.

[09:05] HUSEIN: Are there things that surprised you that you learned since moving here?

[09:10] MARK: The food scene. Absolutely, the food scene. If you're a nightclub person, probably not the right city for you. I think we have one not so great nightclub in the city. But the restaurant scene is really great. There's some truly terrific places here, like award-winning top 100 in Canada restaurants that are truly fantastic and that I can strongly recommend. If you ever need a place to visit next time you're in town, let me know.

[09:35] HUSEIN: All right, now we got a bunch of interesting topics to speak about today in this realm of startup law. And the first topic we're going to talk about is a very interesting development regarding interpretations of contracts and business realities. Now the nature of a startup company often fluctuates and can involve introductions, and departures of various founders. And recent case out of the Ontario Court of Appeal, addresses one such scenario, which involve the termination of a company's founder and a subsequent oppression to remedy.

[10:08] And this case and others like it are given way to new discussions about the lengths that courts will go to, to consider the context and business realities to decide what is fair and reasonable. So, Mark, before we get to the case itself, I know that this case involves a corporate founder, who got terminated from his own company, how often does this actually happen?

[10:28] MARK: Oh, unfortunately, quite a bit. This doesn't happen in every company. Certainly, we talk about lockups investing agreements for every company. But we prefer not to see

Lawyered – Episode 93
Start-Up Law ft. Mark Asfar

founders have a split. But yeah, these arrangements are put in place because founders have disagreements or there isn't a great fit, or life's circumstances change and happens all the time.

[10:53] A lot of startups begin, as small little companies where it's just a couple of folks who know each other, someone usually has technical background, someone usually has business background, and they put together a scrappy little company that begins to gain momentum. And then next thing they know, they're dealing with millions of dollars, employees, pressure from venture capitalists, and an exciting and sometimes challenging competitive market.

[11:16] Sometimes some founders don't get along, they don't see eye to eye. Sometimes the person doing a technical or business role isn't a great fit once things get bigger and more complicated. Or they just decide it's not what they want, and they want to leave. And then those scenarios, some of these founders hold not insignificant amounts of the company, significant portions of the capitalization table, and the company can't afford to have them walk away and still own 30%, 40% or 50% of it.

[11:43] HUSEIN: The case itself is called Pereira and Tell Technologies Inc. The citation there is 2023 OMCA 682 - I'll put the link on our website in the show notes as well. Can you tell us more about what happened in this case?

[11:56] MARK: Yeah. So it's just the classic startup story. Pereira and his founder, start this company Tell Technologies early on, the company grows, they get to the position where they're going to go and solicit venture capital, as most successful startups have to, eventually. And one of the conditions of that is restructuring the company and cleaning up the records, including vesting agreements for the founders.

[12:20] HUSEIN: And what is the vesting agreement?

[12:22] MARK: It's a little bit different than stock options. The idea of a vesting agreement is that a founder owns their shares outright when they create the company, but it's subject to a vesting schedule. So basically says, you will actually fully earn the shares over a set period of three to five years. And if you leave early, or you're let go, a part of those shares are bought back by the company at a penny, basically. We have a three-year timeline and you quit after a year, you don't get to keep all your shares, you get to keep a fraction.

[12:50] HUSEIN: So Pereira and his co-founder enter into these vesting agreements as a part of standard restructuring, venture capital comes into the company starts moving. And shortly thereafter within the year, the company with these new VCs and investors decides Pereira is

Lawyered – Episode 93
Start-Up Law ft. Mark Asfar

not a good fit, and lets him go. So the company exercises the vesting agreement, and opts to buy back a large chunk of his shares for a penny effectively, for a fraction of their value. And Pereira argues, “Well, no, that’s improper. A year ago, I owned the shares outright, I’m going to sue...” not under employment law, but under the oppression remedy of the CBCA, the Canada Business Corporations Act.

[13:29] And that basically gives a claim for a shareholder or a stakeholder to bring an oppression claim where their reasonable expectations have been breached, and they are suffering from some undue hardship or negative effects. So, in this case, Pereira has had his shares bought back for nothing. And he argues that he had a reasonable expectation that that wasn’t going to happen, contrary to his vesting agreement that he just signed.

[13:56] HUSEIN: This went to the trial and got appealed all the way up to the Court of Appeal. And I know that this case gives a lot of consideration to the issue of reasonable expectations and corporate agreements. Tell us more about what the court found and why.

[14:09] MARK: The superior court came to a very cut and dried decision. They said that Pereira had signed a vesting agreement recently with legal advice, was clear terms, that vesting agreement was binding. That was the entire point of the exercise. Whereas argument, of course, was that that wasn’t his reasonable expectation, that in signing this, he’d had talks with his co-founder who had reassured him that he had his back, that he was going to support him, that we’d never exercise or use this vesting agreement against you.

