Dan/Lynne, Since you are gone next week and I am proceeding on moving forward with the new business plan, I thought I would update you on our progress. If you have any feedback, let me know. No decisions need to be made at the moment, since I am in a mostly information gathering mode, but I propose that we incorporate by the second week of September, that we have our new website fully operational by the end of Sept (with all datasets available, etc.) and commercially viable by Oct. 1st. I think these deadlines are feasible.

(1) Our BINC accountant (Dave Peckham, pension fund manager, Santa Barbara Pension Consultants) whom we have had a great relationship for the last 20 years, has been offering some free advice on incorporation (he and his wife stayed at our house for a couple of days, allowing me to pick his brain). He would also be someone I would vote for to deal with TW's taxes and perhaps setting up retirement etc. He is very tight. But we can decide on that later.

Dave recommends an S Corp over an LLC for tax reasons. In an LLC, all income (salary and profit) goes directly to the owner as "salary" and one pays the 15% SS tax on all of it. In an S Corp, we could set our salaries on the lower end (say $50K per year) and we would pay only SS tax on that portion; profits are distributed to the owners (profit distributions, say quarterly, with no SS tax is paid on that amount). I recall doing that in BINC over the years, although not lately since I rarely do BINC work anymore. In addition, there is no difference, liability wise, in an S-Corp vs an LLC.

He also recommended, for financial reasons, to incorporate in California vs Washington. In WA, we would need to pay B&O tax (~3.4%) on GROSS income (not net, which is strange). In CA, the tax rate is 1.5% on Net income. However, corporations in CA pay an annual fee of $800, but that is used to pay tax on any profits (net), which is something on the order of the first $55K; e.g., the tax on the first $55K comes out of the $800 annual fee.

However, Shelley, the attorney I have been talking to about non profit - for profit asset transfer (more on that below) suggested incorporating in Delaware (for liability and other reasons). In particular, she indicated that if we would ever need investors, this would be a strategic move. After I speak with Shelley next week, I may set up a conf call between Dave and Shelley to talk over the issue of state incorporation.

In any event, to start a corporation (and to be seen as a viable corporation in the eyes of a court, in the event of a lawsuit, requires that we put cash into it at the startup, on the order of $5k-10K. We can start to use those funds to purchase equipment etc., but we will need to start at that scale.

(2) I have engaged, via a retainer of $1,000, Steve Gibbons, attorney from Seattle (that Dan and I met a couple of years ago). I gave Steve a webinar about a week ago so he could see what we do and what our potential liabilities are. Apparently there are some, we could get sued for "wrongly" classifying portions of land that would reduce property values. He has proposed liability protection in three ways: i) corporate structure (below), ii) contractual language, and ii) comprehensive general liability insurance.

I have sent Steve the language we already have regarding users of NetMap and our liability; you can find this in the online tech help, under "users agreement". There is also language made available to users of the erosion tools. Steve is going to edit and add to those to make those liability statements more robust, and also we will want similar language for future contracts we engage in.

For corporate structure, Steve highly recommended two companies, an operating company (TerrainWorks) and a "holding company". The holding company "holds" the most important assets of the operating company, and thus, if the operating company is successfully sued and losses its assets, there will be very little assets to loose. And the owners can simply give up the first operating company and begin another company by accessing the assets held in the holding company. However, this requires two corporations at two physical addresses (although if we had an office with separate office spaces, this could work). We can discuss whether this structure is necessary for us, but I suspect in the short term at least, we will go with only the operating company (because of cash flow). If we were to actually ramp up with some serious income, we could then revisit the holding company option.

Steve will be providing me with some contact names for getting an estimate of Comprehensive General Liability Insurance, which may be out of our financial reach, at least initially, but at least we will have that information at hand.

(3) Regarding asset transfer from the non profit to the for profit, we just need to make sure it is legal and effective, and I am engaging Shelley (another attorney from Seattle) to help with that, and I am hoping this will be taken care of with a couple of conversations and perhaps a couple of hours of her time. She has indicated to me that such transfers are fine, but require an independent valuation of assets, so that their fair market value can be determined (and presumably paid for by the for profit entity). However, there are a couple of caveats that may make this painless (but we need the ideas to be legally vetted).

i) ESI, since it must continue to exist at least in the short term (and we may want it to exist, and may even get another board), may not be transferring any assets per se, since it may keep what it has, but as the board, Dan and I may elect to allow another entity (TerrainWorks) to use those assets to enable the increased viability of the NetMap system, via commercialization. The board could go into an agreement with TW specifying ESI's use of IP assets (and databases) for research and educational purposes only, while TW handles the commerical side of things. We could even craft a deal in which TW pays ESI some small percentage of profits (1%, 2% etc.).

ii) NetMap's core programs are open source, thus moving them into another entity (with or without option i) may be seamless and require nothing. In addition, we could discuss the option of making the GUI code also OSL, so that could also be transferred. [We need to become familiar with what OSL means exactly. What code needs to be make available? How much documentation, if any? Are input files included, such as for example in bldgds and add data? How is the code made available? etc etc. I think OSL is a great idea, for all of the reasons Dan has articulated, but on the other hand, we want to make sure that TW becomes viable before anyone takes all of that code and uses it against us, however unlikely.]

