

Start-up Atlas
Legal Insider: What Start-ups Must Know
HKTDC Entrepreneur Day 20 May 2017

Grow Smart, Play Smart:
Tips to Attract Investment
初創成長：吸引創投新攻略

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Partner

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- **Asia Pacific Technology, Media and Telecommunications Practice and PE/VC covering 22 countries**
- Computer science background and in-house experience at Fortune 100 technology companies with regional responsibilities
- Worked on many technology, PE and VC projects in Asia Pacific over the past 20 years, from business plan reviews, fund raising, land acquisition, technology licensing, power contracts, construction contracts, outsourcing, competition laws drafting and clearance, submarine cable networks, satellite transponder leases, spectrum auctions, machine to machine issues, Cloud projects, Apps, peer-to-peer networks, on-net/off-net issues, interconnection issues, government licensing liberalization, environmental law issues, mergers and acquisitions and beyond
- AsiaLaw Leading Lawyers
- The International Who's Who of Regulatory Communications Lawyers
- International Law Office (ILO) Client Choice Award
- Law Society Distinguished Pro Bono Award and Community Services Award
- Law Society Council Member, Vice Chairman of Technology Committee
- Advises Countries, SOEs operators, NGOs, financiers, manufacturers
- Honorary Legal Advisor to Hong Kong Association of Interactive Marketing, Hong Kong Internet Service Providers Association, Hong Kong Information Technology Federation, e-Learning Consortium
- HKUST Council Member
- Chairman and member on various Government panel and appeal boards.

Topics to be covered

Management of Risks

Why do startups fail?

Why do startups succeed?

- Pokémon Go
- Uber
- Spotify
- Airbnb
- Instagram

Valuation

- **Definition**

- Management of purposeful activities towards the achievement of individual or organizational goals
- The process involved with identifying, analyzing and responding to risk. It includes maximizing the results of positive events and minimizing the consequences of negative events.

