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Startups and Unmet Legal Needs

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STARTUPS AND UNMET LEGAL NEEDS

Alice Armitage,^{*} Evan Frondorf,^{**} Christopher Williams,^{***} and Robin Feldman^{****}

TABLE OF CONTENTS

I. INTRODUCTION.....	575
II. STARTUP LEGAL GARAGE—REDEFINING LEGAL EDUCATION.....	577
III. METHODOLOGY.....	578
IV. RESULTS AND BASIC FINDINGS.....	579
V. ANALYSIS.....	582
A. <i>Difficulty of Funding Legal Services</i>	582
B. <i>Necessity of Early Legal Advice</i>	584
C. <i>Disparity of Access to Legal Resources</i>	586
D. <i>Other Unmet Legal Needs</i>	588
VI. CONCLUSION.....	592

I. INTRODUCTION

Among the hard-charging, iconoclastic startups of Silicon Valley, regulation and legal structure are unlikely to be top agenda items during the daily scrum. In this world of constant reinvention and the disruption of obsolete business models, legal needs and regulatory issues are often pushed onto the backburner or dealt with hastily in the interest of focusing resources on product and business development. Rather than risk never getting an idea off the ground, founders often ask for forgiveness instead of permission when legal issues arise.¹ Yet startups have urgent legal needs from the moment of formation—needs that may have serious and expensive consequences if not addressed early.² Undrafted stock and equity agreements may lead to tax consequences and disagreements among founders, the lack of a privacy policy or terms of service may expose a company to liability, and failure to properly protect intellectual property may spur damaging competition. As

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¹ In fact, many startups take pride in “disrupting” existing regulatory structures. This admiration of pushing the envelope adds to the disregard of legal needs.

² See ROGER ROYCE, *Preface to DEAD ON ARRIVAL: HOW TO AVOID THE LEGAL MISTAKES THAT COULD KILL YOUR START-UP* (2012).

Y Combinator, a top accelerator program, declares, “[G]etting [a startup] set up correctly is a nontrivial problem.”³

An understanding is emerging that startups should make a serious effort to tackle their legal needs as soon as possible, preferably by retaining a lawyer.⁴ Yet little research exists into the extent of the legal issues facing early-stage startups and the burden these issues place on growing companies. Previous research, generally focused on the nexus between law and entrepreneurship, has described some of the costly legal obstacles that can stonewall nascent businesses, but these papers have not undertaken a complete survey of the legal landscape for startups.⁵ As part of a grant from the Ewing Marion Kauffman Foundation, we explored this topic using survey data collected from the Startup Legal Garage, our client-based education program at University of California Hastings College of the Law that brings startups, students, and supervising attorneys together to resolve legal needs for early-stage startups. The study surveyed over forty technology startups during the 2014–15 academic year, identifying the most pressing legal issues and investigating how startups handle the legal needs they face. The following paper describes this research. Part I details the background of the Startup Legal Garage, Part II outlines our methodology, Part III describes our results, and Part IV contains an analysis of those findings. The most important conclusions pertain to the difficulty of funding legal services for early-stage startups, the important role those legal services play in a startup’s long-term viability, and the current disparity of access to legal resources among startup founders. Discussion also includes an overview of other prominent legal needs for startups that fall outside the reach of the program, including litigation and immigration matters.

³ *What Happens at Y Combinator*, Y COMBINATOR, <https://www.ycombinator.com/atyc/> [<https://perma.cc/U2WL-9WB3>] (last visited April 1, 2016).

⁴ See, e.g., Nick Allard, *Save Your Startup: Hire a Good Lawyer on Day One*, FAST COMPANY (Mar. 1, 2013, 6:02 AM), <http://www.fastcompany.com/3006369/save-your-startup-hire-good-lawyer-day-one> [<https://perma.cc/6TFJ-4P9X>] (describing the benefits of hiring a lawyer early in the process of startup creation); Conner Forrest, *How Startup Founders Can Stay on the Right Side of the Law*, TECHREPUBLIC (Mar. 31, 2014), <http://www.techrepublic.com/article/how-startup-founders-can-stay-on-the-right-side-of-the-law/> [<https://perma.cc/JTV7-VPZV>] (recommending that startup founders hire a lawyer); see also ROYCE, *supra* note 2 (describing the urgent need to hire a lawyer for tax planning purposes as early as possible).

⁵ See Jeff Thomas, *The Legal Spark*, 78 UMKC L. REV. 455, 456–57 (2009) (describing the expense of legal work for startups and the shortcomings of do-it-yourself resources); Alex Curcuro, *The World Is Indeed Flat: Preparing Students for the Global Market Through Law School and Small-Business Incubator Partnerships*, 78 UMKC L. REV. 543, 549–50 (2009) (acknowledging startups’ need for sound legal advice). Both papers were presented at a 2009 symposium on “Law, Entrepreneurship, and Economic Recovery,” held at the University of Missouri-Kansas City.

The key findings from the study include:

- Almost 90% of the legal issues identified by supervising attorneys fell under one of three general categories: general corporate formation, contracts, or nonpatent intellectual property;
- Sixty-two percent of startups in the Startup Legal Garage program faced legal issues in two or more of these categories;
- The most frequently occurring legal matters were entity formation and creating a terms of service agreement, with about half of startups in the Startup Legal Garage program facing each issue;
- We estimate that Startup Legal Garage services are worth between \$17,000 and \$23,000 for the average company, alleviating a significant burden for these companies, which average less than \$100,000 in outside funding when entering the program;
- Before entering the Startup Legal Garage, startups identified only 45% of the legal needs that were eventually handled by the attorney-student groups;
- Seventy-one percent of startups received assistance with issues not listed on their intake application for the Startup Legal Garage.

This Article concludes with a discussion of a troubling constraint: while addressing legal needs is certainly in a startup's best interests, tackling them properly is beyond the means and financial resources of most early-stage companies. The results should be of interest to numerous stakeholders in startup ecosystems, including entrepreneurs and company founders, venture capitalists, government organizations looking to foster innovation and economic growth, and budding incubators and accelerators hoping to identify and provide key resources for nascent companies.

