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Legal Considerations for Web Based Start-Ups

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Mobile Internet usage is predicted to grow faster in the next few years, making online or web based businesses great opportunities. A leading forecaster found that global mobile internet usage leapt from 14 percent to 25 percent between May 2013 and May 2014. In North America, it jumped from 11 percent to 19 percent and in Europe it jumped from 8 percent to 16 percent during this same period.

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.

Over 80 percent of mobile owners use devices while watching TV. They web surf, shop and talk to their friends online. 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

Initially, starting an online business has the same challenges as starting any other new business.

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.
2. It is very important to get the founders committed to the new venture long-term. This is done with Founders Agreements. Founders Agreements are used to describe the vesting provisions for each founder's shares, and to set forth voting rights and share transfer provisions, among other things.
3. Attracting the right qualified employees is also important for an online business. 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.
4. The business name and intended URL's 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.
5. 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.

Dissecting a Typical Term Sheet

Venture capital investment in 2014 hit its highest levels since 2001. Hedge funds and private equity have also joined the party and are investing in online companies. If you are the next online sensation, you may be presented with a Term Sheet. The following are deal points included in a typical Term Sheet:

1. The financing terms will be addressed, including premoney and post-money valuation. The securities offered will be described, such as preferred stock, convertible debt, etc., setting out the pricing terms. It is important to keep in mind that negotiating valuation is more art than science. It depends on many factors, including:
   - market opportunity
   - strength of the management team
   - intellectual property strength
   - product salability and scalability
2. The rights, preferences, and privileges of "preferred" securities will be described, including dividend

provisions, liquidation preferences, redemption rights, anti-dilution provisions, and conversion features.

3. The voting rights of the securities will be described, with certain protective provisions allowing investors veto/blocking rights for certain triggering events such as new financings or a sale of the company.
4. The composition of the board of directors will be addressed.
5. The investors may require the inclusion of certain investor rights provisions, including registration rights in the event of a public offering, rights of first refusal, and co-sale rights.
6. A Stock Purchase Agreement will be required in which the founders will make certain representations and warranties to the investors concerning the company.

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 are the fantastic growth opportunities presented by mobile internet.

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