PROTECTING THE COMPANY AND YOURSELF WHEN THERE ARE MULTIPLE CO-FOUNDERS

Created by Elizabeth Resteghini from Morse for Scroobious

This article was created by Elizabeth Resteghini from Morse for the Scroobious community.

Scroobious is increasing diversity in the startup ecosystem by providing the education, tools, and community founders need to create investor-compelling pitch material and a platform to help investors easily find them through data-driven curation. For startup founders who have a story to tell but need help telling it, The Pitch it Plan™, or PiP, is a virtual platform that helps you get your compelling story into an investor-ready format. Unlike googling for hours or paying thousands for a pitch coach, PiP is affordable and approachable through online education and personalized feedback from a human who understands the investor mindset. Our framework has been published, vetted by investors, and has helped founders score meetings, raise rounds, and get into prestigious accelerators. Founders can sign up here or book an intro call to chat.

Combining the best practices of traditional law firms with an inventive approach, Morse's founders created a solid basis for a more modern practice of law. We offer our clients responsive and reliable service, sound and insightful business advice, and reasonable fees. We're dedicated to developing real partnerships with our clients, addressing each client's specific challenges, and delivering effective results tailored to each client's needs. While we have long enjoyed a reputation for special competency in technology ventures, we represent clients of all sizes and industries in all stages of the business life cycle. Our clients include startups, emerging growth entities, established family businesses, and Fortune 1000 companies. Our exceptional business model affords clients access to highly experienced counsel in the areas of M&A, Venture Capital, IP, Employment, Taxation, Privacy, and Litigation.

Having a co-founder or two can be a great way to bring additional ideas and multiple areas of expertise to a new business. While your relationship with your co-founder might work out great for the life of the business, co-founder break-ups happen from time to time. This article examines, from the lens of having multiple founders, tips to protect the company and yourself.

Restricted Stock Vesting Provisions

Founders will typically purchase shares of common stock at the time of incorporation of the company, and as a result they will become stockholders of the company. If there are multiple co-founders it is a prudent approach for each of the co-founder's shares to be subject to restricted stock vesting provisions. By adding a time-based or milestone-based vesting schedule to shares of stock, the shares would vest over a designated period of time or achievement of established goals, and any shares that are unvested could be subject to repurchase by the company upon the occurrence of certain events (such as the co-founder's departure). This helps prevent a situation in which a disgruntled co-founder leaves early on and continues to own a large piece of the company. (Remember that if you put restrictions on stock you will want to consider filing an 83(b) for future beneficial tax treatment).

Restrictions on Transfer in Bylaws

While some companies prefer to freely permit transfers of shares in a secondary purchase and sale amongst its founders and/or investors, if there are multiple co-founders consider adding restrictions on the transfer of shares in the Bylaws. This could help prevent a scenario in which a co-founder leaves, or otherwise decides to sell its ownership stake, and transfers its shares to a third party not involved with the company without ever first offering it to the company or other co-founders. With restrictions on transfer added into the Bylaws, the Bylaws could be drafted in a way to require any proposed transfers of stock to first be offered to the company, and if desired, a company could potentially even add a secondary right for the shares to then be offered to the other co-founders if the company does not decide to purchase the shares. This would add a layer of protection that the company and potentially the other co-founders could have a right of first refusal to purchase any shares from a departing co-founder in order to help keep the stock ownership within the company and its current founders.

Stockholder's Agreement

A Stockholders' Agreement can also be prepared if there are multiple founders. This agreement could contain certain restrictions and rights, such as a restrictions on transfer, an agreed upon composition of the Board of Directors, and drag along provisions for how stockholders would vote in connection with a sale of the company. Sometimes companies who anticipate doing a financing soon after formation decide to forego a Stockholders' Agreement in anticipation of having NVCA-style preferred stock financing agreements (such as a right of first refusal and co-sale agreement, voting agreement and investors' rights agreement) in place which would cover similar topics.

Board of Directors Seats

Oftentimes, in situations where there are multiple founders, some or all of them will want to govern the company as a director on the Board of Directors. Depending on the reason a co-founder leaves a company, you may want to ask them to resign from the Board of Directors especially if their interests no longer align with that of the Company. From time to time, an individual may push back on resigning from the Board of Directors. Fortunately, Delaware General Corporation Law permits removal of directors of a Delaware corporation by the holders of at least a majority of the issued and outstanding shares of stock with or without cause (with a few exceptions). (Keep in mind that from time to time, someone may have a contractual right such as in a voting agreement to elect a director, so you would need to check the terms of the agreement and refer to Section 141 of the Delaware General Corporation Law in such situation).

Employment Agreements

If there are multiple founders, there may be a concern that at some point the other founders may try to push you out of the company. One way to protect yourself would be to put an employment agreement in place in which there could be severance terms that require the company to pay you for a certain number of months if you are terminated without cause or leave for good reason. You could also have the agreement have terms that accelerate some or all of your restricted stock vesting provisions upon the occurrence of being terminated without cause or leaving for good reason. For example, you could have a provision that says that if you are terminated without cause then 25% of your unvested shares shall immediately become vested shares, so that they will no longer be eligible for repurchase by the company. In the employment agreement the founder would also want to make sure they are clearly defining what leaving for good reason or being terminated without cause means. For example, if the other founders say you must work in a different faraway state or reduce your title and responsibilities significantly then that might be something that would constitute you leaving for good reason.

For more information, please contact Elizabeth Resteghini at eresteghini@morse.law.