

Business Plan Teams – Addressing Difficult Issues of Role, Commitment and Equity Ownership

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Each year, students working in teams develop business plans. This collaborative process offers a host of benefits, in large measure because it is a very real-world experience, especially for students who are actively considering launching a venture. Recruiting potential employees and meeting with venture capitalists, angel investors and partners all serve as key steps in the actual launch of a business, and also provide valuable educational experience.

A downside of this real-world experience is that, with real dollars at stake (especially other people's money), teammates face hard decisions regarding which students on a team ought to have the opportunity to proceed as founders or members of a start-up team, how much equity each will receive, etc. Sadly, sometimes these disagreements ruin friendships, sour your time at HBS, and – on rare occasions - escalate into real legal disputes.

The most typical misunderstanding occurs when a team has an initial “leader” – typically the person who has come up with the idea. That person recruits some classmates to help develop the plan. Things gain traction, the idea gels, and – perhaps to everyone's surprise – the venture appears to be viable. The team “leader” may naturally regard himself as the sole “founder” and his teammates as secondary figures who have done some work for the benefit of the experience and the academic credit. These other teammates may see things differently, viewing themselves as co-founders – or at least key employees – who have created valuable intellectual property and have a right to participate in the venture going forward (with equity) and/or a right to share in the potential value creation via an equity stake, even if they ultimately do not choose to join the venture.

To avoid costly and disruptive disputes down the road, student teams should consider settling potentially controversial questions of partnership, equity shares, intellectual property, and the confidentiality of proprietary information at the outset of the competition and memorializing their understanding in a written agreement. The somewhat legalistic nature of this note is driven less by the average experience of HBS students – which is quite good – and more by the outliers that, on rare occasions, erupt in to full-fledged disputes. These disputes are not only painful for the participants, but can also disrupt the financing plans for a venture.

We'd encourage using these ideas to tee up these issues for discussion. They are complex, no two situations are alike, and it's unwise to begin a potential relationship by simply putting a legal agreement in front of someone. Think through the issues raised by the examples below, and do seek counsel as you try to memorialize any agreement in writing. HBS is not in a position to provide legal counsel to students. Nor is it HBS's role to broker agreements for student teams or to arbitrate disputes. However, we do offer below some examples of language that students can use as jumping-off points for negotiating agreements among team members. We note that HBS provides this material for informational purposes only, and nothing on these pages is intended to serve as or substitute for professional counsel. There is no “one size fits all” solution to these questions, and we strongly recommend that team members work creatively

together to reach resolution and consult counsel as necessary to commit the parties' settled expectations to writing.

Below are excerpts from a sample of documents that portray two potential ends of the spectrum. That is, one document attempts to stake out a strong claim by a single founder to the idea and to his/her right to determine the identity of team members, if any, who proceed with the venture. Another document attempts to describe a scenario where team members are on more equal footing. Again, there are all sorts of situations that may yield an outcome that is somewhere between these two polar extremes.

Note that throughout, any percentages or amounts are inserted for the sake of providing an example, and are not intended as recommended figures.

Example #1: Single Founder Scenario

When there is a single "founder" and the other students on the team are willing to work with no expectation of anything other than an educational experience, the language below helps capture some sense of how this understanding may play out in writing. It is worth noting that, if an agreement like this is reached early in the process, nothing prevents the founder from renegotiating these terms if the non-founder makes particularly valuable contributions. However, it should be obvious that the starting position articulated in the example below puts the founder in a much stronger position than the scenario described in Example #2, later in this document.

I am writing to document our agreement as it relates to your work on a project at Harvard Business School related to ACME WEB (the "Project") that we contemplate undertaking together. As you know, I have done substantial work to prepare for the Project and the Project is based on my initial ideas. In addition, I am seriously contemplating pursuing the Project as a business venture after we graduate. As we have discussed, I would value your help on the Project, including the development of a business plan, during the coming months. I know that misunderstandings can arise over the nature of the "reward" that teammates may expect or are entitled to as a result of working on such a project.

