

Tech Startups may be able to avoid costly detours with the help of a legal roadmap

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By **Sarah C. Richmond**

Navigating your way through the legal issues that face a startup can be a daunting experience. Below I have highlighted certain issues that almost every emerging business will encounter as they chart these waters.

Equity

You may have decided how to divide the pie among the founders, but how much equity should you allocate to your employees and advisers? How do you prepare for dilution in the event you eventually need to raise outside funding?

Think ahead to what you expect the company to look like in several years to help you in these early decisions. How many management-level employees will you need to hire? You may not want to set a precedent of giving away too big a percentage to early team members if you'll have to be as generous to future employees. And if you expect to go the venture capital route, plan to give away at least 40 percent of the company just in the first round.

If you plan to be acquired at some point, another way to approach the equity question is to think about what price you hope to get from the buyer. Once you have a number in mind, calculate what you consider to be an appropriate amount for each employee to reap from the sale, work backward, and divide the initial pie accordingly.

Personnel

There are a number of "gotchas" in the hiring and employment process. The first is the classification of an individual as a consultant versus an employee. Employers have financial incentives to classify an individual as a consultant rather than an employee, but this is an area in which to be careful if you want to avoid civil and criminal penalties.

In your offer letters, avoid language that could be construed as a promise of employment for a certain period of time. You want to consistently communicate that the person you are hiring is an "at-will" employee, which will give you the maximum flexibility and protection should you later need to terminate the person's employment. In your interviews and applications, try to avoid questions about the applicant's age, race, religion, sexual orientation, or marital status.

Sign non-competes if it is appropriate in your industry. To be enforceable, non-competes should be signed at the beginning of the relationship, or at least upon an event like a salary raise or promotion. And don't be overreaching. Just because an eager employee may be willing to sign a five-year non-compete doesn't mean that a court will enforce it, and you may end up with nothing at all.

Fundraising

If you're not one of the lucky companies that can bootstrap its business, you have no doubt thought about whom you might know, or could get an introduction to, who could provide your company with the funding to get off the ground. If this is your plan, talk to a lawyer early on to make sure that you sell your stock in compliance with federal and state securities laws.

Failure to do so can expose you and your company to penalties, as well as the right of your investors to get their money back down the road. Although no one is likely to ask for their money back in the good times, if times get difficult, you don't want to give your shareholders any leverage to demand a return of their capital.

Intellectual property

Sometimes in their early days, companies shortcut the protection of their intellectual property in their efforts to save money. However, if you are looking to build value and create barriers to entry for competitors, protecting your company's intellectual property is critical.

Employees and consultants should sign agreements for the assignment of their inventions on Day One with the company.

Without an agreement in place, a consultant who develops software code (or anything else) for a company will own the copyright to the materials he develops, even though the company pays for them.

Protect your trade secrets by signing nondisclosure agreements with all business partners, but be realistic about these documents. They can be difficult to police, so if you don't trust the company you are talking to, think twice before revealing anything too valuable.

Protect your patents, trademarks and copyrights, which are key intellectual property assets of any high tech business. When coming up with your company's product name or logo, do the appropriate research to avoid receiving a letter down the road from the owner of a similar trademark, demanding that you immediately stop all use of the name and pay thousands of dollars in damages.

Talk to a patent attorney early on about filing patent applications if appropriate, as patent rights create significant barriers to entry for competitors but can only be obtained through a registration from the federal government.

Be careful not to infringe any other company's intellectual property rights. Nothing will scare away a potential investor or acquirer faster than the threat of possible intellectual property litigation, where the damages can be enormous, and devastating to the value of the company.

Although you can never fully predict what obstacles will present themselves on your company's road to success, the steps outlined above will help you avoid many of the possible legal landmines.

Sarah C. Richmond is a partner with Boston-based law firm Gesmer Updegrave LLP. She specializes in general corporate and intellectual property legal services for technology companies, and can be reached at sarah.richmond@gesmer.com.