[14:36] The Superior court wasn’t sympathetic to that argument and just said, “Well, you signed something in said legal terms, we don’t care what the side conversation was with your then friend and partner.” Court of Appeal, overturn that and sent it back to trial, arguing that in fact, Pereira did have a reasonable expectation and could rely on those discussions with his co-founder that the vesting agreement was a simple branding/reassurance exercise for investors.

[15:06] And so it is going to be reassessed, we don’t have a final verdict in the saga of Pereira, but it cracks open a really big question for startup lawyers who almost all of us use these vesting agreements. They’re template, they’re industry standard. They are used, again, across almost every startup I’ve ever seen. And now they’ve been called into question.

[15:24] HUSEIN: And this decision goes beyond vesting agreements, right? It seems to apply to any sort of business agreement. We have to always consider the context of what was going on. Is that right?

Lawyered – Episode 93
Start-Up Law ft. Mark Asfar

[15:36] MARK: Absolutely. You're spot on. I mean, this has always been the challenge with the oppression remedy, the BCE decision and related decisions, it raises this open-ended question of what else could potentially be considered in the context of a claim and are agreements, strong enough to be relied upon on their own? Startup lawyer, as you know, we are trying to make order out of chaos. The startup world moves very fast, and it moves very, very wildly. And we are trying to take smart, energetic people and pin down their business agreements and their arrangements into clear concrete, reliable agreements. That's hard to do as it is, and it gets very hard when small conversations they have on the side that we're not aware of, could potentially throw an entire contract out.

[16:24] HUSEIN: So given that, are there things that lawyers can be doing to ensure that their written agreements reflect the nature of the expectations and the relationships and perhaps these other side conversations?

[16:37] MARK: The key is one, drafting clearly. One of the things that I think is a really valuable tool of startup lawyers is that a lot of startup lawyers are generalists. We are not really just start up lawyers or corporate lawyers, we're commercial lawyers, we're employment lawyers, we're tax lawyers. We usually wear a lot of different hats and we have, I think, a very broad knowledge of legal implications and background that we have to apply when trying to figure out what clients need for their particular startup or their issue or their question. We have to apply that contextual knowledge in how we guide our clients and how we draft investing agreements going forward and a lot of other contracts like it, I think we're going to be acknowledging the implication of Pereira.

[17:25] Certainly, I'll be drafting my vesting agreements with some very explicit language, so that acknowledging any prior non vesting arrangement, acknowledging that the parties have been advised about the risk of their shares, acknowledging that they recognize that their shares may be taken away from them, at any time after signing, to try and make those contracts a little bit stronger. But the other thing we would do, and that I think, startup lawyers are wise to do, is just talking to our clients and having conversations with them about the details and the context of what's going on.

[17:59] A lot of startup clients come to our offices, lawyers, and don't have clear questions for us. They very rarely say, hey, I need a vesting agreement, "Hey, I need an intellectual property agreement." Usually the question is framed as, "Hey, me and my founder are talking to some VCs and they want us to be committed, how do we do that?" Or, "Hey, I've got this thing that we've invented, and we want to sell it, how do we lock that down to no one can steal it?" And we have to interpret those questions and understand what they're asking for.

[18:30]

And so in a similar way, I think in the prayer a case, a startup lawyer would be who've to say, "Okay, we're going to put a vesting agreement in place for you". What's the context? What are you worried about? Do you understand what this does? What are the conversations you've had with your investors and your co-founders? And maybe with that kind of discussion, that kind of relationship, you can get ahead of problems like these and try to defeat any conversations that might provide the basis for reasonable expectations playing under the impression remedy.

[Music Break]

[19:02] HUSEIN: The era of artificial intelligence, or AI has dominated growth in the startup space with plenty of investment and deal flow, both in Canada and abroad. And this trend in particular is required at startup lawyers to navigate urgent deals, while always think up to date on the legal developments in this particular area. I know that there's a lot of talk about AI about, transforming all different types of industries. How does AI come up in the nature of your job? So you have a company that has an AI product, what sorts of AI thinking are you doing related to that issue?

[19:36] MARK: When a client comes to us and says I have an AI product, and I want to scale up a business or an investor comes to us and says there's an AI business, I want to put money into it. There's a lot of questions we ask. And you know, going to that general theme of startup lawyers are generalists, we do a lot of different practice areas. We have to think with a lot of different hats. AI really test the limits of that. When you look at an AI business, there's a lot of legal questions. I like to start with, where's the intellectual property coming from? You know, the actual AI software, who developed it? What's it based on? Is it open source? Is it developed in house? Have you locked down that IP?