To avoid any such misunderstandings, and as a condition to your participation in the Project, we hereby agree as follows:

1. *All information provided by me to you in connection with the Project, or developed by you and/or the team during the course of the Project, whether written or oral, shall be deemed to be "Confidential Information". You agree to keep all Confidential Information confidential and will not, without my prior written consent, disclose any Confidential Information to any third parties, in whole or in part, during or after the completion of the Project. Furthermore, you will use the Confidential Information only in connection with evaluating and working on the Project. [Note that this language is silent on the point of whether the founder actually has any intellectual property, and if so, how it is being contributed to the venture.]*

2. *Upon the earlier of (i) completion of the Project, or (ii) your no longer being involved in the Project, or at any time upon my written request, all Confidential Information, and all copies thereof, including without limitation, analyses, compilations, studies, or other documents prepared by you for the Project will be destroyed, or at my option, returned to me without you retaining any copies thereof. Upon*

my reasonable request, if Confidential Information is destroyed, such destruction will be confirmed in writing.

3. *In the event that you are requested pursuant to, or required by, applicable law, regulation or legal process to disclose any of the Confidential Information, you will notify me promptly so that I may, in my sole discretion, seek a protective order or other appropriate remedy. In the event that no such protective order or other remedy is obtained within ___ days, you will disclose only that portion of the Confidential Information which you are advised by counsel is legally required. [Note that it is probably fair for the Company / Founder assume the burden of the work required to keep something confidential in this circumstance, and to pay for this legal counsel if indeed it becomes necessary.]*

4. *You acknowledge and agree that you are participating in the Project for your educational benefit, [and potentially for academic credit], and not in anticipation of any financial remuneration or equity stake or role or position in any contemplated business venture, should I indeed choose to pursue a business venture based on the Project.*

5. *In consideration of the educational benefits [and potentially academic credit] you will receive from your participation in the Project, you hereby irrevocably assign any and all rights in all inventions, including without limitation improvements, formulae, processes, techniques, knowhow, data, whether or not patentable, that you may make, conceive or reduce to practice or learned, either alone or jointly with others, during your engagement in the Project, which are related to or useful in the Project or any business I may establish related to the Project;*

6. *You hereby acknowledge that I shall maintain and be the sole owner the all intellectual property that currently exists or may be created over the course of our work together on the Project, including without limitation, ideas, knowhow, designs, improvements, formulae, processes, techniques visuals, pictures, images, likeness, name, data, whether or not patentable, and use of each and all of the materials produced by us for the Project, and all rights for exploitation in all media henceforth. [Note that this leaves unaddressed the status of any “enhancements” that may be made to the original idea after the term of the Project is complete. This is always a very difficult circumstance to deal with.]*

7. *I shall have the sole right to assemble a team and award equity, if any, to anyone related to any business venture I may establish related to the Project, and you acknowledge and agree that your participation in the Project does not establish any right or entitlement on your behalf to be a part of any such team or receive any such equity; and*

8. *This Agreement shall be governed by, and construed in accordance with, the laws of The Commonwealth of Massachusetts.*

9. *This agreement may not be modified orally, but can only be modified in writing.*

Please excuse the unfortunate formality of this letter, but it is important to clearly set forth our respective rights in connection with the Project. Kindly acknowledge your understanding of and agreement to the foregoing by signing where indicated below, and return your original signature to me.

I very much look forward to your working with me on the Project.

Very truly yours,

ACKNOWLEDGED, UNDERSTOOD, and AGREED

Dated: _____, 200__

Example #2: Teammates with Rights to Participate Going Forward

In other cases, teams may have more than one founder, and it may be clear from the start that two or more people have clear rights to the idea. In that instance, the language of any agreement should reflect this. The sample below is one version of an attempt to capture these ideas in writing.

