COMMERCIAL LAW

BUSINESS LAW FOR ENTREPRENEURS

GUIDE Block 1.- Setting up the structure

INTRODUCTORY REMARKS

The Course on Commercial Law has been approached from the perspective of the entrepreneurial activity. Therefore, in the drafting of the syllabus, those issues more likely to impact on the decision process leading to the setting-up and the running of a business project are selected and structured on a systematic basis to devise a program of *Business Law for Entrepreneurs*.

Since lessons and practical exercises are going to be entirely focused on business issues, it may be advisable to read first some materials related to the whole Private Law system and the particular features of Commercial Law in the Spanish legal system in contrast with, for example, common law systems.

To that end, you might be interested in reading the following sections:

Introductory reading materials and other additional references:

- RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, *Introduction to Spanish Private Law: Facing Social and Economic Challenges,* London: Routledge, 2009:

- pp. 1-4: History
- pp. 4-17: Private Law in the Spanish legal system
- pp. 17-20: Civil Law and Commercial law
- pp. 20-27: New Trends

BLOCK 1. SETTING UP THE STRUCTURE
READING MATERIALS, CASES AND PROBLEMS

1. GETTING STARTED. CHOOSING THE LEGAL FORM AND OPENING THE BUSINESS

1.1. Defining the project, planning the organization and assessing needed resources: choosing between individual entrepreneurs and organizational forms

Reading materials and other additional references:

- RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, *Introduction to Spanish Private Law: Facing Social and Economic Challenges,* London: Routledge, 2009:

- pp. 53-64 (*The individual and business*)
- pp. 72-75 (*Legal persons*)
- pp. 77-84, 90-94, 104-117 (Categories of organizations)

Main ideas, aims and questions:

The first step in the decision process leading to the setting up of a business project is to assess if an individual can run the project alone or teamwork is needed.

If an individual decides to set up the business alone will surely become a **sole trader** who makes the main decisions and takes on financial risks arising from the activity. Accordingly, the entrepreneur assumes unlimited responsibility for all (existing and future) debts and risks deriving from the running of the business (Article 1911 *Spanish Civil Code*).

Which are then main advantages of acting as a sole entrepreneur in the market? Firstly, no incorporation costs (costs related to the process, formalities and steps aimed to set up an organization – registration, public deed, legal advice, capital -) have to be afforded. Secondly, management costs are very limited and in some cases inexistent, for the sole trader might manage the business on his/her own. Thirdly, no risk of conflict with partners in the decision-making exists.

Nevertheless, acting as a sole entrepreneur entails risks that are, in certain cases, higher than in a company. Mainly, the entrepreneur exposes his/her assets, both personal assets and professional/business ones to business risks. No line can be drawn between goods devoted to personal/family purposes and professional/business ones. As a general rule, any asset can be sold to pay business' debts. As an exception, a recently enacted Act (Law 14/2013) in Spain allows entrepreneurs to safeguard part of his/her goods from creditors, under certain conditions (text available at http://www.leydeemprendedores.es/leydeemprendedores/).

Capital raising, risk mitigation and needed resources can make wiser the decision to set up a more complex **organizational form**. Take a look at the catalogue of legal organizational forms, as summarized below (read further about in Chapter 3 of recommended textbook), that can be chosen to run economic or social activities and find out main differences and distinguishing features of each one. Notably, companies are the preferable vehicles to run a business project in a market. Among them, stock corporations (SA, Sociedad Anónima) and Limited Liability Company (SRL or simply SL, Sociedad de Responsabilidad Limitada) jointly represent more than 95% of enterprises operating in Spain. Same percentage depicts the fabric of industry in Europe.

Year (*)	Sociedad Anónima	Sociedad Limitada	Others
2017	410	93.803	785
2016	397	100.371	1.628
2015	605	93.976	400

*Número de constituciones. Fuente: Registradores de España. Estadística mercantil 2017

Legal catalogue of organizational forms and key characteristics

1. ASSOCIATION: group of persons / organized / common aim / stable

2. FOUNDATION: non-profit / goals of general interests / distinct patrimony / durable basis

3. COMPANIES: partnership / LLC / corporation

4. OTHERS: Cooperatives, economic interest grouping, worker-owned companies, so on

5. GROUPS: joint ventures, alliances, holding

1.2. Commercial companies. The protection of limited liability

Key vocabulary:

Sociedad Anónima (SA) ≈ corporation (Inc. or Corp.)
Sociedad de Responsabilidad Limitada (SRL) ≈ Limited Liability Company (LLC)
(Artículo/disposición) dispositiva = default provision
imperativa = mandatory provision

Main ideas, aims and questions:

Yet in order to make an informed choice it is important to know the main differences among companies, partnership and corporations. Right now you are in a better position to distinguish between the corporate/LLC form and the form where the individual entrepreneur acts in her own name, or where several entrepreneurs sign a contract of partnership.

Are you precluded from choosing the corporate/LLC form if you are alone (i.e. you are the only individual to start with a business)? No, you are not. Most jurisdictions, including Spain, enable entrepreneurs to set up a corporate/LLC to run business, even if there are no other partners. It is a one-partner company.

One of the most important advantages of choosing commercial companies (in particular SA/SRL) is the **legal protection of limited liability**. Unlike individual entrepreneurs who expose all their assets to business debts and risks, the setting up of an incorporated company (in particular, SA/SRL) entails that entrepreneurs become shareholders/partners of the company and

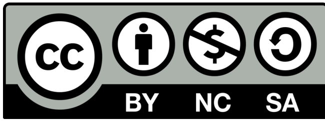
accordingly succeed in limiting their liability. Indeed, the company, as a new legal person, is liable to third parties and its assets will pay existing and future debts. And, each shareholder/partner restricts responsibility to his/her share in the company. Partners/shareholders are not personally liable against creditors. Contracts are concluded between third parties and the company itself, as a legal person, whereas shareholders/partners are not contracting parties in such transactions.