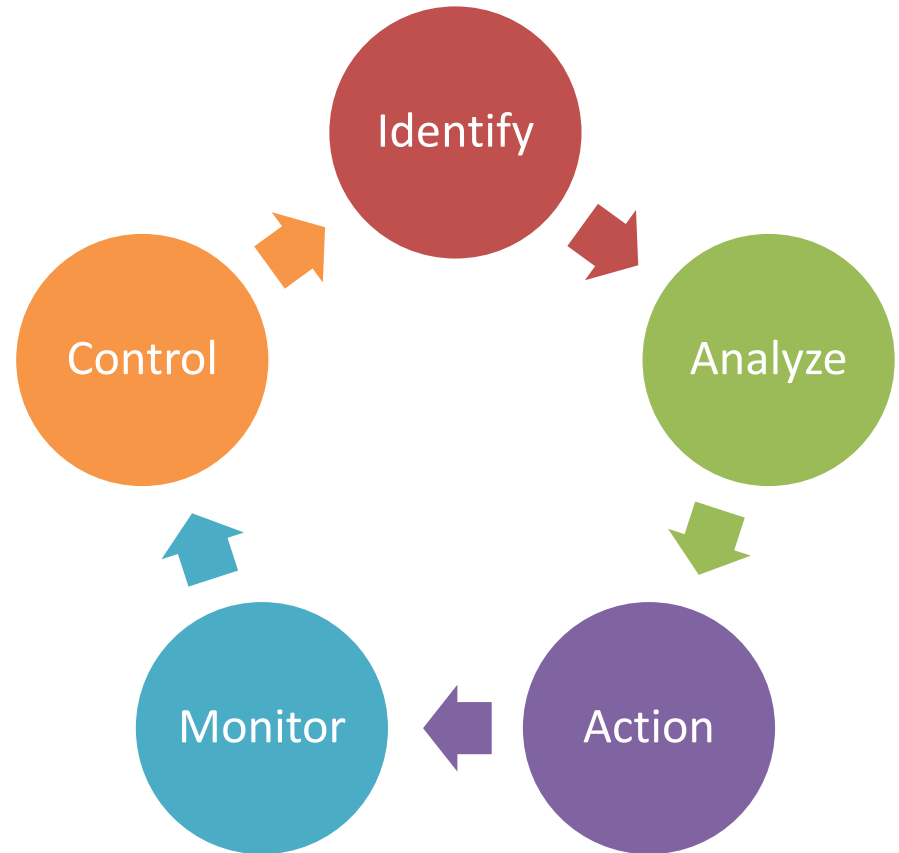
- **Why manage risk?**

- Reduce issues by 90%
- More information and planning



Six risk management process

- Risk Management Planning
- Risk Identification
- Qualitative Risk Analysis
- Quantitative Risk Analysis
- Risk Response Planning
- Risk Monitoring and Control



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Valuation

Why do startups fail?

1. Failure to identify market need
2. Pricing/Cost issues
3. Not the right team
4. Faulty business model
5. No financing or investor interest
6. Legal challenges

- Meant to be the clean alternative between walking and driving
- \$125 million total funding
- Never really caught on, bicycles are easier and cheaper
- Acquired by Summit Strategic Partners



Topics to be covered

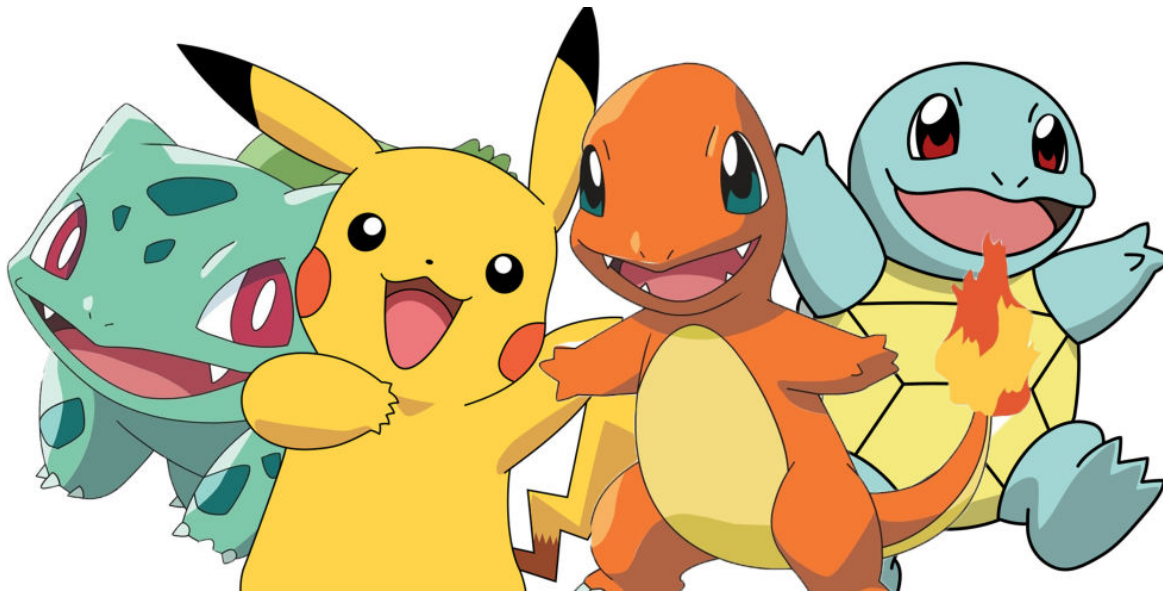
Management of Risks

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History of Pokémon

- Founder: Satoshi Tajiri
- Why was Pokémon set up?





Pokémon Go Terms and Conditions

c. Information Related to Use of the Services.