[20:14] AI also, isn't in a vacuum. It's not just software, it's trained off of things, you feed data into AI to train it. That's a huge question mark for a lot of us. Where is your training data coming from? Did you license that? Did you scrape it? Did you have the permission to use it? Is somebody have intellectual property rights in it or copyright, moral rights to that intellectual property? And have you licensed it appropriately? And that's just the IP.

[20:44] Then we get into the data security elements of it, we get into the business elements of where's this usable? Is it licensable? Is it considered protected technology at large, if you try to take it across the border and sell it abroad? There are so many questions about the technology and its uses and its applications and, and its pieces that it really tests every layer who's dealing with it, because there's so many questions. And every time you think you've figured them all out, there's another one that comes up.

[21:12] HUSEIN: What risk kind of flow out of these questions about, you know, the privacy and the data, and so on?

[21:19] MARK: The intellectual property and data questions, I don't even need to give you an example scenario. There's a ton of lawsuits right now working their way through the courts in the United States. There's a bunch of lawsuits from publications like The New York Times, and The Chicago Tribune against Microsoft and Open AI for using their data to train their AI sets without their permission. The Author's Guild is also suing Open AI, media organizations, the Associated Press, has a whole whack of lawsuits for improperly training AI off of people's copyrighted information, which I'm following and will be fascinated to see. So that's the first risk. And that's just in the datasets and the usage.

[22:03] I would be very curious also to see long term potential claims around the use of AI, I'm sure you heard some of the discussions about AI being used to generate deep fakes and false video and audio and all kinds of stuff. There's going to be environmental questions as well. AI uses a ton of electricity, it's very complicated to get the hardware to actually run AI systems. I don't know if you've noticed Nvidia produce graphics cards for AI, they have like a \$3 trillion valuation right now.

[22:37] It continues to go up and that's very expensive hardware to produce and requires very rare resources to do it. And then just like the applications, I mean, there's a story in the news every other day about some wonky application of AI, including for lawyers, I'm sure you heard the story about a lawyer in Canada who used AI to generate their court submissions, and got improper case citations, false case citations.

[22:59] HUSEIN: What do you think lawyers should be doing if they're seeking to apply AI in their own practice?

[23:03] MARK: I'm of the view that lawyers should be very, very cautious about implementing AI into their practice for the time being. That may change in the future and certainly, we should always be thinking about how we could potentially apply it. I'm a big, big proponent of legal tech and innovation. Because in the profession, we're bad at adapting and innovating and using tech properly. But right now, in the current state it's in, I really don't trust it for anything more than revising emails and helping us keep track of meetings. And that's about it.

[23:34] A lot of people have been talking about how AI, you know, you're going to be able to go to have it draft agreements for you and advise on legal procedures and court filings. The reality

is, I don't think that's going to happen. I want to make a case here that, I would really warn lawyers not to use AI for the next little while. One is that AI has to be trained. And we've seen this everywhere in those lawsuits against major AI companies. You need good data, good data in good data out. Bad data in bad data out. You have to train AI on good legal agreements and precedent for it to understand and there's not a lot of that.

[24:12] Yes, there's legal decisions, legal cases, you could feed into AI. But if you're looking for legal arguments for factum, for agreements and contracts, we as lawyers are not good about sharing that data. It's governed under solicitor client privilege, right? It's locked up in clients records and in our files, you cannot mass grab that information and feed it into an AI in the current age, and certainly not enough of it to get really good outputs. Maybe if law firms start turning their mind now to doing that, that might be able to happen down the road. But I think for now, AI just doesn't have enough to train itself on how to do good legal work.

[24:49] HUSEIN: Actually, I guess me that I won't say the file name, but I'm actually involved in a litigation matter, we had to file written submissions and the other side I can tell used ChatGPT to draft most or all the factors. I can just tell by the way it's formatted and written like the bold font and the colon, the short description, and it just so plain obvious that they didn't do any independent thinking on it. Because also, the inputs are lacking, so you can't expect the output to be much better.

[25:19] MARK: And that actually, it's a great jumping off point to I think the second issue, which is AI is only as good as the instructions you give it. And per some of our other discussions today, law isn't a simple input business. It isn't just okay, I need a vesting agreement, here's the vesting agreement. No, it's all about the context and asking questions to be able to tease out the details and the extra information that matters.

[25:47] No contract is straight template and given to a client. Otherwise, we would all have been replaced by law depot years ago, there's always a conversation to have to figure out what a client needs, what matters, what's relevant how to contextualize things. AI is really bad at that. AI is not going to ask a client: "Are you sure you need a vesting agreement? Do you need it to be this other thing? Do you need to address the special one-off scenario?"