Finally, the choice between the SA and SRL is the trickiest.

a). SRL's origin dates back to the end of 19th Century, when, as *private companies* or *close corporations,* this company type aspires to satisfy unattended needs of trade and business whereby an organizational model suitable for running economic activities by a limited number of members, usually linked by family or close bonds or simply selected on grounds of their personal features and/or professional skills, able to combine flexibility and limited liability, without the complexity and rigidity burden of incorporating a joint-stock company (*sociedad anónima*). Therefore, *sociedades limitadas* are normally described as hybrid companies, interweaving personal elements and capital ones. Members of a SRL are called "partners" (*socios*) whereas in a SA they are shareholders because they hold shares. Accordingly, equity capital in a SA is divided in shares but in a SRL it is divided in parts or units (*participaciones*). Unlike parts or units, shares are negotiable in a regulated market (stock exchange). To set up a SRL in Spain a minimum start-up capital of 3,000 Euros is needed (although it is possible to set up a SRL without contributing that total amount of capital at that time, provided that it is subjected to a specific regimen that of the "limited company of successive formation" where certain rights are limited, e.g. distribution of dividends, remuneration, etc.). However, minimum start-up capital to set up a SA amounts to 60,000 Euros.

b). In general terms one can say that the SA is instead designed for growth, i.e. it requires more initial capital, it is designed to be "open", and its regulation includes more mandatory provisions than that of the SRL, which is presumed to be a form for smaller businesses (in principle, they don't seek to go public and cannot be listed on stock markets), is more flexible, requires a lesser amount of capital, is "closed", and with more "default", rather than "mandatory" provisions.

Notwithstanding different configuration of members' interests in the company, in both types of companies above, investment of members (partners/shareholders) is to be of pecuniary character or in kind. But in any case, contributions of work, industry or professional services are not permitted, except as ancillary obligations (*prestaciones accesorias*) stated by articles of association and whose performance is imposed on partners as a manner to personalize *sociedades limitadas.* As regards investments in kind, legal regime for *sociedades limitadas* significantly differs from the one applicable to *sociedades anónimas.* No expert report assessing the value of investments in kind is required. Value thereof is proposed by the investing partner and agreed by the remainder ones. Hence, failure to duly value the investment in kind entails the jointly and severally liability of all partners for the existence and the value thereof against third parties and the own company.



1.3. Personalizing the organization: by-laws, articles of incorporation and shareholders' agreements.

1.3.1. Choosing the legal form: the company as a (formal) contract. And personalizing the legal form: the different documents and their significance

Vocabulary:

Escritura de constitución = articles of incorporation
Estatutos ≈ Bylaws
Pacto parasocial ≈ pacto reservado ≈ pacto de socios ≈ shareholders' agreement

Main ideas, aims and questions:

A company (especially with corporate form) is a complex creature, because it originates in a "contract" (i.e. an act between several persons) but then, that act gives rise to *another* person, or body of rights and obligations (hence the word "corporate", from the Latin *corpore*). This complexity must be somehow represented in the "ritual" for the incorporation of the company, and the documents necessary for that.

Examining the sample of different documents facilitated, you may identify, between the "escritura de constitución" (articles of incorporation) and "estatutos" (bylaws), which represents better the "contractual" side (where several other parties get together and express their will to create a company) – articles of incorporation -, and which the "corporate" side (where the internal working of the new person is established) - bylaws.

Since the ultimate aim of the incorporation is to create a new "person" (the company) who can assume obligations and be entitled to exercise rights, main features of "its personality" have to be established: name, nationality, ID number, initial "patrimony", domicile, and so on. Most part of these elements are stipulated in the articles of association. How the company name is given to the company? Founders apply for a company name to the Central Mercantile Registry. In the application form (electronically available), applicants propose several names (usually maximum of 3 options) in order to priority and the Registry check if there are other companies using the same name or a similar one likely to mislead third parties. Should the same name be not registered and no risks of confusion exist, the requested company name is reserved in favor to the applicants. Which is the legal relevance of the domicile? Domicile does in most jurisdictions determine which domestic legislation the company and its operations will be subject to.

Once the most suitable legal form has been chosen by the partners to run the business, it has to be tailored to adapt to partners' needs and meet their interest. Such a customizing aim is achieved by carefully drafting the by-laws instead of copying a standard model. To draft the by-laws, main elements of the organization have to be identified and then adapted to partners' interest within the framework of the applicable legislation. Then, which are, in your opinion, the main elements of the organization to be discussed among partners and regulated by the by-laws afterwards?

Considering that bylaws are subject to the applicable legislation, partners cannot depart from certain binding legal provisions in the drafting of the bylaws. Accordingly, very often the company partners or shareholders sign other agreements that do also regulate different aspects of the functioning of the company but aim to better meet their interests. Are these documents valid and enforceable? What aspects of the internal working of the company and business are frequently regulated in these shareholder agreements and why?

The signing of shareholders' agreements is commonplace in the market. They adopt a wide variety of forms, contents and scopes. However, we will study in depth those agreements that are usually signed with venture capital, investors or business angels in financing transactions for start-ups. Which aspects in particular might investors be presumably interested in negotiating?

1.3.2. Legal personality and their implications

Reading materials and other additional references:

- Spanish Corporations Act, 1/2010, of July 2: Article 33

Main ideas, aims and questions:

In the previous section, we have talked about the complex nature of a company, in the sense that a contract between persons creates another "person", but what does it (really) mean that a company has "separate legal personality" for business purposes? Can the creditors of a partner seize the assets of the partnership where he is a member? And the creditors of a shareholder in a corporation (SA or SRL)? Can those assets be the subject of separate rights and obligations? If you had to choose a legal form for your business, would choose one with or without separate legal personality? Why?

