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WEBINAR

QuickLaunch University: Founder Equity

NOVEMBER 18, 2019

Speakers: Glenn Luinenburg, Jenna Ventorino

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Webinar Guidelines

- Participants are in listen-only mode
- Submit questions via the Q&A feature
- Questions will be answered as time permits
- Offering 1.0 CLE credit in California and New York*

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WEBINAR

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

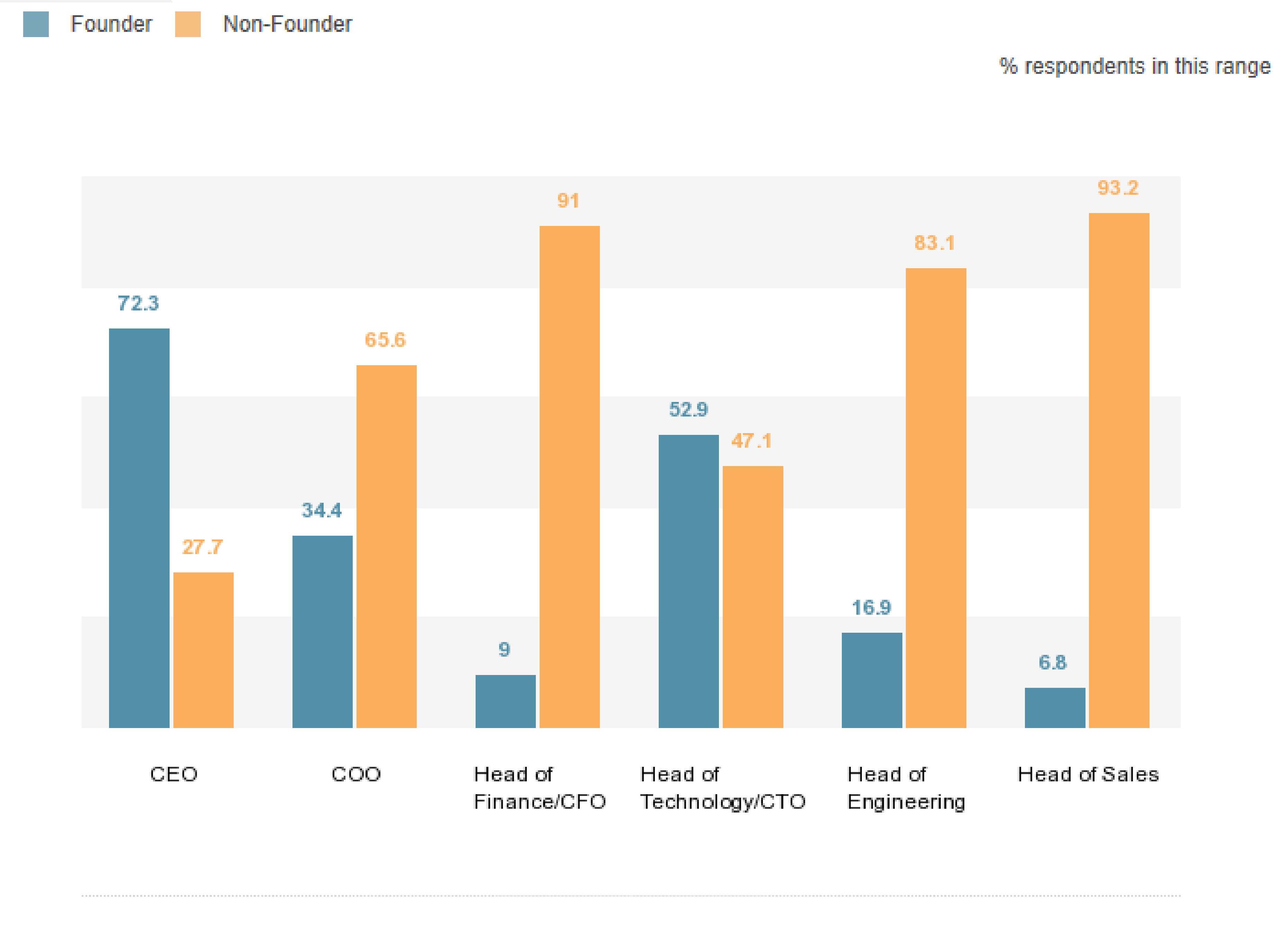
Additional Restrictions on Founder Stock

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

Who is a "Founder"



This chart was generated via CompStudy's online reporting platform (2016, US)

How to Allocate Founder Equity

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

- 10M shares of authorized Common Stock
- Initial Founders will divide the majority of the initially outstanding common stock
- Allocate 10-20% of the authorized shares to an Equity Incentive Plan for issuance to future employees, consultants and advisors
- Consider whether to allocate all authorized shares up front, or reserve some of the authorized shares for issuance later
  - Not all of the authorized shares have to be issued up front
  - Consider whether you will need to reserve equity for additional founders, collaborators or licensors
  - Industry practice may impact your initial allocations
- Authorized shares can be changed with board and stockholder approvals

How to Allocate Founder Equity

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

- Beware of automatically splitting stock ownership equally; assign a relative weight to each Founder's prior efforts and anticipated future contributions
- Honestly assess:
  - how to credit each Founder for his/her initial contributions (ideas, inventions/IP, cash, etc.)
  - the roll each Founder will play in the company going forward (full time, part time, advisory, passive)
  - how each Founder may build value as the company matures (connections, experience, etc.)
- Remember that a great idea is a necessary first step, but it takes execution to build a successful business
- Go to Equity Calculator on www.wilmerhalelaunch.com