II. STARTUP LEGAL GARAGE—REDEFINING LEGAL EDUCATION

Data on the legal needs of startups was collected as a by-product of the work of the Startup Legal Garage, an innovative, real-world educational program offered to students at UC Hastings College of the Law. The Startup Legal Garage matches early-stage startups with students and supervising attorneys from top law firms in California and elsewhere to provide legal assistance to these companies, which are primarily located in the San Francisco Bay Area. Companies are connected with the Startup Legal Garage through referrals from prominent incubators and other community partners, including Y Combinator, QB3, Hackers/Founders, Black Founders, Women 2.0, and others. Students are admitted to the yearlong course through a competitive application process. The program is divided into two modules: the "Tech Module" and the "Biotech Module." Tech Module students work with companies on basic corporate and transactional needs, including entity formation, contracts, and intellectual property protection.

Biotech Module students, who come to the Startup Legal Garage with an educational background in science, work with biotechnology companies solely on freedom-to-operate analyses. This work involves the extensive review of existing patents to identify a safe pathway for product development and to narrow the possibility of patent infringement liability. These analyses are expensive and time-consuming, but they are also critical for biotech companies looking to attract investment. For that reason, the Biotech Module focuses exclusively on completing this work.

Both modules allow students to gain first-hand experience in transactional work under the leadership of a supervising attorney. While this fieldwork portion of the program exposes students to an environment similar to that of a first-year associate at a firm, students also complete a classroom portion of the program that reinforces and supplements their real-world experiences with doctrinal analyses of frequently occurring issues, skills exercises, and discussions of their fieldwork. During the 2014–15 academic year, forty students and forty-two supervising attorneys provided free legal services to forty-three startups in the Tech Module. Twenty biotech companies in the Biotech Module received legal assistance from twenty students and fifteen practicing attorneys.

III. METHODOLOGY

Our study focuses only on the legal issues handled by the companies and students in the Tech Module of the Startup Legal Garage. Because the Biotech Module focuses only on freedom-to-operate analyses for biotechnology companies,⁶ data collected from the work of the Biotech Module is unlikely to be representative of what legal issues a typical startup faces in the early stages of growth. Comparatively, companies in the Tech Module come from a wide range of industries and can receive assistance with a variety of corporate, transactional, and intellectual property matters.

When new Tech Module companies enter the Startup Legal Garage, they complete an intake application detailing their perceived legal needs. Startups are paired with practicing attorneys and two students based on that application. Attorneys are then asked to determine the precise issues to be handled and the final deliverables of the project during an initial meeting between the startup, our students, and the attorney. The eventual focus of the project is based upon the attorney's assessment of the startup's most urgent legal needs. Companies are generally associated with the Startup Legal Garage for one academic semester, and projects span approximately thirteen weeks.

At the end of the 2014–15 academic year, we surveyed all Tech Module students about the legal issues they handled with each of their startups. This survey-based approach was necessary because of the unique, relatively “hands-off” design

⁶ The Biotech Module focuses on freedom-to-operate analyses in part because the companies assisted in the program are further along in their development and have already addressed the foundational legal needs handled in the Tech Module.

of the Startup Legal Garage: unlike other client-based programs, the Startup Legal Garage's faculty and staff members do not participate in the attorney-client relationships formed among the students, supervising attorneys, and startups. Therefore, a student survey was the best way to collect information on the matters handled for each startup, providing only minimal details that do not reveal privileged information or jeopardize the attorney-client relationship.

Granted, surveys present potential issues with accuracy because they cannot be independently verified. It is possible, for instance, that students overstated or understated the number of different issues handled for their client. In addition, different students may have used different thresholds when determining whether a specific matter fell under the scope of their project, e.g., whether a matter should count as an "issue" if a term of service was merely addressed rather than fully completed and executed by the student team. However, given that a matter would need to be at least contemplated to appear on a student's survey, we would not expect this limitation to greatly impact the main purpose of the survey—gaining general insight into the scope and types of legal matters faced by early-stage startups.

IV. RESULTS AND BASIC FINDINGS

The primary data set collected for this study was the student survey of the legal matters actually handled in the Tech Module of the Startup Legal Garage during the 2014–15 academic year. Information was collected for forty-two of the forty-three startups served during the year. We also compare the results of this survey with the legal needs described by startups in their initial intake applications. Table 1 details the types of issues undertaken and the percentage of startup projects in which each matter was addressed.

Table 1: Legal Issues Faced by Tech Module Startups by Category

Category	Issue Type	Number of Startups with Issue	Percentage of Startups with Issue (out of 42)
General Corporate Formation	Entity formation	22	52%
	Equity division	7	17%
	Cap tables	6	14%
	Stock purchase agreement	5	12%
	Simple Agreement for Future Equity and convertible notes (SAFE)	1	2%
	Asset purchase agreement	1	2%
	Stock option plan	1	2%
	Advisor agreement	1	2%
	<i>Total startups facing at least one issue in this category</i>	25	60%
Contracts	Employee/Independent contractor contracts	15	36%
	Vendor contracts	8	19%
	Customer contracts	8	19%
	Licensing agreements	5	12%
	Nondisclosure agreements	2	5%
	Other contracts	2	5%
	Reseller agreement	1	2%
	<i>Total startups facing at least one issue in this category</i>	24	57%
Nonpatent Intellectual Property	Terms of service	21	50%
	Privacy policy	14	33%
	Trademark	9	21%
	Copyright	4	10%
	<i>Total startups facing at least one issue in this category</i>	27	64%
Regulatory Analysis	<i>Any type</i>	8	19%
Research ⁷	<i>Any type</i>	4	10%
Miscellaneous (e.g. tax)	<i>Any type</i>	5	12%

Together, the attorney-student groups identified 150 distinct issues that they addressed with forty-two startup clients in the Tech Module, for an average of more than three and a half matters per startup. Most issues—133 of 150 or 89%—can be sorted under one of three general categories: general corporate formation, contracts,

⁷ “Research” includes analyzing and comparing state and federal laws, preparing memoranda based on these comparisons, and presenting the research results to clients.

