

ORANGE COUNTY BUSINESS JOURNAL



BuchalterNemer
A Professional Law Corporation

Legal Considerations For Web-Based Start-Ups

by Vicki Dallas, Shareholder, Buchalter Nemer

Mobile internet usage is predicted to grow faster in the next few years, making online or web-based businesses great opportunities. Over 80 percent of mobile owners use devices while watching TV. They web surf, shop and talk to their friends online.

What does that mean for you if you are starting an online business? It means access to customers and advertising to sell products without the hard cash investment of brick and mortar facilities. It also means that social media can quickly accelerate your business without investing thousands of dollars in print or other advertising.

The future belongs to the mobile internet. If your business is not getting ready for that future today, your business may be in trouble tomorrow.

Start-Up Considerations

Starting an online business has many of the same challenges as starting any other new business, and some additional challenges as well.

1. Consideration needs to be given to the appropriate legal entity to use for the formation of the business. If the intent is to raise venture or other capital in the near future, a Delaware or California corporation is usually best suited. Angel and venture capital investors favor this approach, as it provides them with state governance laws they are familiar with and allows them to use preferred stock which gives investors added protections. If flexibility in profit distributions or tax allocations is desired, then a limited liability company may be the best option.

2. It is important to get the founders committed to the new venture. Founders Agreements typically provide for restricted stock grants containing vesting, forfeiture and repurchase provisions for each founder's shares, and setting forth voting rights and share transfer provisions (among other things). When restricted stock grants are subject to forfeiture provisions, they should almost always be accompanied by a Section 83(b) election, a special tax election which needs to be filed within 30 days of the restricted stock grant.

3. If there is technology which needs to be transferred to the

business, technology assignments need to be obtained from all founders and any consultants who participated in developing the intellectual property.

4. Attracting the right qualified employees and consultants is also important. Stock options can be used to attract employees, consultants, celebrities and others, particularly when a business cannot afford to pay market compensation for these services. Employees and consultants should be required to execute confidentiality and invention assignment agreements to protect the intellectual property going forward.

5. The business name and intended URLs need to be searched and secured to be sure there are no potential infringement issues. Trademarks need to be registered and patents, if any, need to be filed. Investors are more willing to invest, and at higher valuations, if the intellectual property is properly protected.

6. Website Development and Hosting Agreements need to be prepared, as well as Website Terms of Sale. The Federal Trade Commission (FTC) regulates e-commerce activities, including the use of commercial emails, online advertising and marketing, and consumer privacy; therefore, the FTC rules must also be addressed.

Starting any new business has its challenges and certainly starting an online and web-based business presents these same challenges and many more. What is different for an entrepreneur today venturing into an online or web-based business is the fantastic growth opportunities presented by mobile internet.

Vicki Dallas

Vicki Dallas is a Shareholder with Buchalter Nemer in its Corporate Practice Group. She can be reached at vdallas@buchalter.com or 949.224.6438.