[26:09] Let's gets into the final one, which is AI hallucinates. So if you are a lawyer and asking AI a question, I've got a case and I need a case that stands for a particular argument. That doesn't exist. A junior and articling student will tell you, "I spent hours and I can't find it. The case doesn't exist". AI doesn't know how to say that doesn't exist, or I don't know. It'll fabricate a case of Museum V Mark, Andrew V Esper. And it'll hand it to you and let you run with it. And that's the third and the final one, which is I don't think the technology is useful to lawyers. We

Lawyered – Episode 93
Start-Up Law ft. Mark Asfar

don't need liars. We don't need sycophants. We don't need yes men or yes, tech, we need something that can tell us when we're wrong, or their information doesn't exist.

[26:52] And of course, all of this, I want to caveat by saying that it comes in the context of where this technology is right now sort of mid 2024. It's incredible stuff. And it's very interesting. And its limitations, I think are some of the things I've talked about and very apparent. But it is evolving so incredibly quickly, by the month, by the day sometimes, and what the software can do, the new permutations and the new applications that we're seeing developed. AI in 2025/2026 and onwards, it's probably going to look very different and what it can do and how it does it. Please don't judge me too harshly if we have all been replaced by AI in a couple of years' time.

[27:33] HUSEIN: Of course, I'm sure our AI overlords will be very contented.

[27:38] MARK: Please, please take mercy.

[27:39] HUSEIN: You mentioned that there's all these risks that are available for AI deals. And so are there specific things that lawyers should be thinking about if they are working on a deal that involves an AI component to help protect the clients interest.

[27:53] MARK: I think one of the best things lawyers can do when it comes to AI deals, given how fast the regulatory environments moving, given the vast complexity of the technology, and its legal implications and questions, as we've talked about, probably the best thing lawyers can do is bring in other lawyers to help them figure out all the angles of the potential risks and liability.

[28:19] HUSEIN: Lawyers who have the expertise.

[28:21] MARK: If I had an AI client who wanted me to help them build out and advise in detail on their products right now, I would be calling up my commercial lawyer friends, my colleagues in the Intellectual Property Group, colleagues in data security and privacy, and I'd be relying on a team to tackle the challenge. It's a very cool product. It's a very cool emerging market that we're seeing. It's very complicated. And I think simplifying, it is probably the biggest mistake.

[28:50] One of the key pieces of advice I would give to lawyers who are dealing with AI products, or clients, or any element in the business is to ask a lot of questions and to ask persistent and hard questions. AI is just so multifaceted, there's so many moving parts to it.

Lawyered – Episode 93
Start-Up Law ft. Mark Asfar

And it's not necessarily so complex that we can't get it. I'm not asking any lawyers to review the code line by line to make sure it's good. But the general function, what they're putting into it, what's coming out of it, is sort of intuitively sensible, you can understand it if you ask questions and get info.

[29:29] And I think the folks that are in the space, sometimes lose the bigger picture, the context are so focused on, I built a cool thing and look what it produces. It's cool too. And I'm sure it's all good, but they forget to see the greater picture the little moving parts for what they are. And that's the value lawyers can bring. We can bring that intellectually curious, detail-oriented mind to the game and ask a bunch of questions and make sure that all the individual parts make sense to us.

[Music Break]

[29:59] HUSEIN: While the area of mergers and acquisitions has frequently involved insurance, this specific relationship has dramatically increased over the last couple of years. And in particular, M&A insurance helps to cover potential misrepresentations error and omissions in deals, which removes the requirement to hold part of the deal in escrow. And this may present opportunities for lawyers to provide better advice protection, especially with increasing valuation figures. So Mark, I'm sure most of who are listening have a general sense of what mergers and acquisitions are, but can you explain to us how M&A insurance works and what that means.

[30:37] MARK: It's a really interesting topic that I've been encountering more and more recently, and I've seen some interesting trends in it. So in a normal M&A deal, one of the big key points in negotiation is the representations and warranties. So the promises about the picture of the business and liability for those reps and warranties if they're not true. So, from a buyer's perspective, you're buying a company, you need certain things to be right about it. A great example being you're buying a tech company, you need to know that the intellectual property is secure, that you've got it secured from the employees, that it's patented, that it's appropriately licensed, that it's appropriately licensed on to customers.

[31:19] Because if you buy a company with bad IP, like, what's the point some of these software companies we see getting bought and sold these days, they're 90% IP, that's where all the value is. So, it's a key negotiation point among lawyers and deals of what exactly are you repping? Are you qualifying those reps to the knowledge of parties to their best effort, so on forth? And what's the worst-case scenario if our rep is wrong? And so we as M&A lawyers, we're very often get into long negotiations about creating an escrow fund to hold an emergency amount

of money if a rep is breached. How long is that escrow last? How big is the escrow? What level of indemnification exists?