Whereas Joe Smith and John Jones (“the Founders”) have worked together and have jointly contributed to the idea and intellectual property that constitutes the basis of the initial business plan for ACME WEB (“the Venture”), and

Where the Founders mutually desire to continue working on this idea towards the objective of launching the Venture; and

Whereas each Founder wishes to have his rights acknowledged and acknowledge those of the other, the Founders now agree as follows:

- 1. Founders shall continue to work on this idea during their second semester of Harvard Business School studies, and each shall be compensated with equity in the business, should a business be founded as a result of their efforts;*
- 2. If the business is founded, and if each Founder forgoes other full-time employment to devote his full-time efforts to the Venture following graduation, then the Founders shall each be entitled to a 50% interest in the business, to be diluted equally by any subsequent financing events, and subject to the vesting provisions discussed below.*
- 3. If one Founder does continue with the Venture full-time and forgoes other employment upon graduation, but the other does not, then the Founder who remains with the business shall receive 90% of the initial equity and the nonparticipating Founder, 10% of the equity in the business, again, all subject to the vesting provisions discussed below. [Note that these figures are just examples and the actual figures should be determined by the specifics of the situation. Also, it is common for more than two individuals to work on a plan and to be part of the founding team. In these instances, both past and expected future contributions are rarely equal for all three or four people involved, and equity stakes can end up being quite unequal.]*

4. *If both parties continue as equal Founders their shares shall be subject to vesting provisions, in which 20 percentage points of each Founder's equity share shall vest upon the actual incorporation or legal founding of the business (and the signing of contemplated employment agreements with the business) and the remaining 30 percentage points vests equally in equal monthly installments over the remaining 30 months. [Note this assumes no financing, other employee founders or option pool. If these factors are present, then the figures would obviously need to be adjusted.]*
5. *In the case where one Founder continues with the venture and one does not, then the Founder who is NOT continuing with the venture shall receive his 10 percentage points share free and clear upon the incorporation or legal founding of the business (i.e., without vesting) and the remaining Founder shall receive 30 percentage points of his equity ownership upon the actual incorporation or legal founding of the business, and the remaining 60 percentage points in equal monthly installments over the ensuing 30 months. Note that it is anticipated that both parties' ownership stakes shall be diluted by subsequent financing events and subsequent issuance of stock, although it is anticipated that the issuing of any additional "founder's stock" shall come from the continuing Founder's initial share. [Note that the math is actually a bit more complicated than portrayed in this simple example i.e., if Founder A gets 10% of the Company's shares free and clear – without vesting – and Founder B gets 30% of his shares and the remainder vests, then Person A actually holds 25% of the outstanding shares upon issuance.]*
6. *In the case where one Founder elects not to continue with the business on a full-time basis, he will execute an agreement giving the Venture full right to all inventions, intellectual property, and confidential business information, and irrevocably assign any and all rights in all inventions, including without limitation improvements, formulae, processes, techniques, knowhow, data, whether or not patentable, that he may have made, conceived or reduced to practice or learned, either alone or jointly with others, during the course of his work on the project, and that the 10% ownership stake articulated above shall be full and just compensation for this transfer and any and all work done up until that point on the venture. [Note: if one person is bringing genuine IP developed prior to the project, or a business plan or particular contacts, then he may want to negotiate a higher percentage of the equity as compensation for this contribution if he does not proceed. Alternatively, the agreement could establish that this person has the right NOT to contribute this IP to the Venture if he decides not to continue with the Venture. Note further that the agreement does not address the possibility that neither party continues with the business, and does not address the issue of who has what rights to any IP created under this circumstance.]*
7. *The Founders recognize that these terms may be changed in response to requests from investors who may elect to finance the Venture, and nothing in this agreement shall be construed to restrict the Founders from amending this agreement to conform to the requirements of securing financing.*
8. *The Founders recognize that this agreement is silent on the issue of which individual may fill specific roles in the business, and that this lack of specificity is a necessary consequence of the early stage of this work and the uncertainty that exists. The Founders pledge to use their good faith efforts to resolve these issues in a manner that seems consistent with the ultimate success of the business and with any requirement to obtain financing for the Venture.*

9. This Agreement shall be governed by, and construed in accordance with, the laws of The Commonwealth of Massachusetts.

10. This agreement may not be modified orally, but can only be modified in writing.

SIGNED and AGREED

Founder A

Founder B