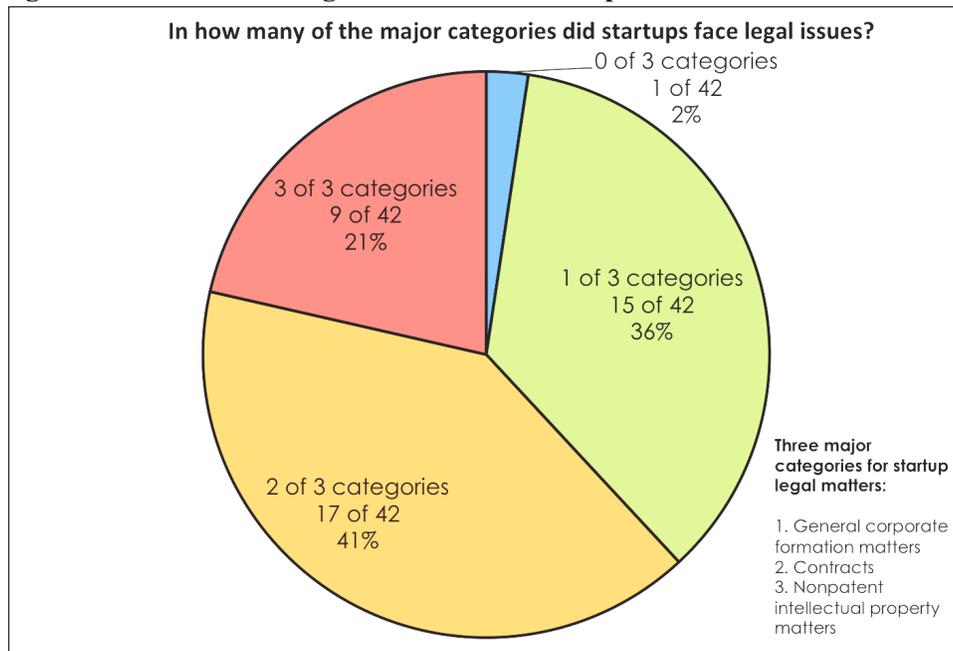
or nonpatent intellectual property issues. For each of these categories, roughly 60% of the total number of startups needed assistance with one or more specific matters in that category. And within these categories, there were dominant issues for which a large number of startups needed assistance. More than half of all startups in the Tech Module were assisted with entity formation, and half received help with terms of service. About a third dealt with issues related to privacy policies and employee or contractor contracts.

Overall, there was a nearly even distribution of issues across the three identified categories. Table 2 calculates the number of issues handled in each broad category and the percentage of total issues that fit within each category.

Table 2: Legal Issues Handled for Tech Module Startups by Category

Category	Number of Issues	Percentage of Total Issues (out of 150)
General corporate formation	44	29%
Contracts	41	27%
Nonpatent intellectual property	49	33%

Figure 1: Number of Categories in Which Startups Faced Issues



Further, a majority of startups faced legal matters in multiple categories. Figure 1 visually represents the broad categories in which startup clients faced legal issues. Sixty-two percent of startups faced legal issues in two or more of the major categories, while only one startup did not receive assistance with any issue falling

into one of the three groups.⁸ Considering the even distribution of matters across categories and the fact that most startups faced issues in multiple categories, our results indicate that our participating tech startups deal with wide-ranging yet similar pressing legal needs: establishing the formal structure of their company, building their staff and relationships with other businesses, and protecting their rights and assets.

It is worth clarifying that the data on legal matters does not encompass all legal needs that might have impacted our startups during their relationship with the Startup Legal Garage. Instead, they represent the most pressing legal issues confronting the company, as determined by our supervising attorneys. This system should give our findings more explanatory power. Specifically, when tasked with isolating important issues given limited time and resources for pro bono work—not to mention the short thirteen-week duration of a Startup Legal Garage project—our attorneys from a wide variety of firms generally selected similar matters for their projects.⁹

Our findings are based on results from only one year's worth of survey data. Data collection is ongoing, as the Startup Legal Garage continues to serve new cohorts of startups, and we hope to add to and sharpen our findings as future semesters of the program are completed.

V. ANALYSIS

A. *Difficulty of Funding Legal Services*

Our results show that most startups will run into similar legal needs at an early point in their development, and many of these needs fall under basic categories of corporate and transactional matters. The matters themselves are not particularly surprising—what is notable is the prevalence and urgency of these issues during the early years of startups. Startup Legal Garage participants must have less than \$1 million in outside funding when they enter the program. In fact, among the thirty-seven Tech Module startups that volunteered funding data, the average outside

⁸ This startup needed comprehensive help with regulatory issues.

⁹ We note that the scope of projects in the Startup Legal Garage is necessarily limited by the still-developing ability and expertise of law students. Students are limited in their depth and breadth of knowledge, their speed in producing and executing final products, the amount of mentorship and oversight required from practicing attorneys, and the time demands placed on them as full-time JD candidates with responsibilities in other courses and activities. Therefore, our groups must choose projects both accessible to students and feasible to complete within a semester. This prevents our attorney-student groups from taking on litigation, complex financing deals, or matters in areas such as immigration, tax, or patent law, all of which may weigh heavily on growing startups. We discuss these issues outside the scope of our program, *infra* Part V.D.

funding at time of intake was under \$100,000.¹⁰ From any angle, this is a level of financing far below the current average of \$6 million secured in a Series A round.¹¹ Thus, startups are facing crucial legal needs in multiple categories from the early-seed stages, long before the company receives serious interest from venture capitalists. These needs represent significant, costly obstacles for burgeoning companies to overcome, often during a time when they are restrained by volatile or minimal cash flow. It is from this perspective that our findings should be especially interesting to venture capitalists, incubators, and startups navigating a daunting legal landscape.

As a proxy for the cost burden startups may face in handling their basic legal issues, we examined the potential value of services each startup received from the Startup Legal Garage. We estimate that, in the Tech Module, each of our startup clients receives free legal services worth between \$17,000 and \$23,000 through the Startup Legal Garage.¹² This estimate was developed through student and attorney feedback and program workload expectations, with the monetary value of services calculated using average billing rates for partners, associates, and legal assistants at large law firms.¹³

¹⁰ Many of these companies said they had no outside funding at all. Of the smaller subset of companies that declared having some amount of outside funding, the average funding amount was still under \$200,000.