[31:57] Some deals, parties, sellers don't want to be responsible for anything. In their view, I've sold the business, it's yours, have a good day. If anything goes wrong, while you're running the business that's your problem. Obviously, a buyer isn't going to accept that if something goes wrong six months later. We spend a lot of cycles going back and forth over what is being wrapped in who's responsible and how. And so there's finally a product for that. It's isn't a new product, but it's an increasingly more common insurance product in the market, which is this reps and warranties insurance issued by all the same insurers that do commercial insurance and professional insurance that our clients use. But what it does is it comes into deals of a certain size, and it provides insurance for misrepresentation or in warranties or breaches of certain reps and warranties.

[32:45] HUSEIN: Does it protect who? Does it protect the buyer?

[32:49] MARK: It technically protect both sides, the primary protection is for the buyer, because it creates, ideally, if it's within the coverage of the policy a pretty much guaranteed payout for damages from reps and warranties, so guaranteed recourse and quicker recourse. So, instead of a buyer in the traditional scenario, having to chase after a seller, sue all the parties, go through lengthy litigation to get their costs recouped. The insurance policy pays out and then we'll chase down sellers if there's a claim to be made there.

[33:21] HUSEIN: So it's analogous to how car insurance would work.

[33:25] MARK: Exactly. Yeah, it's car insurance for a company basically. So from a buyer's perspective, great to have very reassuring if anything goes wrong.

[33:33] HUSEIN: How does this insurance protect the seller then?

[33:36] MARK: It also protects the seller in a couple of ways. One is it's reassuring to a seller. First, there's going to be a smaller escrow, and likely a smaller, hold back condition in the deal. So the seller is getting their money on day one, when they're selling the company, they're not having to leave potentially 20% of it locked up in an account for however long. But it also reassures that if something does go wrong, because there are reps and warranties that can be breached innocently, through a minor error or an oversight or an undiscovered condition.

[34:10] Or, once it can be breached in the normal sense, but whenever a refund warranty is breached, sellers are suddenly on the hook going to court, having to pay extensive fees, and so on. And so some of these policies will cover innocent misrepresentation, they'll step in and potentially covered litigation costs, or they'll even provide for certain expedited resolution mechanisms like arbitration.

[34:33] HUSEIN: And so you mentioned at the beginning of this segment that this is not necessarily a new product, but I gather this has been employed a lot more in recent years. Can you tell us more about that?

[34:44] MARK: Yeah, so market trends are showing that these reps and warranties insurance, RWI, is being employed in more and more deals every year. Which absolutely makes sense and particularly for large deals, you're seeing \$100 million equity and it makes a lot of sense. The thing that's been interesting to me, however, is that I've seen it being used on smaller deals in the last couple of years. So instead of, the traditional very large acquisitions, where you would expect this and it's become an industry norm, smaller businesses are beginning to employ it as a means to address the risks that they're worried about.

[35:18] So I've seen some transactions in the last year, that normally the price, the overall price of the business and the valuation, we wouldn't consider RWI insurance, but we've been able to go to brokers, and we've had policies put into place for companies that were selling and distressed, for example, or they just had lower valuation, but also owners with a lower risk threshold. And so the policy was a way for them to, again, get their payout on the sell, but also, if the company was selling for below value, to kind of give themselves some protection.

[35:56] HUSEIN: How does it facilitate the deal for both parties, then?

[35:58] MARK: Exactly. And it reassures the buyer, the buyer might not have gone forward with that deal in that condition, except for the insurance. And for those sellers, they're not looking over their shoulder for the next two or three years, wondering what happens if there's a small breach am I going to get dragged to court on a business that we were just trying to get rid of.

[36:13] HUSEIN: Do you think this is becoming a more common trend, including for smaller and mid-sized companies? If there's a lawyer that's been asked to draft agreements, negotiate based on this new reps and warranty insurance, what should they be thinking about?

[36:27] MARK: One of the things is to think about it as an option, even where you might not have previously. Again, the trend seems to be that insurance companies are making this product available to more and more deals that in the past would not have been issued at all. So

I think it's important to think of it as a tool. I never saw this used when I was a small business lawyer, I've only really seen it in the context of very large deals, and certainly as a lawyer at Dentons. But I'm seeing it used more in those small contexts and I think that's pretty unique.

[36:57] When it comes to drafting documents and structuring deals, I think it should be an upfront conversation. Having our why insurance on a deal is an important first point of discussion on a deal because it completely changes how we negotiate escrow and indemnification and even how we prepare reps and warranties and disclosures of information. Again, you can feel more comfortable making broader, more detailed disclosures, if you have insurance on top, you're not going to have to draft a whole complex escrow agreement if you know upfront, you've got insurance covering it. So we think it's actually a starting point for a lot of discussions, like what's the price? What's the closing date? Who are the parties is reps and warranties insurance in place is probably the next question. But then does

[37:44] HUSEIN: But then, does that leave open the possibility of buyers or sellers being a bit more cavalier than they should be, knowing that they have insurance to protect them?