1.3.3. Limited liability, general rule and anomalies

Reading materials and other additional references:

- RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, *Introduction to Spanish Private Law: Facing Social and Economic Challenges,* London: Routledge, 2009: p. 74 and pp. 118-120
NOTE: Please note that the references of the book to old legal provisions have to be updated according to the law in force (1/2010, of July 2)

- Spanish Corporations Act, 1/2010, of July 2: Articles 1(2) and (3), and 36-39

Key Vocabulary:

Terceros= third parties
Acreedor=creditor
Deudor=debtor
Sociedad colectiva/Sociedad civil ≈ partnerships

Levantamiento del velo=Veil piercing

Main ideas, aims and questions:

In the previous sub-section, we have started introducing a very subtle distinction between those who are "inside" the company (such as shareholders and directors) and those who are "outside" the company (we called them "third parties"). Those "third parties", however, may have a "right", or "credit" against, or an "obligation" or "debt" towards, the company, for example because they have signed a contract with the company. As holders of such "right" or "credit", they are called "creditors" of the company; and as holders of such "obligation" or "debt" they are called "debtors" (a same party can be both creditor and debtor as a result of a single legal relationship).

You will realize that a crucial part of company law is the "weapons" that the law gives to such creditors in case they do not get paid. What does it mean exactly that a company has "limited liability"? Creditors can only attack company's patrimony, but they are not entitled to seize partners'/shareholders' goods. Partners'/shareholders' liability is limited to their contribution to company's equity capital. Can those creditors sue the shareholders directly then? No, as a general rule, they cannot. Can they sue the company directors? Only if legal conditions are met, usually those conditions entail a negligent behavior able to damage other interests. If you had to choose, would you choose a company form with or without limited liability? Why?

Even if a corporation normally has limited liability, the question is whether this rule is absolute. Is it? Can third parties under no circumstances sue the company directors or its shareholders?

Now let us examine such "anomalies". Let us begin with article 39 of the Spanish Corporations Act. What type of situations does it describe? What is the consequence? What logic do you think is behind that legal provision? What happens if you are exercising your business activity as if under a corporation (SA) or LLC (SRL) but you have not registered it and time passes?

Whereas company in formation constitutes a normality phase in the incorporation process, irregular company emerges as a pathological situation where real intent not to register the company is revealed. Given the legal regime provided for company in formation, irregularity may appear once first year from the deed has passed. Any member of the company is entitled to plead the court for putting the company into liquidation. But should the irregular company operate in the market, *sociedad colectiva* rules shall govern it in case that scope of business is of commercial character or *sociedad civil* rules shall be applicable in case of civil scope of business. Accordingly, founders shall be personally and unlimitedly liable for irregular company's debts.

Now let us look at article 36. What happens if you start your business *before* you register the company? What is the difference between this situation and the one described earlier (under article 39)? Are the legal consequences the same? How about the situation/consequences described under article 37?

Company in formation arises from the time when memorandum of association, including articles of association, has been made before Public Notary manifesting founders' intent to create a company and as far as it is not still registered in competent Mercantile Registry. As matter of fact, registering may be delayed on different grounds, although certain contracts and transactions are to be concluded. Should time gap existing between the deeds and the registration do not last longer than one year and company starts to run business in market, special legal regime is applied. Firstly, those actions, contracts and transactions straight and indispensable aimed to register the company shall be automatically assumed by the company in formation. Secondly, for those acts and contracts other than the foregoing one, persons who have entered thereinto are personally and jointly and severally liable, unless subject to registering condition validity and effect of such acts and transactions. Thirdly, companies, upon registration, can assume actions and transactions previously concluded within a 3-month period. Liability of company members and directors in relation to the said transactions will cease accordingly.

Now let us look at page 74 of the book (*Introduction to Spanish Private Law*) – extracted below - mentioning some decisions of the Spanish Supreme Court on veil piercing (*levantamiento del velo*). In business terms, what is the consequence when a company's "veil" ("limited liability protection") is "pierced" ("disregarded")? Is it good or bad? Is it a doctrine/technique that can be used often, or what are its circumstances? What lessons would you draw as a businessman if you want to keep the benefits of limited liability?

Abuse of legal personality comprises those cases where personifying attributes and separation of patrimonies are unduly used to evade liability and for purposes against good faith. Cases likely to amount to abuse of legal personality are numerous and call for diverse responses. Evolution of legal rules can moreover alter the judgment on certain situations. Thus, the phenomenon of figureheads that used to draw a traditional scenario revealing abuse of legal personality is very differently analysed when one-person companies are allowed by law as in Spain from 1995.

Modern case law and most recent scholar opinions are reacting against situations involving abuse of legal personality by applying techniques meaning the disregard of legal entity. *Spanish Supreme Court* has adopted the foregoing approach under the formulation of the so-called "piercing the veil" theory. The rationale there behind is the duty to exercise rights in good faith and the interdiction of abuse of right and fraud – *Supreme Court,* judgments of 2 April 1990, RJ 1990/2687; of 20 June 1991, RJ 1991/4526 -. By "piercing the veil", legal personality mask is lifted in order to uncover real hidden substratum to third parties' defence.

"Piercing the veil" technique is to be applied on exceptional basis and in moderation in the interests of legal certainty. Accordingly, it is applied as a last resort remedy. Several groups of cases have been typified: overlapping or confusion of patrimonial spheres, underfunding of companies, and abuse of legal personality for purposes of infringing obligations or against the law.

1.4. Choosing project participants and allocating roles.

1.4.1. Choosing project participants and allocating roles in the organizational structure: the business organogram, outsourcing strategy and ownership-control in the company

Reading materials and other additional references:

- (A basic overiew) RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, *Introduction to Spanish Private Law: Facing Social and Economic Challenges,* London: Routledge, 2009: pp. 120-124
NOTE: Please note that the references of the book to old legal provisions have to be updated according to the law in force (1/2010, of July 2)

- Spanish Corporations Act, 1/2010, of July 2: Articles 93, 209, 210 and 225-232

Main ideas, aims and questions:

Once the project has been defined and the most suitable organizational form has been chosen, it is a decisive moment to allocate roles among project participants.