Our servers automatically record certain information about how a person uses our Services (we refer to this information as “**Log Data**”), including both Account holders and non-Account holders (either, a “**User**”). Log Data may include information such as a User’s Internet Protocol (IP) address, user agent, browser type, operating system, the web page that a User was visiting before accessing our Services, the pages or features of our Services to which a User browsed and the time spent on those pages or features, search terms, the links on our Services that a User clicked on, and other statistics. We use Log Data to administer the Services and we analyze (and may engage third parties to analyze) Log Data to improve, customize, and enhance our Services by expanding their features and functionality and tailoring them to our Users’ needs and preferences. We may use a person’s Log Data and other information to generate aggregate, non-identifying information about how our Services are used and use such aggregated information to understand and improve our Services and to administer use of the Services. If we engage a third party to analyze the Log Data, we will ensure that such third party is bound by contractual terms requiring it to process such Log Data in accordance with relevant European data protection laws (including, without limitation, the Data Protection Directive).

b. Mobile Device.

When you (or your child or your authorized child) sends when you (or your child or your authorized child) uses our Services, like a device’s operating system of the device, as well as information about your use of our Services while using our Services, we use this information to improve and personalize our Services (or your authorized child’s).

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- Founders: Travis Kalanick & Garrett Camp
- Why was Uber set up?



Travis Kalanick



Garrett Camp

Legal Status in Different Jurisdictions

- Banned in France, Germany, Spain, India, Thailand and Taiwan
- Drivers are charged with illegal operation in Korea and the Netherlands
- Two Uber drivers were fined and banned from driving for 12 months in the Hong Kong Kowloon City Magistrates Court
- In March 2017, Uber announced that they will withdraw services in Denmark

Issue 2 - Business Model Structure

- Drivers as independent contractors solves the problem of transfer of risk arising from the use of app
- **Legal Aspect:** Uber will normally not be liable for the crime committed by independent contractors (e.g. drivers)
- Disclaimer? Exclude liability for personal death arising from car accident
- Should ensure the terms and conditions are legally enforceable
- Back-up plan: Uber's global insurance policy provides coverage if a driver's own vehicle insurance is exhausted or does not apply to an incident for any reason.



Issue 3 – Big Data vs Right to Privacy

- The use of personal data:
Personal data (Privacy) Ordinance (Cap. 486)



香港個人資料私隱專員公署
Office of the Privacy Commissioner
for Personal Data, Hong Kong



Issue 4 - Big Data vs Right to Be Forgotten

- “The right to be forgotten” is a concept discussed and put into practice in the European Union and Argentina since 2006.
- Weber, Rolf H: The right to be forgotten “reflects” the claim of an individual to have certain data deleted so that third persons can no longer trace them.”
- In a recent Chinese court ruling, it was ruled that individuals do not have the “right to be forgotten”.





- Founders (2006): Daniel Ek & Martin Lorentzon



Daniel Ek



Martin Lorentzon

Ministry of Sound v Spotify [2013]

- Ministry of Sound (“**MoS**”) sued Spotify for music playlist copyright.
- Spotify users have been creating playlist, which was alleged to be infringing MoS’s copyright.
- What was the outcome? Did MoS bring up a successful claim?



Issue 2 - Business Model Structure

- Spotify searches for other nearby users who installs Spotify and have local versions of the tracks stored in their caches.
- In order to facilitate Spotify's service, they can access data from users' caches, hence would it be a breach of Person Data (Privacy) Ordinance (Cap 486)?
- Disclaimer? Exclude liability?

Issue 3 - Business Model Structure

- Shareholder Agreements
- Spotify allocates its shares to a number of record companies
- Why? Protective Measures? Avoid Risk Transfer?



WARNER MUSIC GROUP



UNIVERSAL MUSIC GROUP



- Two ways to open an account in Spotify
 - Sign up with your Facebook account
 - Sign up with your email address, by inputting personal details
- Spotify Premium requires the user's credit card details
- Potential breach in right to privacy?
- What do you think?





