

## Founders' Agreement: Purpose & Components Explained

written by Joysurjo Roy | July 15, 2022



### Founders Agreement

It is common in today's world for like-minded individuals from diverse business sectors to form partnerships. To develop and expand their operations, the bulk of these partnerships eventually become corporations. As such, if you are creating a startup, you must execute a founders' agreement. A founders' agreement spells out the rules for who owns the business and how the founders work together.

This ensures that the obligations, stakes, and rewards of each founder are clear from the start. This helps to avoid problems and confrontations. All possible conflicts are efficiently resolved or eliminated, which considerably reduces business risks, positioning your startup for early success.

### What Is The Founder's Agreement?

A founders' agreement is a document signed by a company's co-founders that outlines each founder's equity participation goals and levels. The agreement details each founder's obligations, benefits, positions, and compensation. It can be used as an LLC or partnership agreement and includes a company strategy, a goal statement, and other documents.

The Pre-Incorporation Contract can serve as the foundation for the founders' agreement because it outlines the nature of each ownership share. The parties will undertake the responsibilities and rights outlined in the contract as soon as it is signed. If a promoter signs a contract on behalf of a company that hasn't been formed yet, the promoter is personally responsible for the company's debts.

### Purpose Of Founder's Agreement

Founder agreements are ultimately intended to protect each founder's rights by ensuring that all founders agree on the core structure of the venture and detailing how the founders will collaborate to construct the business. A contract signed by all firm founders reduces the possibility of a legal dispute over company ownership.

The agreement acts as a framework for the founders' engagement, outlining how they would share work, vision, funds, and legal matters. It also establishes the company's equity ownership, the organization, any existing intellectual property, and the founders' voting rights. The agreement will safeguard against unexpected events such as share transfers, value growth, and confidentiality.

## Components Of A Founders' Agreement

Certain important clauses in a founders' agreement are:

- Term & Termination
- Names, Roles, And Responsibilities
- Equity Ownership
- Vesting Clause
- Ownership Of Intellectual Property Rights
- Restriction On Transfer Of Shares
- Remuneration And Compensation
- Decision Making Process
- Non-compete & Confidentiality
- Expulsion Of A Founder
- Representations And Warranties
- Exit Clause
- Dispute Resolution & Jurisdiction

### 1. Term & Termination

The founders must discuss the parameters of the agreement's expiration. This section identifies the agreement's start date as the date it is signed or executed by the founders and declares that it will remain in effect until it is terminated, such as by the execution of new agreements between the founders of the business's merger or acquisition.

The founders of the company unanimously agree to wind down operations and dissolve the corporation. They may also choose to jointly cancel the contract at the moment of their separation from the company, in which case they are no longer obligated by its conditions.

### 2. Names, Roles, And Responsibilities

Disputes between founders and co-founders are frequently caused by assumptions or verbal designations of tasks and obligations. As a result, it is critical to clearly define each individual's tasks and responsibilities.

### 3. Equity Ownership

One of the most significant aspects of the agreement is identifying each co-equity founder's ownership stake. A lot of factors influence the stock ownership of the company's co-founders, including financial investment, competence, present intellectual property, sector knowledge, and network. Furthermore, the voting rights of the co-potential founder are largely governed by the stake of the co-stock founder.

### 4. Vesting Clause

A corporation successfully ensures that a founder or co-founder will provide enough consideration for the shares pledged by submitting equity to a vesting process. Furthermore, it ensures that no founder has disproportionate influence over the startup. Vesting can be of two types: Time-based & Milestone.

### 5. Ownership of Intellectual Property Rights

It is common for businesses to first obtain intellectual property such as trademarks, patents, and domain names in the names of one or more co-founders, to transfer such assets into the company's name.

As a result, it is advised that the founders' agreement includes a provision stating that the company will always control any intellectual property developed by co-founders throughout commercial operations. This is critical because the company's value is also determined by its intellectual property. However, whether or not this rule applies depends on the circumstances.

## 6. Restriction on Transfer of Shares

The founders' rights and limits on transferring their ownership interests in the company should be considered when drafting the agreement. The agreement may include a lock-in clause that stipulates the number of years previous to the expiration of the agreement during which the co-founder is not permitted to transfer the claimed shares of the company.

The agreement will specify a procedure for when a co-founder must quit the company before the lock-in period expires. It is critical to understand how shares are valued and how counter-weakening rights interact with offers.

Giving investors first refusal is one technique for preventing an organization's value from shifting to untouchables. The founders will only be allowed to transfer their shares outside of the company once, and subsequent investors will be barred from doing so.

## 7. Remuneration And Compensation

The payment schedule should be specified in the contract. The size and frequency of each founder's compensation claim are controversial.

Furthermore, it should specify how compensation will be determined. This should also state that this section may be updated by mutual consent as the company organization changes.

## 8. Decision Making Process

There will undoubtedly be ideological conflicts between co-founders, which must be resolved using appropriate decision-making techniques. The decision-making process will be outlined in the founders' agreement. If a voting system is used, it should specify how many votes each founder receives and include a tie-breaking procedure.

## 9. Non-Compete, Confidentiality, & Non-Solicitation

Non-Compete and Non-Solicitation clauses assure that the founders will keep all business affairs completely confidential and will not solicit staff or engage in activities that compete directly with the company's operations. This restriction is frequently applicable throughout the lifetime of the founders' engagement with the company as well as for a set number of years after the founder's departure.

The founders have access to a wealth of sensitive information, some of which may qualify as trade secrets, due to their close ties to the company. Due to the risk of irreparable harm to the firm's operations, the founders should be contractually prohibited from disclosing any sensitive information obtained by a co-founder during that co-involvement founder with the company.

## 10. Expulsion Of A Founder

Any co-founder who engages in dishonest behavior, such as money laundering, sexual harassment, or a parallel job, will be fired from the company. This clause establishes the monies that must be returned to the expelled co-founder and ensures a proper system for dealing with such circumstances.

## 11. Representations And Warranties

Each founder recognizes and guarantees that they are not bound by any other agreement that would prevent them from carrying out their obligations under the founders' agreement. Each founder acknowledges and warrants that no other person owns any of their intellectual property or other proprietary rights about the business concept.

## 12. Exit Clause

A startup should plan for the departure of its founders from the outset. A consensus should be reached on the terms under which a founder may depart the

business and be liberated from their commitments.

### 13. Dispute Resolution & Jurisdiction

The agreement must specify a clear method for resolving disputes between the firm and its co-founders about any of the agreement's stated terms. The parties must agree on the agreement's controlling law and the exclusive jurisdiction of the courts to which disputes arising under the agreement may be referred.

#### Endnote

In addition to preventing disputes between founders, it is essential to note that a founders' agreement is a crucial instrument for investors to analyze the firm's management before investing. Investors are less likely to back a company that doesn't have a clear management structure that has been agreed upon by the company's founders.

To fulfill the primary goal of constructing a successful organization, the governance structure of the company should be documented to assist the operation and management of the entire business. Management and administration should be taken care of as soon as the company starts up. It should never be left to chance or assumed that the organization will do well on its own because of the combined expertise of the founders.

Contributed by Joysurjo Roy, Associate & Dhaval Bothra