7 Legal Traps Every Entrepreneur Should Consider When Launching a New Company

This short blog can’t address all the legal traps that can trip up entrepreneurs. It should, however, shed light on a few basic considerations entrepreneurs should make when launching a new company.

Considering Where To Incorporate: Where to incorporate should be one of the first considerations entrepreneurs make.The state in which a company is incorporated is a decision that can carry tax and other legal implications. For some companies, the state in which the business is physically located can be a good choice. However, depending on your goal for the business (and especially if you anticipate taking on investors), setting up a Delaware corporation is often the best choice.

Making the Deal Clear with Co-founders: There must be a clear agreement among co-founders on ownership, as well as everyone’s contribution and role. Problems can easily arise when a "forgotten founder" pops up with an inflated view of his or her contribution just when financing is secured or the company is ready to go public.

Work for Hire Rules: When you pay someone to write code for your start up, the company must ensure it owns the code. For many technology companies, software is the company’s most valuable asset. Unless the programmer specifically assigns ownership interest to the company as part of the contract, the company could be faced with costly problems down the road. Assignment often requires a specific written contract with each contributor. Work with counsel to develop a form and make sure each person signs it.

Assignment of Other Intellectual Property Rights: Most startups with venture capital-worthy growth objectives have valuable patents, copyrights, trademarks, trade secrets, customer relationships, etc. at stake. Beyond the software assignment, all this other IP must also be properly assigned to the Company. As with software, that typically means each person signs a legal agreement up front. If this hasn’t happened, you should work with counsel to make sure this is all cleared up before an investor starts due diligence. When the investor finds out you have not been careful with the Company’s core assets, they may think twice about how you will treat the funds they invest.

Trade Secrets: In order to protect trade secrets, anyone who enters the company’s offices should be subject to a Non-Disclosure Agreement. These agreements obligate the person to keep the proprietary information of the business confidential. Without a proper NDA policy, the company may lose its right to claim protection for its trade secrets.

Employment by a Potential Competitor: Hiring an employee or contractor, or even having a friend help develop your software without first checking their agreements with their current or former employer should be avoided. Most companies prevent an employee from working for a competing business, and many take an expansive view on ownership of the employee’s contributions. If you don’t check these up front, you could find that the code that person develops, or even worse the company’s core concepts, are owned by their other employer.

All Legal Problems Cannot Be Solved Later: While good counsel can help you fix some of these problems after the fact, many of the points made here are problems that can't just be patched later. Feel free to contact us if you have questions.

David Goldenberg is a corporate and transactional attorney in Silicon Valley. David’s practice covers a range of clients, many of which are growth-oriented technology companies. He generally counsels companies throughout their lifecycle and helps them with a variety of contractual and corporate matters. He also counsels executives on employment matters. David works with company founders and investors on preferred stock, common stock, convertible debt, secured loan, up-round, down-round, bridge, warrants and other types of financings, and has worked on multiple mergers at all size levels, from $6 million to $1.9 billion, as well as licensing, strategic partner and IPO transactions. He has also advised publicly traded companies in mergers and acquisitions, financing, corporate governance, stock option and executive compensation.