Social Media Law Update BLOG
Highlighting Legal Issues Regarding Social Media
SHEPPARD MULLIN
SHEPPARD MULLIN RICHTER & HAMPTON LLP
ATTORNEYS AT LAW

# Social Media Law Update

Posted at 2:00 PM on November 16, 2010 by Sheppard Mullin

## *Starting Up the Start-Up: Pre-Incorporation Do's and Don'ts*

*By Riaz Karamali*

The last installment of this blog series discussed when the creators of a new social media venture should take the step of formally incorporating their venture. This post will look at some key questions that often arise prior to incorporation.

**Who's on Board?** Ideas for new companies frequently arise out of informal brainstorming and discussions, and as an idea begins to take shape so does the team that will likely work on it. Before you get too far down the road in setting out the business plan and execution steps, it makes sense for the team to discuss and agree on the commitments and expectations of all participants. Among the issues to be considered are the time commitments and financial contributions of each participant before outside funding is obtained.

**Too Many Chiefs?** There should be a clarity of expectations among the founders with respect to their roles in the venture. It usually makes sense to have agreement on who will be the initial CEO, but try not to commit to VP level and C- level roles for the other participants at this early stage. There can be a tendency to be a bit liberal with the handing out of fancy titles that may not be justified by the participants' resumes and track records. This is usually a mistake, because post-funding, investors are going to want to hire the best possible people for senior management roles, and it would be best if those positions were not already all filled.

**What's the Deal?** While people usually talk about the various percentages or shares of the company each participant will hold, it is important for everyone to understand that these are the initial percentages, and everyone will be subject to dilution as additional team members and investors are brought on board. For this reason, it is usually safer to speak in terms of numbers of shares (usually out of a total hypothetical authorized capital of 10,000,000 or 20,000,000 shares) rather than in terms of percentages. If a participant's proposed percentage of equity is ever put in writing (whether in an email or in an offer letter), it should be specified that this is a percentage of the "initial capitalization" or "initial founders' round".

**Crown Jewels?** Before the proposed business concept is shared with outsiders, the founders should consider filing for patent protection, either in the form of a provisional application or regular application. A patent application can originally be filed solely in the name of the inventor(s) and later assigned to the newly formed company. Although investors will typically refuse to sign non-disclosure agreements, it makes sense to give consideration to whether NDAs should be used with other parties, such as potential partners and potential new team members.

**What If?** Before the participants start acquiring or creating intellectual property rights (whether these be to software, trademarks, domain names or content), there should be a clear understanding as to how these rights

will be distributed or shared in the event that a new company is ultimately not formed or if one or more of the principals parts ways with the core group.

Because of the complexities of some of the issues described above, when there are multiple founders involved and work is beginning in earnest, it often does make sense to go ahead and incorporate the new company. In any event, in order to limit the potential personal liability of the founders, it will virtually always make sense to incorporate by the time the beta version of the new social media site is actually launched.

*This is the second installment of a series of blog posts addressing start-up matters specifically. The third installment will take a look at "Setting up the Founders' Round".*

For further information, please contact Riaz Karamali at (650) 815-2603. (Follow me on Twitter!)