¹¹ Danielle Morrill, *For Y Combinator Startups, the Average Series A Round in 2014 Is 5X Larger Than in 2008*, MATTERMARK (June 26, 2014), <https://mattermark.com/y-combinator-series-a-average-round-size/> [<https://perma.cc/56PS-99J3>].

¹² The freedom-to-operate analyses performed by the Biotech Module generally are more costly than the work estimated in the Tech Module.

¹³ See Katelyn Polantz, *Billing Rates Rise, Discounts Abound*, NAT'L L.J. (Jan. 5, 2015), <http://www.nationallawjournal.com/id=1202713809557/Billing-Rates-Rise-Discounts-Abound?slreturn=20160411152640> [<https://perma.cc/N74V-23MD>] (offering average billing rates for partners and associates); NAT'L ASS'N OF LEGAL ASSISTANTS-PARALEGALS, 2015 NATIONAL UTILIZATION AND COMPENSATION SURVEY REPORT 3 (2015), <http://www.nala.org/Upload/file/PDF-Files/News-Articles/15SEC3.pdf> [<https://perma.cc/S4EM-9KSH>] (using the 2014 rate for paralegals and legal assistants in Region 7, which includes California). Our range for the value of Startup Legal Garage services is by necessity an inexact estimate. First, the time spent on a Startup Legal Garage project is not an accurate reflection of the time a first-year associate would actually spend on a project—in fact, we use an average billing rate for paralegals and legal assistants to value the time of Startup Legal Garage students. Second, our mentoring attorneys spend time working on the volunteer projects for startups, but they also spend valuable time mentoring and teaching students. These hours are not included in our estimate. Overall, we are confident that the *order of magnitude* of our \$17,000–\$23,000 range is a reasonable estimate. In fact, if we were to “bill” our students as first-year associates or expand the number of hours given by our supervising attorneys, our value estimates would be much higher. Regardless, the overarching point still stands: startups with minimal resources are facing tens of thousands of dollars in legal costs to properly organize and secure their company.

B. Necessity of Early Legal Advice

Considering many of our startups had no outside funding at all, relying solely on “sweat equity” and bootstrapping for cash flow, and numerous others had under \$50,000 in funding, even these basic legal needs represent a substantial and costly obstacle for promising companies to overcome. Spending \$20,000 to resolve legal issues when a company has just a few months of runway is infeasible and impractical. Yet a failure to address these issues properly may quickly lead to trouble, especially when contract, ownership, and liability issues inevitably arise. Indeed, basic legal issues such as incorporation will need to be addressed before outside funding becomes available. Venture capitalists and other funders may be deterred when legal work has not been performed or when it has been performed improperly.¹⁴ Founders are thus mired in an insoluble tradeoff between short- and long-term prosperity—a company’s long-term health would benefit from early spending on quality legal work, but this expenditure is impossible when the company faces a budget constraint and the urgent short-term goal of remaining solvent.

As a result, many young companies without access to incubators that provide customized legal services or programs like the Startup Legal Garage told us that they turn to online legal service companies such as LegalZoom and Rocket Lawyer to obtain forms and complete essential legal tasks such as incorporation and employment contracts. While these services may offer templates and a starting point for companies, they are unlikely to be sufficient for a startup company’s more sophisticated needs, such as creating stock purchase agreements, issuing securities, and protecting intellectual property. They also do not specialize in providing advice as to *what* legal matters need to be resolved, although some services do claim to provide access to attorneys online.¹⁵ Finally, do-it-yourself legal tools create the risk that founders will get it wrong, particularly given the intense pace and broad range of demands characteristic of startup companies.

Even “simpler” issues such as incorporation and basic contracts are often fraught with nuance depending on a company’s circumstances. Once a startup finally retains a lawyer, both attorneys and founders frequently speak of having to “undo” and “redo” the thin legal frameworks the company had quickly created using online tools.¹⁶ In their intake applications for the Startup Legal Garage, numerous startups described their legal needs as including revisions to terms of service agreements, changes in incorporation status, and other modifications and updates to existing frameworks and filings. Online forms often ask users to answer questions about their business and their desired corporate structure with little context or background as to what an appropriate choice might be for their company.¹⁷ It is thus easy to provide

¹⁴ See ROYCE, *supra* note 2.

¹⁵ LEGALZOOM, <http://www.legalzoom.com> [<https://perma.cc/JU5C-MTMX>] (last visited Mar. 9, 2016).

¹⁶ On file with the author.

¹⁷ LEGALZOOM, *supra* note 15.

wrong or incomplete answers that do not reflect the unique needs or characteristics of a business or recognize important tax and corporate liability consequences.¹⁸

Even among incubators, not all legal services are equally reliable. In addition to online tools, some incubators, accelerators, and coworking spaces offer informational lectures from local attorneys or “office hours” in which companies can ask brief questions from attorneys who agree to sit in for a few hours.¹⁹ Both of these approaches can leave founders feeling that the information is too general or the interactions too brief to address their specific needs.

Finally, some groups have unmoderated forums on which the founders can trade information on how to address legal issues.²⁰ Like the blind leading the blind, however, these forums can exacerbate errors and misunderstandings.

The lack of direction and advice is also problematic when startup founders have little experience navigating legal and regulatory issues. For example, at a roundtable including the U.S. Securities and Exchange Commission (SEC) Commissioner Kara Stein and startup organizations, participants discussed the frequent mistakes that early-stage companies make in failing to follow SEC rules for soliciting investments.²¹ In fact, we find that early-stage startups generally do not accurately foresee all of their legal needs. Using our survey data, we examined how well the matters actually handled for startups matched with what they identified as their pressing legal needs in their intake applications. Of the 150 legal matters handled for Tech Module startups, only sixty-seven of these needs were originally identified by the startups, meaning that only 45% of issues were acknowledged by companies at the time of application. In all, 71% of startups received assistance with issues not listed on their intake application.²² Figure 2 illustrates this finding.