A clear line has to be drawn to divide those positions related to the legal structure of the organization (company) and those ones concerning the business model (enterprise).

a). On the one hand, legal positions within the company are two: owners (shareholders/partners) for those who contribute to the company capital, enjoy expected benefits and assume business risks, and directors for those who will be empowered to manage and represent the company in its transactions. Can a shareholder be nominated as a director? Is it advisable?

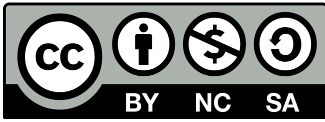
b). On the other hand, corporate positions within the enterprise are established in the business organogram showing different levels of management and subordination/collaboration relationships (employees). Whereas owners and directors are subject to Company Law, Labor Law or Commercial Contract Law govern the latter positions. Therefore, company bylaws do regulate owners and directors' rights and duties but do not aim to govern employee-employer relationships. Do employees assume business risks? Do they participate in the decision-making process? Can the company link to any extent employees' remuneration to business performance? How and what is the rationale behind?

We are going to study in depth in next sections shareholders' rights and director duties.

1.5. Understanding and handling formalities and registration procedure to set up a business

Reference websites in Spain:

- RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, *Introduction to Spanish Private Law: Facing Social and Economic Challenges,* London: Routledge, 2009: pp. 124-130



NOTE: Please note that the references of the book to old legal provisions have to be updated according to the law in force (1/2010, of July 2). Besides, please take into consideration that, from 2010, electronic process is also applicable to individual entrepreneurs as detailed below.

- Fully electronic process of incorporation to create a company in Spain: www.circe.es

- Taxes, licences and permits to set up a business in Spain
http://www.ipyme.org/es-es/creacionempresas/procesoconstitucion/Paginas/ProcesoConstitucionTramitesASeguirPorLaEmpresa.aspx

Main ideas, aims and questions:

To create a company, some formalities have to be met and a registration procedure has to be completed. The rationale behind such formal requisites is two-fold.

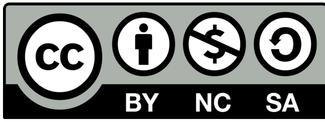
On the one hand, by creating a company (with distinct and separate legal personality) a new person is giving birth for the purposes of the legal system. Unlike natural persons (individuals), legal persons are legal fictions. Therefore, they do only exist provided that certain legal requirements are fulfilled. The incorporation process does then aim to provide the company with its “personified features” as a person (name, domicile, nationality) and to verify the compliance with legal requirements accordingly. Besides, like individuals, who are registered in the Civil Registry upon birth, companies have to be registered in a specialized Registry (Mercantile Registry / Commercial Registry / Companies Registry, depending on the legal system). In that way, third parties can become aware of the existence of the newborn person and know its characteristics.

On the other hand, the creation of a commercial company entails the protection of limited liability for the benefit of shareholders / partners. Such a privilege requires the fulfillment of some legal requirements to avoid misuses of legal personality.

Both above mentioned goals fuel the incorporation process of companies in any legal system. However, each country decides to implement a longer or shorter procedure, a stricter or an easier one depending on the prevailing interests. Indeed, each country may decide whether it wishes to perform its control functions over companies *ex ante* with prior formalities and authorities supervising the process or relaxes the incorporation process and exerts an *ex post* supervision.

In any case, to the extent that the incorporation process of companies is critical to promote entrepreneurship and may contribute to policies to attract foreign investment, most countries have strived hard to streamline the incorporation process by simplifying procedures, shortening time and reducing costs. To that end, fully or partially electronic processes for the creation of companies have been implemented in some countries.

In Spain, companies – LLCs (*Sociedad Limitada*) from 2003 (all LLCs from 2006) and individual entrepreneurs from 2010 - can be created through an electronic process available at www.circe.es by using the Electronic ID and in an average time of 48-72 hours. This electronic procedure



enables enterprises (LLCs and individual entrepreneur) to handle the payment of taxes and Social Security contributions and process other formalities that are needed to operate a business.

- Company name has to be previously reserved at the Central Mercantile Registry (*Registro Mercantil Central,* www.rmc.es - also available in English). Does this formality make any sense?
- Public Notary: what is the role of the public notary in the incorporation process? Which documents have to be presented before the Notary? Why? What does it mean that something is in "escritura pública" (public deed)? Who needs to have signed it?
- Who have to appear before the Notary and sign the deed? Why?
- Registry: which are the effects of the company registration?

Finally, certain activities require special permits from the regional and local administration, something that may vary with the town, region or country. Permits do not condition the existence of the company as a legal person but the running of the economic activity according to the applicable law.

2. STRUCTURING INVESTMENT AND DECISION MAKING

2.1. Decision-making in the company

Reading materials and other additional references:

- (Read again) RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, *Introduction to Spanish Private Law: Facing Social and Economic Challenges,* London: Routledge, 2009: pp. 120-124
NOTE: Please note that the references of the book to old legal provisions have to be updated according to the law in force (1/2010, of July 2)

- Spanish Corporations Act, 1/2010, of July 2: Articles 58-60, and 86-89

Main ideas, aims and questions:

Once the organizational form has been chosen for running the business, we are going to study how this new legal person (the company) acts in the market: how this person adopts a decision and how interacts with third parties to enter into economic transactions. The premise is that we have decided to set up a commercial company, in particular, a Limited Liability Company (LLC / SL under Spanish Law) or a Corporation (Corp. / SA under Spanish Law).

Within a commercial company there are two basic positions: partners / shareholders (ownership) and directors (management and administration). Note that we use "partners" to describe LLC's owners and "shareholders" to denominate Corporation's owners. Whereas shareholders hold shares that can be negotiated in a stock exchange, partners hold an interest (stakes) in the company that are not negotiable in financial markets, albeit they are transferrable. For convenience purposes, we can use the expression "members" to designate partners as well as shareholders indistinctly.