[37:52] MARK: Absolutely a risk, yeah, you're spot on. And I think that's also the lawyer's role, is to remind clients that insurance doesn't cover absolutely everything under the sun, just as you would with a normal policy. Reckless, negligent, fraudulent representations are not going to be covered under this. So you still do need to pay attention to disclosure schedules, and to the reps and warranties you're making. But I think that's a normal conversation for lawyers to have, and if they are familiar with these kinds of policies, it's one that they will raise with their clients. It's just very interesting to me, insurance is such a fascinating product. It's something that I think a lot of lawyers overlook, because it's not in our direct sphere of influence very often, but it's such a valuable tool.

[Music Break]

[38:45] HUSEIN: And to wrap up, we're going to do our Ask Me Anything segment with Mark, about questions that were submitted about startup law. As listeners of our show will know, the bonus reward for members of our Patron crowd-funding community, it's your opportunity to submit questions that they want to hear answered on the show. This can be questions about anything within our guest's area expertise, so long as they are not asking for legal advice. We usually do a call out for the questions about a week before each recording. If you want to learn more about how you can become a patron and submit your own questions to upcoming guests, you can check out our crowd-funding website, which is www.lawyeredpodcast.com/patron, for more info.

Lawyered – Episode 93
Start-Up Law ft. Mark Asfar

[39:22] Okay, so, Mark, a lot of interesting questions this week about startups and startup law. And the first one is this, “Many startups, especially at an early stage have a reputation of being chaotic and unfocused. So the question is: “What are some things that startup lawyer can do to bring some order and structure to these organizations?” And I will say an answer to their questions.

[39:48] MARK: It’s a great question. And I would absolutely agree a lot of startups are a little wild in their early days and it could be kind of hard to get them on track and organized and put together in a way that we would like as startup lawyers. As a startup lawyer, I found a couple of approaches that I think are really successful in helping my startup clients. One is, as startup lawyers, we really play the role of business advisor a lot more than I think traditional small business, or corporate M&A lawyers do.

[40:19] HUSEIN: So what do you mean by that?

[40:21] MARK: So you’re usually asked questions here and there in a small business or in an M&A deal and the context of it. Clients will come to you and say, “I want to sell my business, and what kind of terms should I get?” Startup clients, usually, in the early stages, don’t even know what questions to ask, they come to you and say, “I’m starting up a business, what do I do next in the context of...” And so that’s quite hard for them. And so we play a real business advisor role in that very often we help them identify what questions they need to be asking.

[40:51] So for when startups come to me, very often, the first conversation I have is, where are you? What are you doing? What are your current plans? And then I spend the second half that usually of my first meeting with clients, laying out what a traditional startup roadmap looks like. You do incorporate. Do you have a founder’s agreement or a shareholder’s agreement? Have you thought about stock options? How’s the team that you’re building out? What’s your pathway to financing and capitalizing? And I lay out the forms of agreements, the steps, the expectations around each of them. It’s one of the rare areas of law, I think, where you’re not just solving client’s problems, but you’re kind of guiding them on here is the problems that you should be trying to solve. And that really helps them get organized.

[41:35] The other one, I would say, a lot of these startup founders, they’re sophisticated in their world, they’re usually very often business or technical experts about their area and don’t know the legal minutiae of navigating these issues. It’s usually their first business. So very often, when you’re getting into long, complicated conversations with them about something, I find it’s very easy to sort of cut through some of the back and forth and ask them, what are you trying to achieve? Because they’ll very often come and say, “Can I do this? Can I do that?” And you’ll

have to say, “No, that’s not right. No, that’s not legally proper. No, that doesn’t quite make sense for you.”

[42:05] It’s much easier to say, okay, what are you trying to achieve? Okay, you need a technical founder in a different country who’s going to be involved in this way. And then you can navigate around the way to get them to that end goal, rather than playing the, okay, what about this way? What about this way? What about this way? Between those two, I find it’s much easier to help them get organized.

[42:26] HUSEIN: The next question I want to ask is: “What are some factors that startups should consider when deciding between different structures?” Whether it’s a corporation or limited partnerships, or I’d say even its sole proprietorship?

[42:41] MARK: This is going to be unfortunately a bit of a boring answer for me, and I apologize. Well, that’s a great question from the person who asked it, just incorporate your business, please, don’t do anything else. It’s the simplest and the best model, from a liability perspective, from a structuring perspective. If you’re any kind of modern normal startup, a corporation shields you from liability that creates shares with which you can distribute ownership among key players and potentially financiers and investors. That’s the standard model.

