

QuickLaunch University Webinar Series: **Founder Equity-How to Divide The Pie**

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- Questions will be answered as time permits
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Speakers



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Agenda

What Does it Mean to be a Founder?

How to Allocate Founder Equity

Vesting and 83(b) Elections

Founder Stock Alternatives

Restrictions on Transfer of Founder Stock

Additional Resources



What Does it Mean to be a “Founder”?

- No legal significance to the title “Founder”
- Nonetheless, the title “Founder” is extremely important and the relationship between Founders is critical
- Who should be a Founder, and how many Founders should your Company have?
- The roles of the Founders should be clearly established



How to Allocate Founder Equity



First Let's Look at the Typical Initial Capitalization of a Company

- 10M shares of authorized Common Stock
- 5M-6M shares initially outstanding on a fully diluted basis
 - 10-20% Stock Option Plan for future issuances
 - Remainder split among the Founders
- Remaining shares to be used for a rainy day
- Purchase price per share = \$0.0001 per share



How to Allocate Founder Equity



Next, Let's Figure Out How Many Shares Are Allocated to each Founder

- Honestly assess the anticipated contribution of each Founder over the next several years of the Company
- Assign a premium to execution, a great idea is just that, it takes execution to build a successful business
- Beware of automatically splitting stock ownership equally



How to Allocate Founder Equity



Founder Equity Do's and Don'ts:

- **Do** address the hard decisions early on and resolve issues quickly.
- **Do** understand the roles of each Founder and their relative future contributions to the Company's success
- **Do** consider future dilution of Founder equity
 - Reserve option pool (10-20%)
 - Positive impact of dilution-additional human or investment capital
- **Do** subject Founder equity to vesting



How to Allocate Founder Equity



Founder Equity Do's and Don'ts:

- **Don't** wait too long to issue Founder equity
- **Don't** over value past contributions
- **Don't** over-allocate equity to non-active Founders
 - By way of example, Y Combinator will not invest in a company with a non-active Founder holding more than 10% of the Company)
- **Don't** overcomplicate your cap table



Vesting and 83(b) Elections

- Company's right to repurchase unvested shares of Founder Stock at original purchase price
- Founder Stock should be subject to vesting to help keep the interests of Founders aligned and ensure that Co-Founders' equity better reflects actual contributions.
- Investors expect Founder vesting terms to incentivize Founders to maximize value of shares over a number of years



Vesting and 83(b) Elections

- Standard vesting schedule for Founder stock
 - One year cliff, three year vesting thereafter or four year monthly vesting with no cliff
 - Variations: Upfront vesting to reward “effort to date”; milestone based
 - Consider acceleration terms



Vesting and 83(b) Elections

- Vesting Acceleration: Single- or Double-Trigger Acceleration
 - Single Trigger: Accelerated vesting upon change of control or upon termination without “cause” or with “good reason” – less common
 - Creates a misalignment with a potential acquirer who may be unwilling to buy Company unless Founder(s) stays on
 - Investors do not want Founder(s) to be able to hold up potential sale
 - Usually for advisors to Company whose role is to help Company get to an exit
 - Double Trigger: Accelerated vesting upon both a change of control **and** termination by Company for other than “cause” or by Founder for “good reason”
 - More common for founders and employees



Vesting and 83(b) Elections

- Founders typically file 83(b) elections when issued restricted stock and paying fair market value for stock
- Without making election, Founder may have taxable income as stock vests
 - Difference between fair market value of shares that vested and the price paid for such shares
- With election, taxed on difference between fair market value of all unvested shares at time of grant and the price paid for such shares
 - No tax payment when price equals fair market value
- Within 30 days of Board approval of issuance
- Consult a tax advisor (personal tax matter)



Founder Stock Alternatives

- Control based:
 - Dual class voting stock
 - Class A and Class B Common Stock
 - Different voting rights for each class
 - Super voting stock
 - For example, a single stock can have 100x voting rights
 - Helps Founders retain control
- Liquidity based: Series FF Preferred Stock