The Making of Airbnb

- Founders (2008): Brian Chesky, Joe Gebbia & Nathan Blecharczyk
- <https://youtu.be/axqh6SJ0O0c>



Brian Chesky



Joe Gebbia



Nathan Blecharczyk



Different Legal Requirements in various countries

- **Berlin:** short-term rentals that have not received explicit permission from the Berlin Senate are banned.
- **San Francisco:** Airbnb rentals are capped at 90 days and all hosts must register with the city.
- **London:** is more receptive, allowing homeowners to rent out their flat for up to 3 months a year.
- Is Airbnb legal in **Hong Kong**?



Mutual trust between host and guest

and igloos.

services.

Airbnb.

[Learn more](#) about hosting on Airbnb and show your guests they're right where they belong.

A Community Built on Trust



Profiles and Reviews

Hosts and guests get to know each other through detailed profiles, personal reviews, and confirmed verifications.



Trusted Services

Airbnb verifies personal profiles, maintains a smart messaging system so hosts and guests can talk with confidence, and collects and transfers payments securely.



24/7 Customer Support

Our world-class customer support team is ready to help you around the clock, anywhere in the world.

- What if the trust is breached?
- **Legal Aspect:** Can Airbnb be held liable for crimes committed by hosts / guests?
- Disclaimer: “Airbnb does not have an obligation to conduct background or registered sex offender checks on guests and hosts”
 - Is this disclaimer legally enforceable?



Case 1

- Airbnb is currently a defendant in a lawsuit pending in California. Mr Stockton used Airbnb to arrange for a stay and invited Ms Schumacher to stay there with him.
- Ms Schumacher preferred to sleep and walk naked.
- Ms Schumacher discovered a remote controlled camera that captured the activity in the hallway.
- Is Airbnb negligent for failing to properly screen participants?



Case 2

- Some Australian customers using Airbnb are worried about their privacy being breached, with the company confirming it shares people's personal information for "**marketing purposes**".
- The Australian Privacy Principles (APPs) (2014):
 - APP1: “to ensure that APP entities manage personal information in an **open and transparent** way’
- Airbnb’s privacy policy: personal information is used for “security reasons”, “internal business purposes” or “product development purposes”





Founders: Kevin Systrom & Mike Krieger (2010)



Kevin Systrom



Mike Krieger

How does Instagram protect themselves?

- Each and every user is required to agree to the terms of use and conditions posted on the platform before gaining access to the services provided by the application.
- Under “Proprietary Rights in Content on Instagram”
Paragraph 1: “Users grant a limited license to Instagram.”
- Instagram does not CLAIM any ownership rights of any Content posted by their users
- Is Risk Transferred to the Users at this stage?

The Instagram API Platform for Consent

Getting Started



Register

We'll assign an OAuth client_id and client_secret for each of your applications.

Authenticate

Ask users to [authenticate](#) and [authorize your application](#) with Instagram.

Start making requests!

Make requests to our [API Endpoints](#) with the users' OAuth credentials.

Obscene and Grossly Inappropriate content?

- “Compensatory Dating”
- According to the Terms and Conditions, Instagram may remove content that are unlawful, obscene, etc.
- But they may have NO OBLIGATION to do so.

Disclosing images for Criminal investigation?

- *Regina v Adeel Khan 2015* (UK case)
- An appeal concerning an Attempted murder investigation.
- The appellant appeals, with picture evidence from Instagram.

Disclose of information for criminal investigations?

HKSAR v Ho Kai Yiu (Hong Kong Case)

- A Fraud case, evidence of fraudulent advertisements were found on Instagram.

Instagram's Position?

- They have no ownership rights of the contents posted on the application?
- Users may use contents, as compliant to the Personal Data Ordinance within Hong Kong jurisdiction.

Defamatory Content?