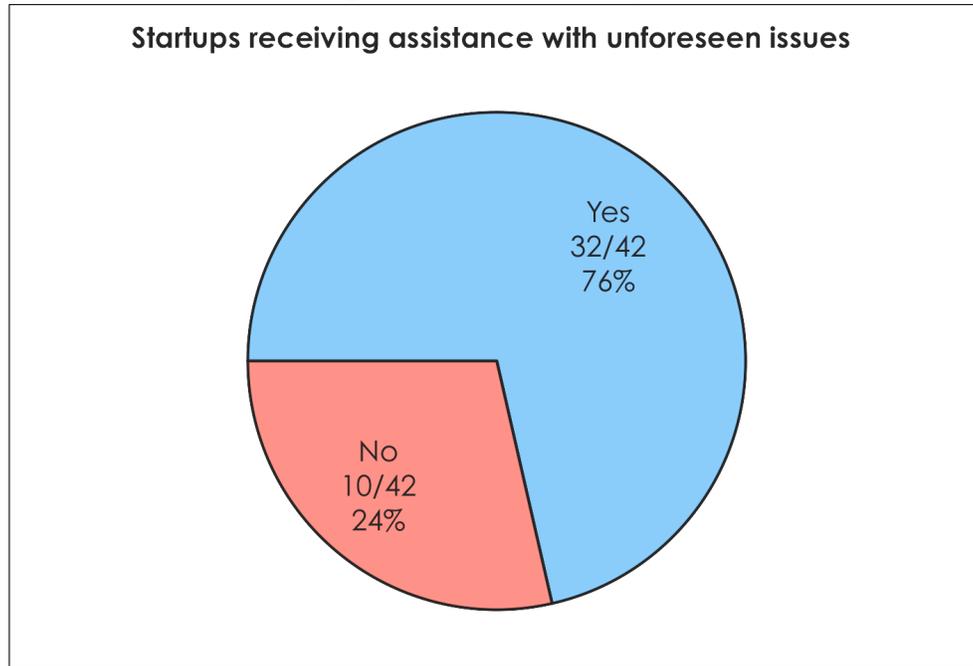
¹⁸ But see this section *infra* for a discussion of how open-source or crowdsourced document repositories aimed at lawyers may provide a solution for this growing legal market.

¹⁹ On file with the author.

²⁰ On file with the author.

²¹ Kara M. Stein, Comm’r, *Supporting Innovation Through the Commission’s Mission to Facilitate Capital Formation*, U.S. SEC. & EXCH. COMM’N (Mar. 5, 2015), <https://www.sec.gov/news/speech/innovation-through-facilitating-capital-formation.html> [<https://perma.cc/3HZ9-XJ6Y>].

²² One potential response to this finding might be to argue that lawyers are suggesting or providing work that is unnecessary or not particularly urgent for a startup. However, since the legal work in this Article is done within the context of the free Startup Legal Garage, we would not expect lawyers to “overprovide” when the work is pro bono. Moreover, the very limited time available for each project means that attorneys are likely to focus on the most important matters that can be fully addressed in the time allotted.

Figure 2: Number of Startups with Unforeseen Legal Issues

C. Disparity of Access to Legal Resources

For most startups, there are few viable solutions to the legal paradox. A select few receive connections to legal assistance through their incubator or accelerator. For example, two Y Combinator partners perform basic legal work for all startups accepted into their funding cycles.²³ As the group explains, it is easier for Y Combinator-funded companies to raise money than it is for random startups, because investors know they are set up correctly.²⁴ Similar models exist elsewhere. Companies accepted into Techstars, an accelerator program, receive some legal fee coverage as part of their membership.²⁵ Other law firms are sponsoring or even creating their own accelerators and incubators.²⁶

Yet these programs are available only to a small number of startups. Along with much of the startup world, they also suffer from imbalances in the gender and minority statuses of their founders. In the Startup Legal Garage's survey of

²³ See Y COMBINATOR, *supra* note 3.

²⁴ *Id.*

²⁵ Techstars Frequently Asked Questions, TECHSTARS, <http://www.techstars.com/faq/> [https://perma.cc/6R7G-WPP4] (last visited Apr. 14, 2016).

²⁶ Kevin Davis, *Law Firms Are Sponsoring Incubators, Cozying Up With Young Entrepreneurs*, A.B.A. JOURNAL (June 1, 2014, 10:20 AM), http://www.abajournal.com/magazine/article/law_firms_are_sponsoring_incubators_cozying_up_with_young_entrepreneurs [https://perma.cc/9QRE-UHKB].

organizations that support startups across the country, including accelerators, incubators, and coworking spaces, more than 60% of these organizations said that women made up less than 33% of their community or founders.²⁷ In the Startup Legal Garage, women-founded teams accounted for 37% of startups participating in the Tech Module program, and 60% of startups in the Tech Module were founded by a woman or minority entrepreneur. From the program's intake applications, we also note that few of our women-led startups were referred to our program by general-focus incubators and accelerators; rather, women-founded startups were far more likely to enter the program through a personal recommendation or through a women-focused organization. With reduced access to organizations that may provide a link to legal services, women- and minority-founded startups may frequently face significant and possibly prohibitive legal costs on their own, further hampering the possibility of their growth and future success.

Moving forward, solutions might include crowdsourced collections of legal documents and templates that can be modified to fit individual circumstances, such as the repository offered by open-source project CommonAccord, where editable templates have been uploaded by major law firms, business associations, and universities, among others.²⁸ Other leading examples include Cooley GO,²⁹ the "KISS" system offered by 500 Startups and Gunderson Dettmer,³⁰ and "simple agreement for future equity" financing documents provided by Y Combinator.³¹ Unlike LegalZoom and Rocket Lawyer, which are aimed directly at consumers and founders, sources like CommonAccord are geared toward attorneys as a way to jumpstart their work without having to create even basic documents from scratch. These sources could conceivably reduce costs for startups while allowing attorneys to spend more time counseling their clients and working on more complex matters. In previous work suggesting a similar "Foundation System" of widely available forms, Jeff Thomas emphasized that these systems should serve as a bridge between clients and attorneys, not as a replacement.³² Indeed, multilayered systems of coordinated legal assistance that include lawyers, students, advocates, and unbundled resources are growing in popularity throughout the profession and lessening the need for constant lawyer input for routine matters.³³

²⁷ See ALICE ARMITAGE & ROBIN FELDMAN, *THE ROLE OF CATALYSTS IN ENTREPRENEURIAL ECOSYSTEMS: A PRELIMINARY STUDY* 8.

