

# Article

## Allison Knight Details Legal Landmines for Tech Startups in VC-List

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*VC-List*

In my perfect world, tech startups would stop before every major decision to consult an attorney. But in a world plagued with impatience, attorneys usually aren't pulled in until the first significant financing round. As one of those attorneys, here are common problems I run into:

**PROBLEM:** The company's equity ownership "documentation" consists of vague memories and long-lost text messages.

**CONSEQUENCE:** If it wants to obtain funding or an exit for the founder, the company has to slow down and pony-up legal fees to draft proper documentation.

There may be a handful of former employees or high-net-worth connections who think they have rights in the company's equity. Maybe they simply remember an off-the-cuff agreement for "stock options" at happy hour a couple years ago, and maybe the company never actually implemented a stock option plan, but that informal agreement is all it takes for someone to be a potential threat.

Equity ownership can be expensive and time-consuming to retrospectively document. Proper documentation is integral to financing rounds and exits, so nothing will close until the issue is handled. For a tech startup in sight of investor cash, the sooner the equity ownership cleanup starts, the better.

**PROBLEM:** An investor is claiming a bigger piece of the pie than the founder agreed to give.

**CONSEQUENCE:** The founder either lawyers-up to fight the claims, or ends up siphoning off his or her own hard-earned value to appease the investor.

Unbeknownst to some bright-eyed founders, there is a lurking investor ready to manipulate the company into funneling more funds his or her way. These investors are typically conflict-instigating and stubborn. In the worst cases, they are ready and willing to take the company to court.

The founder is looking to close the deal and get on with life, so these investors use that to pressure the founder into diverting more money out of the waterfall. Manipulative investors have all sorts of explanations for deserving extra cash, but essentially they earn it by successfully playing "chicken" with the founder as the closing date impends.

**PROBLEM:** Ideas are flowing into the company, but no one is keeping track of it.

**CONSEQUENCE:** It's uncertain who legally owns the company's ideas.

The framework of a tech company is built on its intellectual property, but not all founders think of it that way. Many aspects of company creation are protectable under copyright, trademark, or trade secret laws, but the protection is not necessarily automatic. It is particularly important for tech companies to track down everyone who touched software code and get them to assign their rights in the intellectual property back to the company.

Tech startups should always have employees sign these agreements—called Proprietary Information and Inventions Assignments (PIIAs)—to maintain the company’s ownership in its intellectual property. The last thing a tech startup needs is a software engineer with the ability to hold the company hostage in exchange for licensing fees or threats of an infringement suit.

The company should also evaluate what kind of licenses any of its third party code is subject to. It is particularly problematic to find the company subject to the free-lovin’ communism of certain open source licenses, which essentially release any of the company’s improvements to the code into the public’s outstretched hands.

**PROBLEM: The company collects legally-protected personal information from people in the U.S.**

**BIGGER PROBLEM: The company collects it from Canadians or Europeans.**

**CONSEQUENCE: The company risks exposure to governmental penalties and private litigation for failure to comply with applicable privacy and data security laws.**

In the U.S., people’s names, birthdates, contact information, and especially sensitive information like medical records or social security numbers, should be treated with care.

Additionally, in Canada and Europe, even technical data like mobile device identifiers can be “personal information”. There is also concern around identifying people with religious beliefs, ethnicity, or other traits—a concern not yet pronounced in the U.S.

For most tech startups, collecting personal information seems innocuous enough, but the trend worldwide is toward stricter regulations. At a minimum, U.S. companies need to have a privacy policy and data security plan in place to protect people’s personal information.

**PROBLEM: The company has one or more of the problems above.**

**CONSEQUENCE: The company should brace itself for increased legal fees and, in the worst case, the nails-on-a-chalkboard pain of litigation.**

Ignoring problems like these is a great way to blow up a company from the inside out. Each problem represents a potential landmine for the company to step on and end up in court, and actual courtroom battles are neither as efficient nor as well-lit as they are on TV.

For the founder and employees, running a tech startup is strenuous enough. So getting pulled into day-long depositions, sorting through myriad emails, and enduring computer forensic examinations—as a few examples—can really put a strain on their daily lives.

As a social matter, the relationship between the company and the opposing party was probably strained before the lawsuit, and the process of resolving the dispute will only worsen it. At best, it is coldly cordial between the parties; at worst, it looks like an episode of Jerry Springer.

Even with the world’s best lawyers, nothing can fully protect the company from an emotionally-driven jury or the fact that the judge is a sorority sister of the opposing counsel. The human element is difficult to predict. Unfortunately, justice isn’t always served, and it will be expensive either way.

In sum, it’s worth digging for legal landmines early on. Less landmines means less legal fees and opportunity cost, which means more value for investors.

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Full article can also be accessed [here](#).

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