HOW TO INCLUDE AND REWARD INVESTORS TO AN IDEA

Dan-Alexandru SITARU*

Abstract

More and more it can be found that platforms, mostly online nowadays, tend to fish for new idea s that some other might have and reward them by putting in contact with potential investors, of their have market value. But this opens up the big problem of sharing the burden of realising the business, sometimes the heavy task of creating and implementing and nevertheless the final share of profits. These may rise lots of judicial problems starting from the very human component. The objective of the paper is to focus on the small guide regarding what does a partnership between a person having an idea or a know-how and its potential investor might look like. As the author, from personal experience has noticed, most people are more focused in financial matters and/or on their creation rather than the fine print of the contract the investor, as more versed, gives them to sign. Since usually the one with the idea is just a simple person starting out from a garage, it does not have the expertise or the resource to pay a qualified person for assistance. Without having exhausting the subject, which is huge, one may find some stating point or some advantages or disadvantages that may give an idea what king of future partnership it should have with the investor. Also, from the investor perspective, since idea may be good or bad, profitable or not, this small presentation may provide some points to look after.

Keywords: *investor, initial partner, shareholder, company, joint-venture*

1. Introduction

Investment is a notion that subsumes two aspects: one that refers to economics and represents the financial and money aspects of the investment and one that refers to the legal side. The latter is our main focus because however important money may be without a proper legal back setting any investment is soon to be proven a failure or result in crime or contravention that might attract fines or even penal sanctions.

But recently another aspect has arisen, started from the mistrust of the investors or from the desire to control your partner. Any mistrust might come from the fact that id a person has an amount and is willing to invest it (money must circulate) history has proven that although the investment is sound the person that takes care of the investment, sometimes the agent, is untrustworthy. Our paper however shall focus on the other idea, regarding one controlling the business partners that will invest in your business from future acquiring so much power and by becoming major shareholders or by taking over, either hostile or by more votes, and thus protecting the founder's position, not so see themselves become minority. The notorious case of Steve Jobs, the founder of Apple, sets as an example were only his resourcefulness and wit made the new investors call him back after being expunged.

Therefore, in the content of the present paper our goal is to show the most common and well used legal solutions for attracting investors but keeping them under check while returning only their investment or even if they become partners not to give them the possibility to ever threaten the founders position. At all solutions there will be a set of pro and cons that might help from a practical perspective.

All this becomes helpful in situations such as when a person launches a business plan to develop a certain idea or type of business, such as in the IT business where platforms for various aspects, selling, buying, transactions, gatherings, idea expression, debate, applications etc. Sites that advertise for finding investors for new idea, were anyone may enter a business plan and might find an investor willing to pour money into its development, is no longer an exotic concept. But taking the case of such and entrepreneur that came with the idea of an online platform for exchanging crypto currency, being a well thought plan, it got an enthusiastic response and more than fifty investors were lining up to finance his project. Of course, they all desired to pe rewarded or compensated for their initial investment, some of them only wanting the return of their investment, like a loan plus interest, and mostly wanting to participate as some form of partners.

At first glance the solution seems simple, but the Romanian Law for companies states in the chapter regarding the stock company that loans and other forms of credit from the company to the shareholders or managers are not permitted[1]. Also, the offering of bonuses or guarantees for personal endeavours of the shareholder or manager are not permitted also.

However, the Romanian Fiscal Code[2] states that under a certain amount loans may be realised and paid between the company and its shareholders, managers or third parties, but the amount is low and limited by daily transactions thus making it inconvenient for large or expanding business. Hence, the Romanian law is iv

* Lecturer, PhD, Faculty of Law, „Nicolae Titulescu" University of Bucharest (email: dan.alexandru@sitaru.ro)

[1] Law no. 31 /1990 regarding companies as it was amended.

[2] Published in Official Gazette part I, no. 688 from 10 September 2015.

favour of allowing loans only to be distribute by banks and financial companies, were regulation is strict and controllable.

2. Content

2.1. Becoming a shareholder.

The fist solutions we bring forward is to insert the investors into the initial company, by means of making them shareholders, with all the legal consequences that derive from this status.

This solution presents particularities because of the two main types of companies regulated by Company law, the stock company and the limited liability company.