[43:14] In the US it’s a bit more complicated because they have different forms of corporations. And certainly in parts of Canada, we have ULCs and other types of corporate structures. But normally, the standard model is the private equity corporation. And that’s just the best way to set it up. It’s the easiest to structure the shares makes sense.

43:35[] HUSEIN: Isn’t it complicated to incorporate a company?

[43:39] MARK: It’s both. It is and it isn’t. Actually, you can go right now, we could do it on this call if you want Husein and we could set up a corporation for you with 200 bucks and 15 minutes of time on the Canada website, Industry Canada makes it really easy. I would generally recommend talking to a business lawyer or to an accountant in setting up a corporation. But out the gate, it’s not that hard, incorporation would be pretty straightforward. Getting the documentation together is a pretty fast and simple process.

[44:07] Again, I recommend you get a lawyer to do it if you’re planning to turn that corporation into a multi-million or billion-dollar business in a few years’ time, we can certainly help you avoid some pitfalls down the road. But if you’re starting a small business for yourself, the simple incorporation really isn’t out of reach.

[44:24] HUSEIN: The next question is somewhat related. And we talked about earlier on this episode, a case of this pressure already being used in the context of a vesting disputes. The question is: “How should founders approach equity distribution among co-founders, employees and investors to mitigate future legal disputes?”

[44:45] MARK: This is another one with a pretty simple answer, but it’s informed by a lot of war stories, which is whatever you do, however you want to distribute it, one - and this is the most important - paper it, please, get it in writing, I’d prefer you do it with a lawyer. But if you want to do it with something you printed from the online world or a napkin in a bar, I don’t care, please put it in writing. It’s my big ask. My second ask is to do it properly and thoughtfully and in detail. Ideally, consult a lawyer for advice on how to do it. But my number one is, please, please get something in writing. It’s the number one.

[45:25] HUSEIN: But what about the actual distribution? How much should go to…?

[45:29] MARK: Distribution is so hard. And I’ve seen founders talk about this ad nauseam, in every company ever. Keep it simple, and in a sensible way, if there’s one founder who’s doing 80% of the work right out the gate, probably they should have 80% of the shares. If it’s you and a couple of people and you want to go in, we’re the Three Musketeers and we’re going to do this equally as partners, divide it equally in thirds among each of you. It doesn’t have to be a complex formula, this doesn’t have to be something you agonize over.

[46:02] And the reality is, in the long run, if you’re going to be a successful startup, you are good to go and raise capital very often, you’re usually going to find investors, some of the biggest and best businesses usually find a lot of investors and those core founders, their shares are always diluted down and topped up later on with stock options and via personal salaries and so on forth. Agonizing over what percentage you have of a very small pie early on, a lot of time wasted. You’re better off, working hard to get the company to the stage where you can bring in the money, see that dilution, actually get the business successful. And a few years from now you can negotiate some very healthy stock options in a multimillion-dollar business with your board.

[46:41] HUSEIN: That’s a great segue to our next question, which is: “What are some legal considerations for startups who are seeking venture capital or angel investment?”

[46:50] MARK: Yeah. This is another one where there’s so many thoughts and theories on this out there of what’s the best way to pitch VCs? How do you structure your business the best

way possible? And this is another one where I often break the mystique for my startups and just tell them, keep it simple. Don't over structure your company, don't come up with all kinds of crazy share structures or deal terms, set up your company properly. Get the basic legal docs in place so you're not in any kind of legal risk when someone does their due diligence. Go out and find VCs that are interested in what you're doing.

[47:26] Don't focus on the legal, don't get over fussed with all this sort of the business technicalities. Really it comes down to, are you making a good product? And can you go find a venture capitalist or an investor that's excited about your product and wants to put money in it. When they show up with the money, that is the best affirmation of what you're doing. They will negotiate reasonable deal terms with you, you will figure it out at that point, just up until that stay organized, keep it simple. There's no magical thing you can do in your share structure, in your documents, in your sales pitch, that's going to automatically make it for your company, it really comes down to business fundamentals.

[48:02] HUSEIN: If you're a lawyer advising a client who's gone to one of these investors, are there specific things that you would advise or suggest?

[48:10] MARK: Yeah, it's a conversation I have all the time when my clients are going out to their angel or their seed rounds, pretty early on. And it's, "Are you incorporated? Are your records updated? Have you issued any options you haven't told me about? Do all of you have your employment agreements? Have you signed a vesting agreement? Check, check, check, great, go talk to the VCs."

[48:29] From a legal perspective, at that point, you're great. And if the VCs have follow-on questions that come back to us and check on it. But really for us it's, do you have all the basic agreements in place? If someone looks at this, are they going to say, "Where's your intellectual property? What? You don't have a contract?" As long as none of those questions are coming up, you are as good as you can be. It just comes down to your pitch and your product.