In a commercial company, partners / shareholders are the owners of the company because they have contributed to the company's capital. This contribution can only be in form of money, property or rights that are susceptible of economic appraisal (i.e. cash, goods, real state, equipment, trademarks, patents, receivables, and so on). In exchange for this contribution, the member receives shares (stakes or interests) that represent a part of the company. Therefore, in commercial companies (LLC/Corp.) members cannot receive shares or hold stakes in the company in exchange for services or work. Notwithstanding the fact that shareholders/partners cannot provide services of any kind to the company in exchange for shares, can they be obliged to perform other ancillary obligations (i.e. to provide professional services)? Can they be expelled from the company in case of non-compliance of ancillary obligations? See Articles 86-89, Spanish Companies Act.

In their condition of company's owners, partners/shareholders are entitled to adopt decisions regarding the company and making a profit from running the business. To that end,

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partners/shareholders have decision rights and economic rights. The extent of those rights does only depend on their interest in the company's capital (in principle, the percentage in the total capital). So, higher the percentage of the capital holds, higher the power to decide is and higher the expected benefits are.

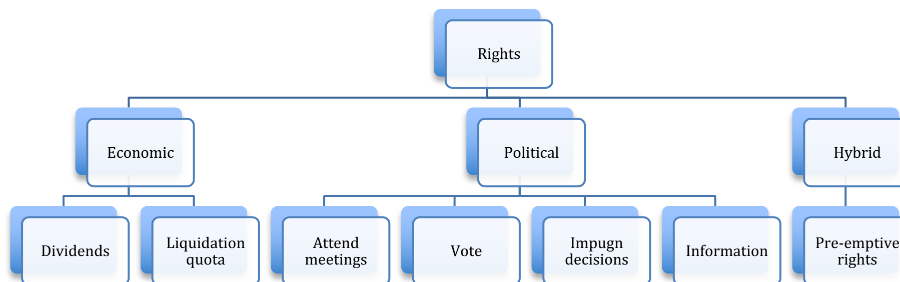
2.1.1. Decision rights and economic rights

Reading materials and other additional references:

- Spanish Corporations Act, 1/2010, of July 2: Articles 93, 209, 210 and 225-232

Main ideas, aims and questions:

According to Article 93 Spanish Companies Act, members have three types of rights: economic rights (rights of patrimonial or economic character), decision rights (rights of personal-political character); and to a certain extent rights of hybrid character.



a). Pure economic rights comprise right to share in the profits (right for receiving dividends), and right to receive corresponding liquidation quota in case of company liquidation. The right to receive dividends resulting from the distribution of company profits is not an absolute right. That means that a member has only the right to receive dividends provided that in the Shareholders' Meeting such a decision is adopted. It can be decided instead that a portion of benefits or the totality of them will be retained to increase financial reserves or to compensate for previous year losses, *Supreme Court,* judgments of 27 March, RJ 1973/1126; of 10 October, RJ 1996/7063. Therefore, shareholders / partners do not have to receive benefits always and in any case, but only if the company has benefits and these earnings are to be distributed. However, a decision adopted by the majority of members likely to entail the systematic deprivation of dividends from minorities could be considered null on abusive grounds or even reason for separation (art. 348 bis LSC).

b). Decision rights encompass those rights articulating member position in decision-making. Accordingly, they are distilled in the voting right that presupposes the right to attend meetings, that is susceptible of being limited (only in Corporations (SA)) by requiring a minimum number

of shares never up to one per thousand of the capital), and the right to be duly informed on relevant matters related to company.

Likewise, right to impugn decisions adopted by Shareholders' Meetings (or similar body) on the grounds stated by law stems from the essential right to participate in decision-making. If the impugnation is accepted, the decision will be declared null and void.

c). Hybrid right category gathers those rights combining political aspects and economic elements. Thus, pre-emptive right reveals, on the one hand, political dimension as far as it prevents shareholder/partner (and convertible debenture holder) from diluting relative share on an increase of capital (shares or convertible debentures), and, on the other hand, economic dimension since constitutes the respective widening of share in profits and other patrimonial effects in conformity with newly acquired shares. Pre-emptive right can be relinquished and transferred by the holder, and in certain cases and under specific conditions it may be derogated or excluded.

Basic rights as expounded above shapes an ordinary model of shares. Nevertheless, classes of shares can be issued whereby the redefinition of rights conferred to holders in order to satisfy varied needs of investors and companies' fundraising. Spanish Companies Act contemplates the possibility of issuing different classes of shares where rights differ and different series of shares where nominal value of shares changes. Classes of shares available under Spanish legislation are the following.

i). Firstly, privileged shares that aim to grant a preferred divided without altering proportion between nominal value and voting right (and pre-emptive right) and provided that privilege does not entail the receiving of an interest as being fixed interest investments (Article 96). Why the granting of a fixed interest is forbidden? Because, unlike creditors, holders of shares, albeit privileged ones, are assuming the risks that the business venture entail. They are owners of the enterprise and participate in proportion in its success and failure. Unlike interests, dividends are by nature uncertain and variable.

ii). Secondly, non-voting shares – provided that nominal value of issued non-voting shares does not amount up to half of pay-out capital - that logically are deprived of voting right in exchange for the right to receive minimum fixed or variable dividend per year (not an interest) that is to be paid as far as there is distributable profit. Once agreed the payment of minimum dividend, non-voting shareholders are entitled to receive ordinary dividend as the remainder ordinary shareholders (Articles 95). Non-voting shares are suitable for minority shareholders whose main purpose is of financial character (receiving dividends) and slender interest in participating in decision-making. Issuance of non-voting interests by LLC (*sociedades limitadas)* is also admitted, but moreover, possibilities to personalize interests by modifying voting rights are greater that in SA. Accordingly, LLC (*sociedades limitadas)* are authorized to issue interests with plural voting rights or under a one person-one vote scheme.

iii). Thirdly, redeemable shares that can be only issued by quoted companies - Corporations (*sociedad anónima*) - and in a number (nominal value) not greater than a quarter of capital.