As for the stock company we will refer furthers below at a different section, but as for the limited liability company any person that desires to become a shareholder must be voted in by the other members[3]. This comes from the idea that such a company is set up on the idea that all members are intuitu personae. So, if all members are chosen in consideration to one another this means and leaving or entering the company must be approved by at least ¾ of the members, by law.

So, in short, being a shareholder gives the person at least the following rights:

- to participate and vote in the general assemblies of the shareholders;
- to convene and to be taken consul with it in management decisions;
- to contest and ask for annulment of the decisions of the general assembly of shareholders;
- to veto any entry or exit of shareholders, if ¾ of the remaining members do not decide otherwise;
- to receive dividends, should this be voted by the general assembly of shareholders. The value of the received dividends is always proportional to the percentage of share ownership of the company.
- to receive a portion of assets at the liquidation of the company, proportional to the percentage of share ownership of the company.

The main problem with this solution is that this procedure implies the dilution of the shares hold by the founding members. The solution is to increase the number of shares and distribute them to both the newly come shareholders and to the initial members. This will allow for the share distribution to remain the same, and the percentages of ownership to be unchanged, thus not allowing the new members to gain control or more votes.

But even so, two addiction problems arise from this, one being that the new shares must be bought and the initial members must come up with the sum from personal funds, and second that the status of shareholder is forever, until the company enters liquidation/bankruptcy or the shareholder decided to sell.

In dealing with the fists problem, one might add that a compensation for unpaid dividends may be implemented, settling thus the need to bring additional finances by the initial members. Also, since the Fiscal code allows certain minimum amounts of loans between the company and its shareholders and that there is no actual need for shareholders to actually cash in any of those loans, such operations might be only set in motion in order to prepare a near future emission of new shares and then the shareholders compensate their uncashed loans and interests with new shares, bringing them to the same or similar ownership percentage as before.

In dealing with the second problem, a contract might be drafted between the parties stipulating that the investors will only enter the company for a limited time period, until their investment is returned with interest preagreed. This contract shall be a sale-purchase agreement in advance that will enter into force once the conditions are met. If any party refuses to acknowledge and execute this agreement in the future, the other party may address the court to rule for the realisation of the sale purchase agreement[4].

As for the stages for implementing this solution, no special conditions must be fulfilled other than those stated by art. 202 of the Company law. A validation by the Trade Office and the passing of the minimum required term is mandatory.

If one should analyse the law and the scope for such solution to be implemented, the following advantages and disadvantages might be noticed.

One advantage is that it is a simple, step by step and already verified solution. It also involves very few steps, good for urgent situations.

Another advantage is that it is very advantageous for investors, conferring them trust that once they have invested, they may not be pushed out discretionary. The contract and the shareholder title make them safe against any exclusion from the company other than fraud or serious charges[5].

Another advantage is that being part of the general assembly of shareholders it may vote the sharing of dividends or contest the lack of sharing should the other members decide to vote against the investor's rights.

Another advantage, which regards all, is that neither the shareholders nor the investor may not leave the company without the approval of a minimum of ¾ of the total shareholders. This makes for a secure situation for all parties.

As for the disadvantages, one might be that the presale agreement should be carefully negotiated and drafted because of the chance that the investors might reconsider. Once the new person enters the company and gains shareholder status it becomes equal in rights

[3] Art. 202 of Law no. 31/1990 regarding companies.

[4] See art. 1279 of the Romanian Civil Code

[5] See for the causes for exclusion art. 222 of Law no. 31/1990 regarding companies.

to all other shareholders. This might become an issue since that shareholder may try to use his position to overcome the effects of the presale agreement and remain in the company.

Also, since they have equal rights the new shareholders may intervene and actively participate in the day to day affaires of the company, either blocking it or slowing it down. This does not indicate ill faith, but more likely an excessive desire to protects one's rights.

Another disadvantage it that the existing shareholders must pay, at least once, a supplement of money for the purchase of the new issued shares, in order to keep their percentages of stock ownership. Should none of the solution provided before be possible, regarding compensation with past debts owed by the shareholders, it might be very difficult if not impossible to retain control of the company.