²⁸ COMMONACCORD, <http://www.commonaccord.org> [<https://perma.cc/TF22-SQRJ>] (last visited Apr. 11, 2016).

²⁹ COOLEY GO, <https://www.cooleygo.com> [<https://perma.cc/TAE4-8SZE>] (last visited Apr. 11, 2016).

³⁰ *500 Startups Announces 'KISS'*, 500 STARTUPS, <http://www.500.co/kiss/> [<https://perma.cc/C6S5-H7XC>] (last visited Apr. 11, 2016).

³¹ *Startup Documents*, Y COMBINATOR (Feb. 2016), <http://www.ycombinator.com/documents/#safe> [<https://perma.cc/T2JW-MKV2>].

³² Thomas, *supra* note 5, at 468.

³³ This is not to say that lawyers are not an extremely important part of solving legal needs, of course—but ensuring that all startups have access to effective legal assistance will require new unbundled resources to be developed. See Jeanne Charn, *Celebrating the "Null"*

D. Other Unmet Legal Needs

The Startup Legal Garage has provided over one million dollars of free legal services to nearly one hundred early-stage startups. Despite the success of the program, its focus necessarily limits the universe of legal matters that can be addressed by our attorney-student groups. While the program aims to assist startups with their pressing legal needs, it is also primarily an experiential program for law students. As discussed above, students are limited in their depth and breadth of knowledge and by the time demands placed on them as full-time students. We also developed the program with the desire to accommodate as many students and startups as possible. Working toward these goals requires regular turnover of students and companies to bring fresh sets of learners and companies into the program. We further recognize lawyers' limited pro bono capacity. With all of these requirements in mind, the projects undertaken by our program must have a foreseeably contained scope. They should be mostly routine matters unlikely to run over the allotted thirteen-week semester, and they should be feasible for students to handle.

We realize, however, that this means that the Startup Legal Garage does not cover some important legal matters. Perhaps the most notable area of legal need is in patent law and its associated litigation. Neither the Tech Module nor the Biotech module handles filing patents. Such work would extend well beyond a semester or even a year.

On the other end of the spectrum, early-stage startups frequently find themselves on the receiving end of threats or lawsuits claiming that the company is infringing another entity's patents. This phenomenon of "patent trolls"—entities whose core activity involves using their patent portfolio to profit through licensing and litigating rather than by creating products or services—is well documented.³⁴ The business model of patent trolls relies on the fact that settling is often more cost-effective for companies than fighting in court, regardless of the merits of the

Finding: Evidence-Based Strategies for Improving Access to Legal Services, 122 YALE L.J. 2206, 2234 (2013) (discussing the possibility that "swaths of problems can be resolved effectively with less or even no lawyer input," allowing "lawyer services [to] be triaged where we have evidence that they are needed and will make a difference").

³⁴ For overviews of the issue, see EXEC. OFFICE OF THE PRESIDENT, PATENT ASSERTION & U.S. INNOVATION 1–2 (2013), http://www.whitehouse.gov/sites/default/files/docs/patent_report.pdf [<https://perma.cc/6SH3-5BJV>]; ADI KAMDAR ET AL., ELEC. FRONTIER FOUND., DEFEND INNOVATION: HOW TO FIX OUR BROKEN PATENT SYSTEM 1–2 (2015), https://www.eff.org/files/2015/02/24/eff-defend-innovation_0.pdf [<https://perma.cc/AD32-7BTP>]; Colleen Chien, *Startups and Patent Trolls*, 17 STAN. TECH. L. REV. 461, 461 (2014) (focusing specifically on the interactions between patent trolls and startups); Robin Feldman, *Patent Demands & Startup Companies: The View from the Venture Capital Community*, 16 YALE J.L. & TECH. 236, 238–42 (2014).

infringement claims.³⁵ Further, early-stage startups' generally minimal cash flow means that extended, costly litigation is especially risky. The resulting economic incentives make startups a particularly attractive target for patent trolls.

In fact, research has shown that large majorities of companies in the portfolios of venture capitalists surveyed have received patent demands, which can include licensing demands, threats of litigation, or actual lawsuits.³⁶ Colleen Chien has also found that companies with less than \$10 million in revenue make up more than half of defendants in patent troll lawsuits, a group of companies likely to include most of our Startup Legal Garage companies.³⁷ Patent trolls may also take advantage of a startup's vulnerabilities when it is seeking funding by pursuing a company for settlements and licenses as it approaches an initial public offering.³⁸ More so than for large companies, startups report that patent demands have had significant operational impacts on their business, including product changes, market exits, or delays in meeting milestones.³⁹ Beyond these institutional harms, patent demands may also have a substantial impact on a startup's ability to secure investment. In a survey of venture capitalists, Feldman found that all respondents (100%) could be deterred from investing in a company with an outstanding patent demand, with 48% calling patent demands a major deterrent.⁴⁰

When even settling a patent lawsuit costs in the range of \$340,000 or more,⁴¹ it becomes clear how just one patent demand could have a devastating effect on an early-stage startup. The costs of patent litigation can be magnitudes higher than basic legal costs for startup formation, which are already burdensome for startups. Thus, startups also require reliable, affordable assistance when they receive patent demands, both in tackling potential litigation and in reviewing documents with lawyers to know when baseless threats can be ignored or reported, preventing unnecessary settlements and unwise action.⁴²

Another emerging legal issue for startups is the labor and immigration challenges involved in keeping their foreign employees in the United States. Limited

³⁵ See EXEC. OFFICE OF THE PRESIDENT, *supra* note 34, at 5; KAMDAR ET AL., *supra* note 34, at 9–14; Chien, *supra* note 34, at 467–68; Feldman, *supra* note 34, at 239–40.