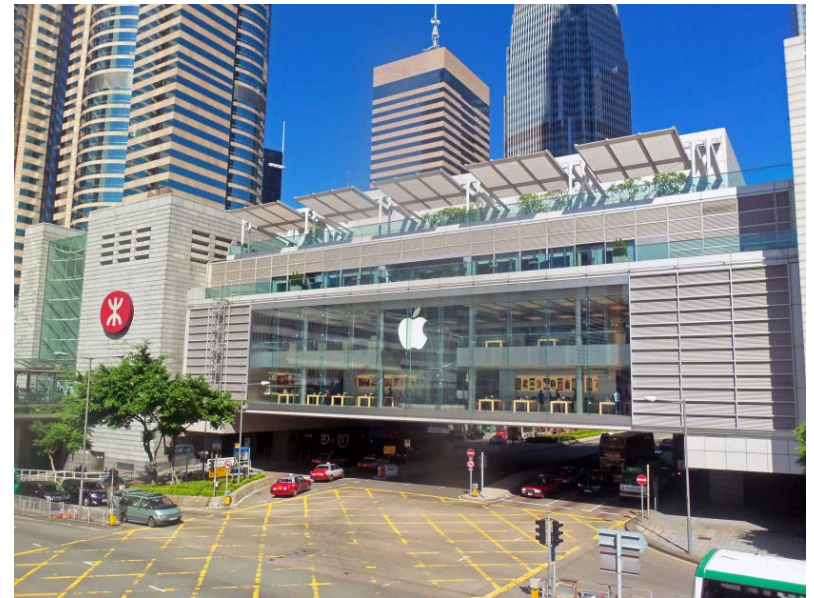
- According to Instagram's Terms of Use, users must not defame people or organizations.
- Instagram "doesn't mediate disputes between people who use our service".
- What if victim is unclear to who actually attacked his or her reputation on Instagram?

- Using technology to make financial systems more efficient
- Disrupting traditional financial services



Feeling gloomy?

- **Apple was a startup!**
- Steve Jobs, Steve Wozniak, Ronald Wayne
- Original start-up cost: The infamous garage where they worked



- Valued May 2017 : market value >US\$800billion Photo Source: wikimedia.org
- More than the value of Walmart, General Electric, Pfizer, and Kraft Heinz combined

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Valuation



Ways to increase start-up valuation

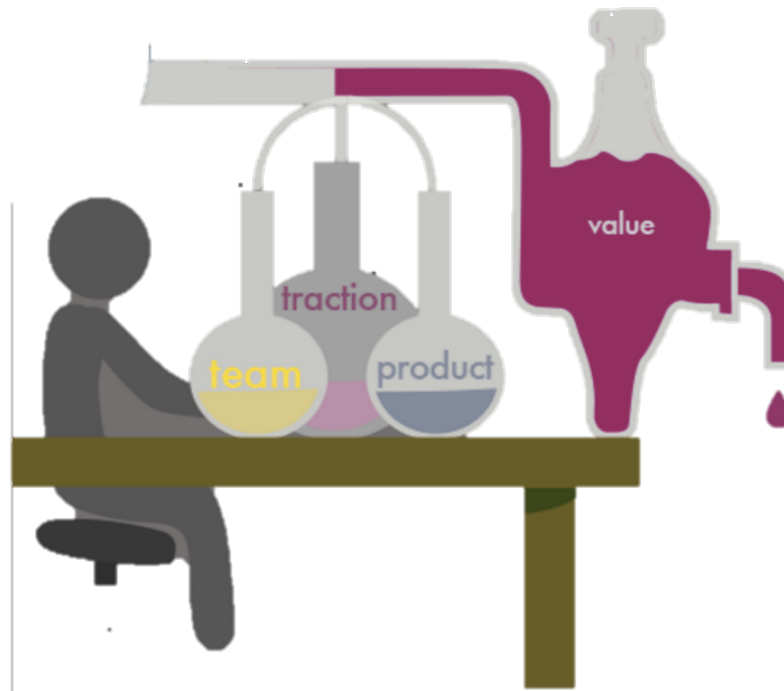
START UP VALUATION

Factors that affect a firm's valuation

Target market size
and growth

Market competition

Entry barrier



To analyze, try to compare:

- Recent financings or exits
- Companies that are similar to you
 - Stage
 - Progress
 - Size
 - Team composition