Not the least, all amendments to the constitutive acts of the company must be taken by all shareholders. This might create all sorts of problems and arguments between shareholders. However, the unanimity condition may be fined down by vote of the shareholders.

Summing up intro some pro and cons, it could be said that the negative aspects tend to overwhelm. However, this is the case only when you take into consideration a large expansion involving lots of investors who will potentially become shareholders. But for small or step by step progressive growth that takes one of few investors at a time it might be the most effective means to controlling them, especially having signed a pre selling agreement.

2.2. Creation of transformation of a company intro a stock company followed by issue of shares to the new shareholders (investors)

A second solution might be either transformation of a limited liability company into a stock company or the creation of a new one and the main shareholder being the limited liability company and the inclusion of the investors as new shareholders.

Basically, the effect is the much the same as the former solution but the advantages are for the initial shareholders that a new company has its own juridical personality and it is fully independent, therefor any issues or potential risks that might be encountered will not be reflected upon the initial company. Also, having shareholders, it is much simple to enter and exit the company without having the need for a general assembly of shareholders.

Separately, this solution might also fit to creating a comandita stock company. The idea is that investors might feel threatened by the creation of stock company, either independent or resulting from conversion, because they might feel that the old shareholders could at any time leave them to go bankrupt and deprive them of the possibility of recovering their investment. In order to provide credibility, one might use a comandita stock company that, in essence, is composed by law of two types of shareholders, one with full liability, who control the company and make up the general assembly and one with liability only in the limit of its initial investment. There for the old shareholders retain the control of the company but become liable and thus give securements to the new shareholders who only come in as investors and do not participate at the day to day activities of the company.

To sum up the effect of this solution, the transformation to a stock company would have as affect the becoming of shareholders to the new company. They will gain mainly the same rights as before mentioned, such as the right to participate and vote in the general assembly (condition is is not a comandita company), the right to be informed regarding the activity and financial statements of the company, the right to contest the general assembly's decision and ask for annulment, the right to freely sell their shares etc. One special right that only shareholders of a stock company have is the right to take oneself off the company by demanding that the company buy back their shares[6]. But this right is not likely to be made us of it because it will mean losing part of the initial investment and interest.

As for the steps needed to take intro effect this solution, the procedure of rising the capital by supplementing the number of shares is to be followed[7]. This includes the steps made obligatory by the Trade Office[8].

The main advantage for this solution is that it is the most versatile one, it covers a large potential solution to different conditions and special demands that investors might have while offering credibility. Also, it is the safest one for the initial shareholders since it will always keep the investors in check.

Another advantage is that by means of modifying the constitutive acts, while implementing this solution, the voting power of the new shareholders may be diminished. So, the Company law indicates that usually 1 share gives 1 vote, but this may be modified to so that 2 shares give only one vote, this limiting the votes of certain shareholders[9]. The new shareholders have the right to either accept or not the proposal since this is a package deal modification of the constitutive acts.

Not the last, by this solution we separate all issues either to a new company or between the shareholders. Old shareholders might even have special privileges for a period of five years resulting in them taking a part of

[6] See art. 132 of Law no. 31/1990 regarding companies for conditions that need to be fulfilled and necessary procedure. Not all are allowed to take themselves off but only those who are under one criteria set forth by the law.

[7] See art. 18 and the following of Law no. 31/1990 regarding companies.

[8] See Law no. 26/1990 regarding the Trade Office.

[9] See art. 101 of Law no. 31/1990 regarding companies.

the dividends in advance and regardless of remaining other dividends for the rest of the shareholders[10].

The main disadvantage is that creating a stock company requires a minimum investment of 90.000 lei [11]. This may present as a financial challenge as it is also going to be topped with the investment need to keep the percentage of the ownership of capital at the same level. Although only 30% is required to be given at beginning, the entire sum must be put forward by the end of the procedure.

Another disadvantage, in contrary to the previous solution, here the no show of the investors as new shareholders to the special or extraordinary general shareholders meeting will result in a lack of minimum participation quorum and thus the assembly may not vote. Also, the old shareholders must always retain 51% of the votes in order not to lose the majority.

Last, also regarding the shareholders assemblies, if one may ask for annulment of a decision take by the general assembly it may also ask for suspension of the decision until the courts final rule. This equals to the blocking of the company.