Redeemable shares can be redeemed on terms and conditions stated in the issuance agreement by the company at its own request or/and at the request of holders (Articles 500-501). In which situations can the issuance of redeemable shares be an advisable strategic decision? For instance, a company may decide to issue redeemable shares to finance the running of a particular project. Once the project is completed, the company might not need such an additional capital and decide to reimburse the contributions and redeem the shares to keep the capital within more reasonable or affordable limits. As far as shareholders are concerned, redeemable shares offer an easier and more convenient exit. As a matter of fact, they can recover their investment upon the redemption of their shares. Unlike ordinary shareholders, their exit from the company is not dependent on the fact that a third party (or a current shareholder) wishes to acquire their shares. Should shares be illiquid (low negotiability degree), shareholders might be locked in the company longer than expected. Moreover, in such a case, price has to be negotiated, is uncertain and might be unprofitable. Contrarily, redemption of redeemable shares is subject to a set of pre-defined conditions.

2.1.2. The shareholders' meeting, statutory formalities of decision-making, and voting syndicates

Reading materials and other additional references:

- Spanish Corporations Act, 1/2010, of July 2: Articles 159-168, 173, 175, 176 and 178 and other provisions expressly stated below.

Main ideas, aims and questions:

Decision-making is vested in the General Meeting of shareholders/partners (called in Spanish *"Junta de accionistas"* in SA (Corp.) or *"Asamblea de socios"* in SL (LLC)), duly convened for deliberating and deciding on majority basis on certain matters related to the company within the scope of competence. General Meetings can be classified in two modalities: ordinary meetings and extraordinary meetings. Ordinary meetings are to be held in first half of the year with the purpose of deciding and agreeing on three matters: to evaluate management, to approve previous year accounts, and to allocate current financial results. Extraordinary meetings are defined by exclusion as those meetings other than ordinary meetings.

Shareholders/partners are entitled to participate in the decision-making process in their capacity of owners. Accordingly, they have to be duly called to attend the General Meeting where decisions are adopted. In small or medium-sized companies, meetings might be convened *in practice* more easily, with no formalities and individually to each partner. However, in big companies with a high number of scattered shareholders, even living abroad, or in small companies with conflicts among members, meetings have to be convened formally, guaranteeing sufficient notice and complying with some formalities (time, location, agenda). Those situations would explain the formalities that traditionally have to be met under Spanish Law to validly convene Shareholders' Meetings: the call is to be published in the Official Bulletin of Mercantile Registry and one newspaper among those of major circulation in the province where registered

address is located. However, company members are entitled to modify such a formal legal regime and lay down more flexible and realistic rules likely to better meet their interests and more suitable for their company's characteristics. Accordingly, bylaws can provide for rules to be followed to convene a Meetings: call can be published on the website, an automatic service of electronic notice can be implemented, or meetings can be validly convened by email, text or any other mechanism likely to acknowledge receipt.

Notwithstanding the abovementioned call procedure, a meeting can be validly held on an informal basis. This meeting is called "universal meeting" and is held when members holding the entire capital are attending and agree to adopt decisions according to the agenda they decide, even if it has not been formally convened (Article 178). That is very common in small and medium-sized companies where partners can agree to celebrate a meeting and adopt decisions, seizing, for example, the opportunity of being together anywhere and for any purpose.

In any case, all decisions adopted by company members have to be recorded in the Minutes (Article 202). What are the Minutes for? Firstly, Minutes are for evidence purposes. Secondly, Minutes enable shareholders to exercise their right to be informed about company's activities and decisions. Thirdly, if the decision adopted in the meeting has to be registered in the Registry, it is recorded in the Minutes.

Decisions are adopted on majority basis. Different majorities are established by law depending on the matter to decide on (Articles 198, 199 and 201). More important the decision is, higher the majority is required. Bylaws may modify majorities stated by law (Articles 200 and 201.3), stating higher majorities that those provided for the law; unless expressly forbidden. Legal majorities cannot be reduced by bylaws though. For bylaws to personalize decision-making model, legal majorities (number or percentages of votes) can be increased. Nevertheless, requiring unanimity (100%) is not admissible. Why cannot companies require unanimity in the decision-making? Decision-making in commercial companies is inspired by a capital-based majority rule (a kind of "capitalist democracy"). In practice, if unanimity is required, companies might become ungovernable.

Deliberating and decision-making processes are traditionally presumed by the law to be naturally face-to-face and mainly oral. Today, the use of new technologies enables distance attendance and voting by simulating digital spaces able to emulate presence meetings (videoconference, digital platforms) (Article 182). Which risks should be prevented? Impersonation (use of electronic signatures or sophisticated identification keys), interception, hacking or technical failures, ineffective participation of any shareholder due to its location, limited technical skills or reduced percentage of participation, lack of transparency or manipulation of votes and decisions.

Decisions adopted are subject to contestation by members on the following grounds: being against the law, infringing articles of association, or harming company's interests in the benefit of one or several shareholders/partners or third parties. According to the severity of infringed interest decisions are classified as null or avoidable. As far as null decisions are concerned, all shareholders, directors and any other person holding legitimate interest, are entitled to claim for

declaring decision void. In case of avoidable decisions, only those shareholders having attended the meeting and whose opposition has been recorded in the minutes, directors and non-attending shareholders or those shareholders illegitimately deprived of their voting rights.

2.1.3. Choosing a model of direction

Reading materials and other additional references:

- Spanish Corporations Act, 1/2010, of July 2: Articles 209-210
- Law 31/2014, of December 3, to improve Corporate Governance

Main ideas, aims and questions:

Administration body is entrusted with management functions, performance of adopted decisions and representation role of company in relationships with third parties. Directors are part of the administration body.