- Attack **Billion Dollar Market/ Industry**
- Supply and Demand
- Think international

Market sentiment

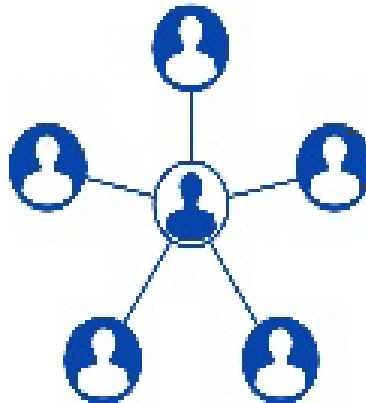
- How hot the space is at any given moment
 - What are the mega-trends emerging in the private equity space?

Barriers to entry

- Raise **high and sustainable barriers to entry**
- Aim to achieve product network effect, i.e. **critical mass** that uses the products and/ services



One user joins Facebook



At five friends, the
user's network value
is 36



An average user
with 130 friends has
a network value of
17,161

Decide who you want on the team:

1. Skills/ expertise
2. Reputation
3. Past startup experience
4. Personalities that fit with the team
5. External advisors and connectors?

Timing of the launch

- What do people need?
- Existing similar products and/ services in the market



**To a large extent,
differentiating factor might be IP:**

- IP assets = valuable
- IP assets = be exploited commercially

Different ways to value IP

- Qualitative methods
- Quantitative methods



Qualitative valuation methods

- Internal IP assets management
- Example: **Patent**
 - rating and scoring patents based on factors
 - e.g. Strength and breadth of patent rights
 - e.g. Legal certainty
 - Classifies patents into 4 basic management tools:
 - » Monopoly = ?
 - » Defensive = ?
 - » License = ?
 - » Joint venture = ?

Quantitative valuation methods (static vs dynamic models)

- Market value of a company LESS net tangible assets
- Three main valuation approaches:
 1. Cost
 2. Market
 3. Income



Market value LESS NTA

- **Market value of company** - to value IP assets of public companies
- $NTA = A - L - I$
- Market capitalisation (C)
- Unidentifiable intangible assets (U) = estimated at 10% of C
- Market valuation of company :
$$C = N + U + \text{IP assets}$$
- **IP assets = C – (N+U)**
$$= 0.9C - N$$

= residual value of company **AFTER** deducting
 - (1) NTA; and
 - (2) Estimate of U

Weaknesses of this approach?

The three valuation approaches

Cost

Market

Income

Based on several economic principles

1. Principle of Substitution
2. Principle of Externality
3. Principles of Functional, Technological and Economical obsolescence
4. Principle of shifts in supply and demand.

- **Advantages?**
- **Disadvantages?**

- Based on **market transactions** involving *comparable* assets
- Requires:
 1. Active market
 2. Sufficient number of similar exchanges
 3. Publicly available price information
- **Problems?**

By way of **future capabilities of obtaining profit**

1. Direct capitalisation

- Measure of economic income for one period is defined and divided by a capitalisation rate

2. Discounted future economic benefits

- Measure of economic income is projected for several time periods in the future
- Projection is converted into a present value by the use of a present value discount rate.

➤ Disadvantage

- Future uncertainty

Methods of Valuation

- Should compare the result by 2 methods for the purpose of challenging the results
- **NO** one universally applicable methodology

Licensing out:

- Do you have the right to license out?

Licensing in:

- Do full patent search
- Find the one you want to license in to your company

- Develop a core story or unique selling proposition
- Identify **target audience**
 - Promote from the target audience' perspective
 - What does this product do for me?



- Growth numbers
- Demonstrating traction

Revenue → user adoption → traffic
→ churn → brand

Cash burn





How to create and hit your milestone?

- Create budget and work backwards to set milestones
- Show thought/accounting behind our milestone projections

Milestones should be quantifiable and associated with a timeline.

– Examples:

- Reach breakeven in 6 months
- Acquire 3 new Fortune 500 company customers in Q2



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Thank you!

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