Summing up the pro and cons one may still see that this is the most effective solution of them all, should the investors insist to participate of have a big role in the company that they are investing in. Otherwise, the next solution may prove the best yet.

3.3. Drafting joint-venture agreements with investors

Another solution consists of drafting of joint-venture contracts either of civil association[12] or independent ones. By this contract the investors come as simple persons willing to give finance and receive the guarantee of the return of their investments. The receiver of the finance participates with the idea or business plan and also will take responsibility for implementing and making profit. Profit shall be split according to the party's choice.

One partner should be manager of the joint-venture and usually that is the one who implements the contract. But exceptions are known to have been agreed.

This type of contracts is by definition free of any specific rules and do not give birth to legal entity. It is flexible, well known and hugely implemented, there for is a beaten path that may hold no surprises for any of the parties.

Each contract with all investors, regarding how many they are, can be tailor made to suit their interests or special demands. Any clause may be inserted and there is no limitation to what goods or the amount of investment that is poured into the joint-venture. Since the initial partner, has nothing beside the idea or business plan it may very well only bring into the contract this know-how and it would be enough to ask for finance. No risk involves the initial investor as due to the contract's confidentiality, that might be agreed by the parties, the know-how is protected should the deal fail. However, the investor stands to lose the investment, should it not take back the money in due time, according to a before agreed clause in the contract.

According to Romania law, the contract is only to be declared at the fiscal administration. The option of either opening or not a separate bank account for each contract or one for all is at the free to be decided by the parties. It is necessary only to keen accounting book for all contracts.

This also represents the main advantage of this solution, that it has no limitations and with the exception of the registration at the fiscal administration parties may not disclose the content or exitance. Negotiation of all the clauses is free.

Another advantage is that the investor becomes only a creditor to the company of the initial partner and does not have the status of shareholder and none of the deriving rights. It does not give the right to obtain a part of the profit of the initial partner and only gives right to taking back the investment and some interest. This investment is legal and free of the restrictions of loaning between a company and its shareholders or third parties.

Another advantage is that by not giving both to a legal entity none of the partners may need to register a group of companies, which would make them oblige special law provisions.

Last, but very important, it does not generate addition costs and the level of taxes are the same for any other transfer of goods or money.

The disadvantages consist of that fact that accountability must be kept for each contract. So, one must reflect all incoming and outgoing transfers from all contracts with precision.

And a final disadvantage, more from the investor's perspective, is that the initial partner, the one with the know-how who implements the contract, pours revenue intro the joint-venture and for this it pays taxes. Once the revenue is distributed both partners have to pay another tax, this time on the revenue that is coming t them as personal income.

Summing up the pro and cons, this solution is inclined to having more advantages for both partners. It is clean, transparent and does not tie any of them together in other than a binding contract.

3. Conclusions

Co-opting a partner to finance your investment is no easy task, but one may find that a negotiation is non other than the realisation of both partners dreams and the overcoming of their fears. The paper does not pretend to exploit or present all the possible ways in

[10] See art. 32 of Law no. 31/1990 regarding companies.
[11] See art. 10 of Law no. 31/1990 regarding companies.
[12] For the legal regime of civil associations see art. 1949 of the Civil code and the following.

which one can include or reward investors but hopes to cover some elements and give new thoughts to this emerging and ongoing growing market.

Institutions such as angel investor that existed in the European legislations for years are not regulated in Romania, which makes for the need to invent and combine existing legal solutions in order to give effect to effective partnerships. It is recommended that future legislation, on these sole aspects, be discussed with business forums and passed for the benefit of the society.

References

- Stanciu D Carpenaru, Treaty for Romanian comercial law, Universul Juridic publisher, Bucharest, 2014
- Vasile Nemes, Commercial law, Hamangiu publisher, Bucharest, 2018;
- Stanciu Cărpenaru, Sorin David, Gheorghe Piperea, Company law, C.H. Beck publisher, Bucucharest, 2014
- Law no. 31/1990 regarding companies
- Law no. 26/1990 regarding Trade registry
- Romanian Fiscal Code from 2015
- Accountancy Law no. 82/1991
- Civil Code of Romania