[48:50] HUSEIN: The last question we have is kind of a broad question. The question is: "What are some key ways in which the work of a startup lawyer like yourself differs from a "typical" corporate commercial lawyer?"

[49:01] MARK: Yeah, I think for us the difference—and I might have alluded to this in other parts of the podcast—is that we play the role of business advisor and partner very often, in addition to lawyer. We're not just negotiating contracts, we're not just advising on deals or legal implications of issues, founders very often come to startup lawyers to ask them business questions, to ask them how they stack up to the normal lifecycle of a startup of what they can

Lawyered – Episode 93
Start-Up Law ft. Mark Asfar

be doing differently. Even just to check in. I have a couple of startups that I love working with that I think are really promising companies. And I just have a standing coffee chat with them every other month, where we just grab a coffee and chat about you know, what VCs have you pitched to? What's the company looking like? How are you making progress on some of those key business goals?

[49:51] And we're not even talking about key legal terms or any of those issues. I'm just there to check in, what's going on, see if I can identify a potential legal issue that they might want to talk about, and be a resource to them, even connecting them to other professionals in the industry. I don't think that's common in a lot of areas of practice. Even when I've been a small business lawyer in the past, small businesses similarly do like to ask you for advice. But I think as a startup lawyer, you're a uniquely important player to these businesses. And very often they view you as a part of their team. It's a nice thing, it comes with a lot of responsibility, I certainly feel a lot of responsibility to my clients to give them good advice, and to try and help them be successful in what they do. But it's also wonderful once they do succeed, when they do get that first big investor, when they do hit a big milestone, you really feel like you're a part of it.

[50:43] HUSEIN: So Mark, I want to thank you so much for being on the show, I learned a lot about all these topics. This is not an area that I was well versed in at all. So I appreciate you educating me personally. I'm sure a lot of our guests as well about kind of what goes on behind the scenes in startup life. And on a personal level, I've known you for quite a while, I know you've transitioned to different types of work and so personally rewarding to see you thrive in such an area that's so I guess tailor made for you. So I'm really happy to see your success in this area. And thanks again for being a supporter of the show. And I'm sure we'll stay in touch in the future as well.

[51:18] MARK: Husein, thanks so much for having me. Again, longtime fan of the show. I think I speak for a lot of listeners who say they've learned a tremendous amount from it and are a fan. My only question for you is, do I get CPD hours from listening to myself?

[51:33] HUSEIN: Well, check of lifestyle and let you know. Thanks, Mark.

[Music Break]

[51:43] And that's going to do it for this episode of Lawyered. Thanks for listening. On today's episode, our guest was Mark Asfar. You can learn more about him and the work that he does as part of the Corporate and Venture Technology and Emerging Growth Companies practice groups at Dentons, at their website, which is www.dentons.com. And for more on today's

Lawyered – Episode 93
Start-Up Law ft. Mark Asfar

show, and links to all the cases and issues that we spoke about on our episode, you can find those in our website, which is www.lawyeredpodcast.com.

[52:10] And our next episode is going to be another big one, we're going to be speaking about gender equity law, with the prolific Pam Hrick. Pam is the Executive Director, and General Counsel at LEAF, which is the acronym for The Women's Legal Education and Action Fund. And we got a bunch to talk about in that episode. We're going to be focusing on a new federal private member's bill, of course control in the context of domestic abuse. And we're also going to be speaking about the Quebec Bill 21, regarding the prohibition of religious symbols, with a special emphasis on the implications on section 28 of the charter. And finally, we're going also going to be speaking about litigation that's ongoing in Saskatchewan regarding a new pronoun-based policy for students.

[52:55] And of course, if you want to help improve this show, and get some neat and affordable legal awards, including early access to every episode, and the opportunity to submit questions on our show, you can be very helpful to us if you can become a patron of our show for our final few episodes. You can find out more about how to do that on our crowd-funding campaign, which is www.lawyeredpodcast.com/patron.

[53:20] I want to give a shout out to a few of our supportive patrons over the years including, Candace Cooper, Carolyn Poutiainen, Conner Coles and Don Bourgeois. Thank you so much for supporting the show and making the show what it is. And of course, if you're not already doing so, you can also subscribe to this podcast for free on iTunes or wherever you get your podcasts. You can also follow the show on Facebook, LinkedIn, or on Twitter. And our Twitter handle is @lawyeredpodcasts. Our sound editing work is managed by Solomon Krause-Imlach, the music by Ben Swirsky, and our websites maintained by Steve Demelo.

[53:52] And finally, please be advised as well this show is going to be helpful and informative that it is not legal advice. However, if you do want legal advice, please reach out to a lawyer directly to help you with your particular situation. And with that, we'll see you back here in two weeks' time. Until then, keep it legal.