Restrictions on Founder Stock

- Restricted Stock Agreements contain vesting provisions and right of first refusal in favor of the Company
- Company/Investor Right of First Refusal and Co-Sale
 - Typically put in place as part of an investment transaction
 - If Founder wishes to sell stock to a third party, Company has the right to purchase the stock on the same terms as those offered by third party, if the Company does not purchase the Founder shares the investors have the right
 - If Founder wishes to sell stock to a third party and the Company and the investors do not buy all of the shares, investors have a right to sell their shares to the buyer identified by the Founder



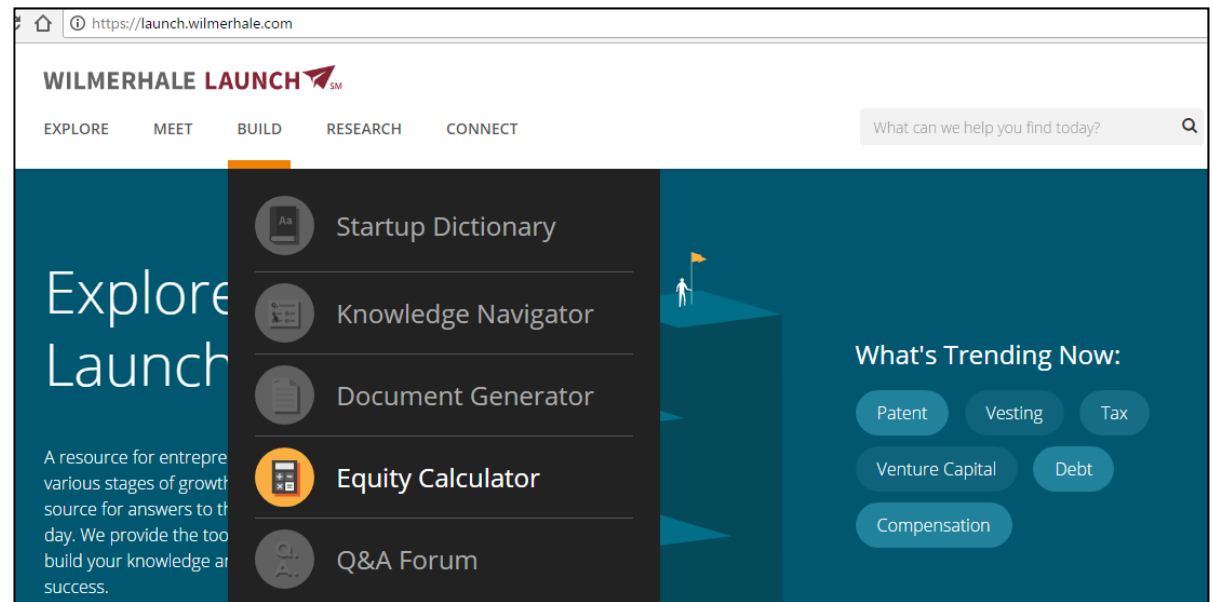
Restrictions on Founder Stock

- Voting Agreements
 - Typically put in place as part of an investment transaction.
 - Governs election of directors and voting of Founder Stock
 - “Drag Along” provisions
 - Cannot have voting agreements governing votes of board of directors
- Lock-up
 - Founder agrees not to sell shares during a specified period following an IPO
 - Typically 180 days

Additional Resources

For more information visit WilmerHaleLaunch.com

- A website full of vital information, tools and connections needed to position entrepreneurs and startups for success
- Draws on expertise of WH's extensive team of lawyers practicing in areas critical to emerging companies in various stages of growth
- Features a growing library of video insights from lawyers, investors and other experts
- Allows entrepreneurs and investors to build knowledge, research topics with everyday impact and connect with dedicated lawyers
- **Contains Founder Equity Calculator**





Questions?

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