Administration body (or direction) may adopt the following structures:
- sole director,
- several directors acting on jointly and severally basis – either director is fully entitled to bind the company, and accordingly, can sign individually in the name of the company and represent it against third parties -;
- two directors acting on joint basis – both directors have to sign any transactions to be valid, they cannot act individually and separately -; and
- Board of Directors that is collective body (a committee) acting and deciding on collegial basis and according to majority rules.

2.1.4. Anticipating conflicts and breaking deadlock

In case of parity of composition (an even number of members), a lack of agreement may lead to an indefinite deadlock. If the company becomes ungovernable for no decision can timely be adopted or even is indefinitely postponed, the company heads towards to dissolution.

Therefore, several preventive measures should be advisable: an even number of members in the Board of Directors, a mechanism of dispute resolution in case of conflict (arbitration, mediation), the nomination of an expert if disagreements refer to technical issues, an informal protocol to break deadlock (resort to holding company).

2. STRUCTURING INVESTMENT AND DECISION MAKING

2.2. Financing the business project: financial structure, investors and investment agreements

2.2.1. Sources of investment, stages of company's development and types of investors

2.2.2. Partners/shareholders: basics of capital and consideration for shares

<u>Main ideas, aims and questions</u>:

Yet the company is incorporated, available financing options for the business project have to be considered.

Firstly, company-financing strategy can be based on two different funding sources: equity and credit.

a). On the one hand, **equity financing** entails that financial needs of the company are covered by current partners (founders) or prospective investors wishing to become owners of the business. As owners, they are exposed to business risks but, in exchange, they are entitled to participate in company's benefits via dividends. Dividends are, however, variable and uncertain. Depending on the stage of development, financial resources can be contributed by: existing partners, different types of investors or the investing public.

a.1. Partners: if the company needs further funds, current partners (or shareholders) may be willing to make additional capital contributions to the company. The capital increases accordingly; new stakes (or shares in a Corporation) are issued and existing partners exercise their right to subscribe them in the corresponding number in exchange for each contribution. In a capital increase, nevertheless, a dilution problem may arise. Should all existing partners be able to contribute in an amount likely to allow them to maintain their previous percentages in the company capital, no distortion in the power balance results. But if some partners cannot or do not want to subscribe new stakes (or shares) enough to retain their previous percentages, the capital increase has an unwanted dilution effect. Those partners who are not subscribing entirely the new stakes package, or they are not even subscribing any new stake at all, will lose part of their control of the company and will receive less dividends comparatively.

An example: PAYMING, SL

Year 1: Start-up
Initial capital: 50.000 Euros
3 Partners:

- Patrizia: 10.000	20%
- Carlos: 10.000	20%
- PayMicro, S.L.: 30.000	60%

Year 2: First financing phase
Financial needs: 50.000 Euros
Final capital: 100.000 Euros

Situation A: all partners can contribute in the required amount

- Patrizia: additional 10.000	Total 20.000	20 %
- Carlos: additional 10.000	Total 20.000	20%
- PayMicro: additional 30.000	Total 60.000	60%

Situation B: two of the partners cannot make any additional contribution to subscribe new stakes (*dilution effect*)

- Patrizia: 0	Total 10.000	10%
- Carlos: 0	Total 10.000	10%
- PayMicro: 50.000	Total: 80.000	80%

a.2. Investors: third parties might be interested in investing in the company. Hence, investors may subscribe new stakes (or shares) after a capital increase or buy stakes sold by existing partners. Investors become partners (or shareholders) accordingly – types of investors will be explained under section 2.2.3 below -. The entry of investors arouses, however, dilution risks. We will study under section 2.2.5 below how to prevent and manage dilution in those cases.

a.3. Public: the final and most ambitious funding decision of a company is going public. Only corporations, whose capital is divided in shares, can go public provided that it complies with a set of requirements laid down in the Financial Markets Regulations and specifically in the Rules and Procedures approved by each stock exchange. A company who decides to go public sells part of its stock (shares) by an Initial Public Offering (IPO) addressed to the public. If the IPO is successful, company's shares start to be negotiated in a stock exchange. Therefore, a quoted company (also called publicly-held company, publicly traded company, listed company) has access to capital markets to finance its business. But, at the same time, it starts to be subject to a tougher regulation and supervision and have to comply with disclosure and information obligations. We will study financial markets and listed companies further in Block 4.

b). On the one hand, **credit-based financing** means that the company receives money from a creditor that has to be repaid in an agreed period of time with interests. Therefore, the capital of the company is not affected by the credit. Creditors are not considered owners (partners / shareholders) of the business and are not entitled to exercise any of partners' rights (voting rights, rights to dividend, right to attend meeting, right to nominate directors, right to subscribe new shares). So, creditors do not assume business risks, at least, in theory. Their expected returns are the interests that the company has to regularly (monthly, yearly) pay along the agreed time. Unlike dividends, interests are certain and fixed in the sense that they are not conditioned existence of benefits and the amount of them.

Basically, credit can be received from financial entities (a bank loan, for example) or from the public (bondholders). In the second case, the company, instead of asking for a credit to a financial entity, issues bonds that can be bought by the public. Bonds are financial instruments representing parts of a credit. A bondholder buys bonds paying to the company the value of them and receives interests in exchange for. At the end of the agreed time, the company repay to the bondholders the amount received from them. Thus, the issuance of bonds is a method for financing companies via credit.