³⁶ COLLEEN V. CHIEN, NEW AM. FOUND., PATENT ASSERTION & STARTUP INNOVATION 10–11, fig.1 (2013), <http://ssrn.com/abstract=2321340> [<https://perma.cc/MM77-LJQK>]; Feldman, *supra* note 34, at 263–65.

³⁷ Chien, *supra* note 34, at 471.

³⁸ Robin Feldman & Evan Frondorf, *Patent Demands and Initial Public Offerings*, 19 STAN. TECH. L. REV. 53 (2015), <http://ssrn.com/abstract=2591648> [<https://perma.cc/5TTT-YQGM>].

³⁹ Chien, *supra* note 34, at 475–76, 476 tbl.2.

⁴⁰ Feldman, *supra* note 34, at 280.

⁴¹ Chien, *supra* note 34, at 473 tbl.1.

⁴² Of course, it is possible that a startup could receive legitimate patent demands, or demands from a product company that would not be classified as a “patent troll.” Legitimate patent assertions do occur, and startups, even if well meaning, are capable of infringement. Yet, even in these cases, startups should still be entitled to an affordable defense and routes to a reasonable legal resolution.

visas restrict the number of talented workers who can remain in the United States,⁴³ and the application process is strenuous, costly, and complex for both companies and their employees.⁴⁴

Making it to the United States and beginning a startup career is comparatively easy. Enterprising foreign nationals come to the United States for college under a student visa.⁴⁵ Once they graduate, they can receive an “Optional Practical Training” work permit allowing them to work in the United States for one to three years depending on their area of study.⁴⁶ But once the added “training time” runs out, foreign employees find themselves with minimal options that are open to a select few successful applicants due to the demand for and limited supply of H-1B visas.⁴⁷

The most common additional employment visa is an H-1B, which allows highly skilled foreign workers—such as “scientists, engineers, or computer programmers,”⁴⁸ but also including many other occupations requiring a bachelor’s degree⁴⁹—to work for a sponsoring company in the United States for up to three years, with extensions possible.⁵⁰ A company must submit a detailed application sponsoring the applicant for a visa, and even if the application is acceptable, the

⁴³ Miriam Jordan, *Demand for Skilled-Worker Visas Exceeds Annual Supply*, WALL STREET J. (Apr. 7, 2015, 8:11 PM), <http://www.wsj.com/articles/u-s-demand-for-skilled-worker-visas-exceeds-annual-supply-1428431798> (on file with the Utah Law Review).

⁴⁴ *Understanding H-1B Requirements*, U.S. CITIZENSHIP & IMMIGR. SERVS., <http://www.uscis.gov/node/39951> [<https://perma.cc/JDY2-QGBM>] (last visited June 25, 2016); see also Matthew Faustman, *Answer to: How Does a Company Sponsor H1B Visas?*, FORBES TECH (Apr. 7, 2014, 11:01 AM), <http://www.forbes.com/sites/quora/2014/04/07/how-does-a-company-sponsor-h1b-visas/#21d2a0f7377d> [<https://perma.cc/Y25D-5UJY>].

⁴⁵ See *Student and Exchange Visitor Information System*, U.S. IMMIGRATION & CUSTOMS ENFORCEMENT, <https://www.ice.gov/sites/default/files/documents/Report/2015/sevis-bythenumbers-dec15.pdf> [<https://perma.cc/U3T4-2ZRP>] (last visited Mar. 9, 2016) (demonstrating the procedure by which students obtain a student visa).

⁴⁶ *Understanding F-1 OPT Requirements*, U.S. CITIZENSHIP & IMMIGR. SERVS., <http://www.uscis.gov/eir/visa-guide/f-1-opt-optional-practical-training/understanding-f-1-opt-requirements> [<https://perma.cc/F8Q3-TR94>] (last visited June 30, 2015) (describing the story of one immigrant entrepreneur facing visa issues); see also Aaron Sankin, *How U.S. Immigration Laws Push American Startups Out of America*, DAILY DOT (Apr. 9, 2015, 4:28 PM), <http://www.dailydot.com/politics/let-pj-stay-us-immigration-h1-b-visa/> [<https://perma.cc/FRD6-ACFW>].

⁴⁷ *UCSIS Reaches FY 2016 H-1B Cap*, U.S. CITIZENSHIP & IMMIGR. SERVS. (Apr. 7, 2015), <https://www.uscis.gov/news/news-releases/uscis-reaches-fy-2016-h-1b-cap> [<https://perma.cc/9H38-KPFL>] (last visited Mar. 9, 2016).

⁴⁸ *H-1B Fiscal Year (FY) 2017 Cap Season*, U.S. CITIZENSHIP & IMMIGR. SERVS., <http://www.uscis.gov/working-united-states/temporary-workers/h-1b-specialty-occupations-and-fashion-models/h-1b-fiscal-year-fy-2017-cap-season> [<https://perma.cc/3MPK-HMWZ>] (last updated Apr. 7, 2016).

⁴⁹ *Understanding H-1B Requirements*, *supra* note 44.

⁵⁰ *Entrepreneur Visa Guide*, U.S. CITIZENSHIP & IMMIGR. SERVS., <https://www.uscis.gov/eir/visa-guide/entrepreneur-visa-guide> [<https://perma.cc/A76T-QC5B>] (last visited Apr. 4, 2016).

number of applicants far exceeds the number of available visas.⁵¹ U.S. companies submitted 233,000 applications for H-1Bs during the five-day 2015 application period for only 85,000 spots, and “winning” applicants were decided by lottery.⁵² Applicants and their sponsoring company could fully comply with all instructions, and yet random chance frequently decides whether a highly skilled worker will face deportation.