Regarding the existing ESI datasets, they could be provided to TW with the goal of making them better, which may require a batch run where we add an additional parameter or two. What is left might only be a couple of old computers and a camera and a field computer, which we could buy outright or rent from ESI.

Along those lines, BINC has put up ~$2500 to upgrade Kevin's fast computer since it experienced a hard drive crash last week. Four new faster hard drives and new memory (148 GB) will be in place. BINC intends to buy that computer from ESI (before the upgrade) for a specified amt soon.

I will be meeting, via phone, with Shelley next week to discuss the options outlined above and to get her legal opinion on the best option. I propose that what ever is decided, that we put that strategy in place by the second to third week of September just following incorporation.

(4) I have engaged two web designers/developers (from Ashland) and have given them a starting fee of $800 (BINC), although the total cost may be in the low $2,000s. The plan is to stay in Drupal and to upgrade it forward two versions. I am working with them on new design and functionality, including ecommerce (ecommerce function yet to be fully defined). Thus I am working on articulating in detail products and services. Our target for completion is end of September. Kevin and I will be responsible for uploading much of the content, including uploading all of the available datasets which likely will be all of WA, OR, ID, western MT, and N CA. Kevin and I have devised a formal plan for support and upgrades, which will be incorporated into the tools and into the website. Along the way, you can weight in on design and function, perhaps when you return from MN.

(5) More on incorporation. From Glenn and from Dave, I have assembled some of their documents on articles of incorporation, bylaws, corporate minutes, shareholders agreement, stock certificates, and shotgun clauses . Unless something unforeseen happens, we will start one corporation probably using Legalzoom (~$300-400). The state of incorporation will be decided in the next 2 weeks.

At this point the parameters are: Lee and Dan are owners (51%/49%, the exact ratios can be revised or even 50-50); there will be a shotgun clause (see definition below); perhaps 2 million shares will be created and distributed between the owners. Issues of salaries, profit distributions, and other business dealings are handled externally to the articles. However, profit distributions are tied directly to the percent ownership and must be distributed accordingly. Varying time commitments within the organization can only be addressed at the salary level. Owners who want to reinvest all or a portion of their distributions back into the S Corporation can do so via loans to the corporation (with interest paid) (this is my understanding so far, based on conversations with the accountant).

(6) At least in the interim, all employees will remain in ESI. Money that comes into TW can be used to pay TW business expenses (as already incurred and as outlined above) and they also can be routed into ESI based on a business agreement (I would like to get Shelley's legal view of this as well, as to the best way to proceed). However, all future potential agency related work (the national LCC proposal, DOD, EPA, non of which has much of a guarantee to actually happen) could be run through TW. In addition, it might be that if we were to obtain NFWF funds for work in AK (webinar at 5pm dealing with that today), that could also potentially be run in TW, which means there could be a shift of personnel into TW sooner rather than later.

Well, that's it, in a large nutshell. I will keep you updated on any important developments.  Lee

PS I suggest that when you return from MN the week of Sept 2nd, and when I have additional information in hand, that we hold a phone conf/webinar to discuss all of the above and so that you can see the final draft product line/business plan/web structure/design, and make comments and adjustments accordingly.

Shotgun clause definition:

***shotgun (exit) clause*** is a [term of art](http://en.wikipedia.org/wiki/Term_of_art), rather than a legal term. It is a specific type of exit provision that may be included in a [shareholders' agreement](http://en.wikipedia.org/wiki/Shareholders%27_agreement), and may often be referred to as a [buy-sell agreement](http://en.wikipedia.org/wiki/Buy-sell_agreement). The shotgun clause allows a shareholder to offer a specific price per share for the other shareholder(s)’ shares; the other shareholder(s) must then either accept the offer or buy the offering shareholder’s shares at that price per share.

 Shotgun clauses are usually recommended for companies where there are two owners with equal shares in the company, roughly equal involvement, and similar financial resources although they are by no means limited to these situations. If the shareholders are not in an equal position and of equal circumstances, then one of them may have no choice but to sell and consequently the other may, through the triggering of the shotgun, work an injustice on the other.