Vesting: Overview

- Vesting gives the company the right to repurchase unvested shares of Founder Stock at original purchase price
- Helps 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
- Typical vesting schedule lasts 4 years
  - One year cliff of 25%, three year vesting thereafter
  - Four year monthly (or quarterly) vesting with no cliff
  - Variations:
    - Upfront vesting to reward "effort to date"
    - Milestone based—must be clear and easy to determine whether the milestone is achieved
    - Short term vesting schedule—incentivize/reward for expected limited engagement
- Consider acceleration terms

Vesting: Acceleration

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: 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

Additional Restrictions on Founder Stock

- Vesting and other terms set out in a Restricted Stock Agreement—signed when Founder’s stock is issued
- Company Right of First Refusal
  - 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
  - Likely to be expanded as part of an investment transaction
- Lock-up
  - Founder agrees not to sell shares during a specified period following an IPO
  - Typically 180 days
- Voting Agreements
  - Typically put in place as part of an investment transaction
  - Governs election of directors and voting of Founder Stock
  - “Drag Along” provisions

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 capital, investment capital, IP
- **Do** subject Founder equity to vesting and right of first refusal in favor of the Company

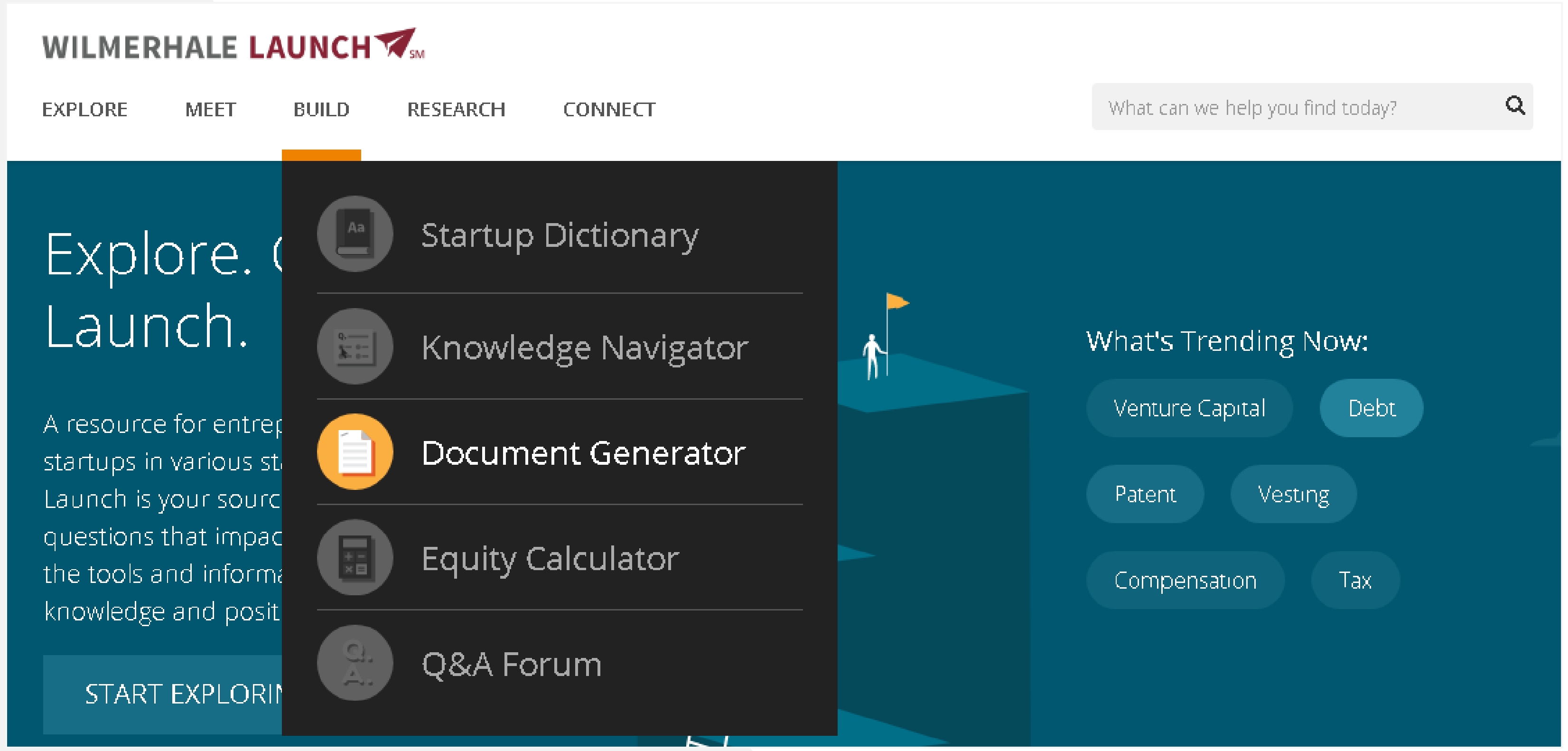
Founder Equity Do's and Don'ts:

- **Don't** wait too long to issue Founder equity
- **Don't** overcomplicate your cap table
- **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)

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 WilmerHale'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 Document Generator



Questions

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