The requirements present even more difficulties for early-stage startups. Application filing fees can run in the thousands of dollars,⁵³ and extensive attorney assistance will almost always be needed to help the startup meet the requirements imposed by the U.S. Citizenship and Immigration Services (USCIS). USCIS requires sponsoring companies and applicants to prove that the employee has a legitimate relationship with the employer; provide detailed evidence that the job is in a specialty occupation and that the occupation is related to the applicant’s degree; and show that the employee will receive a wage at least as high as the prevailing wage for the occupation, which can depend on numerous factors, including geographic location.⁵⁴

This is an elaborate showing of fact, and one that can be particularly onerous for small startups with just a few employees. Since applications must demonstrate a clear employer-employee relationship, self-employed startup founders can find it challenging to navigate this requirement when they are their own employer.⁵⁵ USCIS suggests providing documents proving the existence of a board of directors or shareholders that have the power to “control the terms and conditions of your employment” to meet this requirement,⁵⁶ but this may *still* not solve the problem for many early-stage companies. Other, less popular visas require more demanding applications and are even more selective.⁵⁷

Immigration policy issues aside—for example, whether the lack of visas for skilled workers is an “unmet legal need” of startups—the cost and burden of meeting

⁵¹ See Jordan, *supra* note 43.

⁵² Sara Ashley O’Brien, *High-Skilled Visa Applicants Hit Record High*, CNN MONEY (Apr. 13, 2015, 6:28 PM), <http://money.cnn.com/2015/04/13/technology/h1b-cap-visa/> (on file with the Utah Law Review).

⁵³ *H-1B Fiscal Year (FY) 2017 Cap Season*, *supra* note 48.

⁵⁴ *Understanding H-1B Requirements*, *supra* note 44.

⁵⁵ See Sankin, *supra* note 46.

⁵⁶ *Understanding H-1B Requirements*, *supra* note 44.

⁵⁷ For example, an “O-1A” visa is available for those with “extraordinary ability in [their] field.” *Understanding O-1A Requirements*, U.S. CITIZENSHIP & IMMIGR. SERVS., <http://www.uscis.gov/eir/visa-guide/o-1a-extraordinary-ability-and-achievement/understanding-o-1a-requirements> [<https://perma.cc/7ECY-8JJA>] (last visited May 21, 2016). While those applicants with an international award on the same tier as a Nobel Prize are lucky enough to be automatically eligible for an O-1A, all other potential applicants must meet a number of criteria from a list, including evidence of top-level scholarly publications (including citation counts and letters testifying to the importance of the articles) or evidence of a significant contribution in the field (including documentary evidence in the mass media, website usage and traffic data, and even contracts or licenses demonstrating that the applicant’s contribution is being used in the field). See *id.*

the visa application requirements is problematic for early-stage startups, notwithstanding the damage that could occur if an application is unsuccessful. Even “alternative” providers such as UpCounsel, which connects clients to attorneys online to handle specific one-off matters, say that the full cost of an H-1B application, including filing fees and the use of UpCounsel, is between \$2,500 and \$5,000 per applicant.⁵⁸ This is a very real cost for many startups, many of which may have at least one employee requiring an H-1B application.⁵⁹ Immigrants founded 28% of American businesses started in 2011,⁶⁰ and 75% of the top fifty venture-backed companies have at least one foreign-born member as part of their core corporate team.⁶¹ Thus, startups are likely to face considerable legal costs—on top of the capital needed for basic foundational work—within a few years of their establishment.⁶²

VI. CONCLUSION

Our survey results demonstrate that startup companies are exposed to a wide variety of legal needs from an early stage: when attorneys associated with the Startup Legal Garage were asked to handle a company’s most pressing legal needs, the average startup received assistance with over three distinct legal matters over the course of a thirteen-week academic semester. These issues often spanned multiple categories. Although matters frequently touched on a variety of topics within companies, strong similarities emerged in the types of issues faced by all startups in our sample. Almost 90% of the legal matters addressed by Startup Legal Garage teams fell within the categories of general corporate formation, contracts, and nonpatent intellectual property.

We also discovered that startups generally had difficulty identifying their most pressing legal needs. Startups identified fewer than half of the issues eventually addressed through the Startup Legal Garage, and over 70% of companies received assistance with at least one issue not listed on their intake application. These findings

⁵⁸ Matthew Faustman, *How Does A Company Sponsor H-1B Visas?*, FORBES: TECH (Apr. 7, 2014, 11:01 AM), <http://www.forbes.com/sites/quora/2014/04/07/how-does-a-company-sponsor-h1b-visas/> (on file with the Utah Law Review).

⁵⁹ See *id.*; see also ROBERT W. FAIRLIE, P’SHP FOR A NEW AM. ECON., OPEN FOR BUSINESS: HOW IMMIGRANTS ARE DRIVING SMALL BUSINESS CREATION IN THE UNITED STATES 6 (2012), <http://www.renewoureconomy.org/sites/all/themes/pnae/openforbusiness.pdf> [<https://perma.cc/PZ8A-WP86>] (noting that “immigrant entrepreneurs are playing an increasingly important role in new-business creation across the United States . . .”).

⁶⁰ FAIRLIE, *supra* note 59.

⁶¹ P’SHP FOR A NEW AM. ECON. & P’SHP FOR N.Y.C., NOT COMING TO AMERICA: WHY THE U.S. IS FALLING BEHIND IN THE GLOBAL RACE FOR TALENT 6 (2012), <http://www.renewoureconomy.org/sites/all/themes/pnae/not-coming-to-america.pdf> [<https://perma.cc/W8G4-7ZKV>].

⁶² See Faustman, *supra* note 58. Particularly “disruptive” companies—such as startups focusing on Bitcoin, crowdfunding, or the sharing economy—might see their costs climb even higher as they face research and litigation expenses as part of their regulatory battles.

indicate the importance of working with a skilled attorney for both comprehensively handling legal issues and identifying which issues need attention.

Most importantly, we find that addressing legal needs, while necessary, presents a costly burden for emerging companies. As a proxy for the expense of ground-level legal work for a startup, we estimate that Startup Legal Garage services are worth between \$17,000 and \$23,000 on average. Considering that the startups in our sample typically have limited outside funding, these costs represent an enormous and exclusionary obstacle to growth. This is especially concerning given that there are currently few high-quality resources for startups to inexpensively address their legal needs.

Stakeholders in the startup ecosystem have a clear challenge: to foster innovation, we must find solutions to provide effective, affordable legal services on a large scale to early-stage companies from all backgrounds, while ensuring that companies have the opportunity to receive individualized and accurate advice. Otherwise, legal issues will continue to be a strong impediment to responsible and sustainable startup formation.