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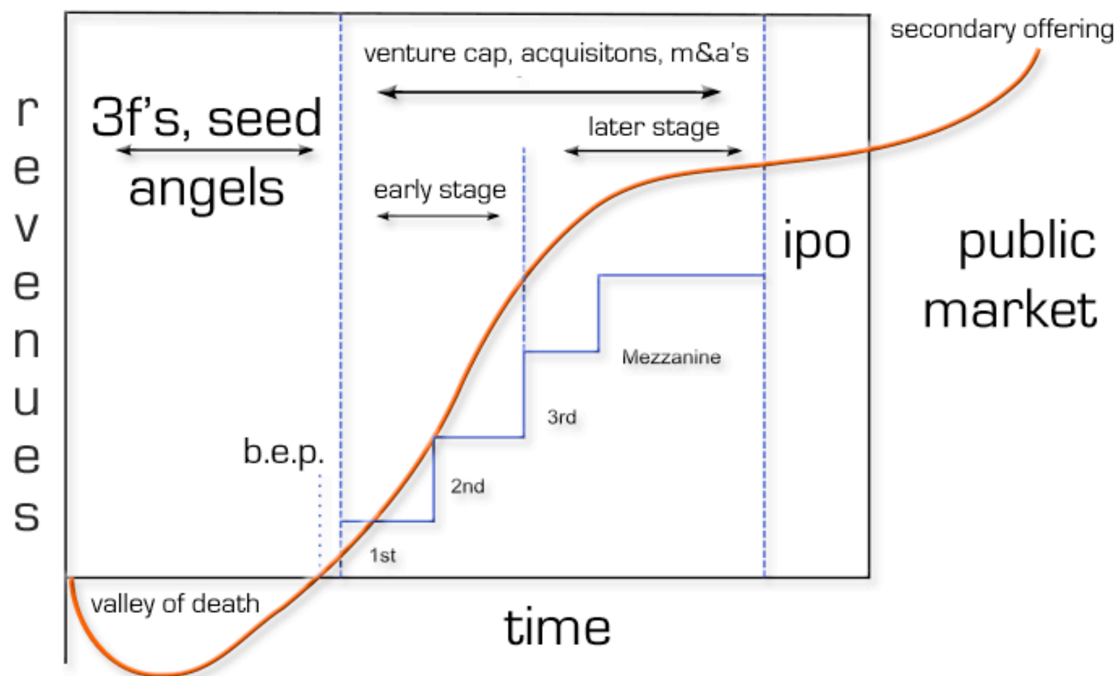
Secondly, it is well worth noting as well that there is a close link between the stage of the business' development and the most suitable financing option. Therefore, not all available financing options should be considered adequate for any kind of business in any stage of development. The diagram below illustrates the abovementioned relationship between the business development and the sources of financing.



STAGE 1: IDEA AND START-UP (seed-capital)

3FS: Family, Friends and Fools

Business Angels

Incubators and seed accelerators: funding, mentoring, training, expertise, management skills, technical support, a place to work…

Crowdfunding

STAGE 2: EARLY GROWTH AND EXPANSION

Venture capital funds

Private equity

STAGE 3: MATURITY

Mergers and acquisitions and others

Bank financing

Management Buy-Out, Management Buy-In, Buy-in Management Buyout

2.2.3. 3Fs, business angels, venture capital and emerging forms of "crowdfunding" to finance business projects

1). 3Fs ("friends, fools and family"): the people who may provide the initial funds when partners have no money or assets of their own, or what they have is not enough;

2). Business Angels: the first external source of capital. Business angels (or informal investors) are individuals who are interested in investing, usually, in highly innovative and creative start-up business in exchange for equity (usually 10%-20%)

3). Venture capitalists: companies or funds whose main activity is indeed invest in other companies. They are then professional investors who subscribe stakes or shares of the company in exchange for their funding. Their ultimate aim is to disinvest in the future (an average range of 3-5 years) with capital gains.

4). Crowdfunding (crowd financing): describes the collective effort of individuals who network and pool their money, usually via social networks and P2P platforms, to support, sponsor and finance projects leaded by other people or organizations.

They are a variety of crowdfunding models: based on pre-sale, reward, donations, microcredits or equity. Some examples:

1. Kickstarter www.kickstarter.com
2.- Partizipa www.partizipa.com
3.- TheCrowdAngel www.thecrowdangel.com
4.- Coworking Utopic_US www.utopicus.es
5.- Verkami www.verkami.com
6.- Microcredits platforms: P2P Social Lending: MycroPlace, Kiva, MyC4

2.2.4. Attracting and keeping talent: participation in profits, stock options schemes and "vesting" plans

An important aspect of a start-up company is attracting and keeping talent. An effective method to attract and retain talent may be to offer to directors and key employees a direct part in the company's capital, which also means a participation in its benefits.

The company should carefully design a remuneration system that attracts, keeps and motivates talent according to the law: stock option plan, vesting plans or stock appreciation rights schemes. Any system of incentives and compensation that the company can design will usually consist on either:

1) the company giving money to a designated person;
2) the company giving shares to a designated person; or

3) the company giving the designated person options to buy the company's shares; and including a stipulation that if the designated person ceases to be involved in the business, she will lose (or will not acquire) any rights to money or to exercise options, and/or will have a duty to resell the already acquired shares to the company.

If the plan involves giving a person *actual* shares, or options settled by the delivery of shares (i.e. not cash-settled options) the company needs to give that person those shares. There are 2 possible ways: the company can (1) issue new shares; or (2) give the person shares that the company owns. Can a company issue and subscribe its own shares (articles 134-136 Spanish Corporations Act)? At the time of incorporation, a company cannot subscribe its own shares. Such as acquisition is null and void. However, only in certain cases (articles 140-143 Spanish Corporations Act) a company can subscribe its own shares after its incorporation but they have to be sold within the next three years.

2.2.5. Preventing dilution while facilitating entry: nominal value and premiums

The entry of an investor in the company could arouse an unwanted dilution problem. Since the investor may be willing to invest a high amount of money as equity capital, existing partners / shareholders can have to face a dramatic reduction of their percentages and, as a consequence, a significant decrease in prospective dividends and, as a matter of fact, a loss of control. Remember this example:

Year 1: Start-up

Initial capital: 50.000 Euros

3 Partners:

- Patrizia: 10.000	20%
- Carlos: 10.000	20%
- PayMicro, S.L.: 30.000	60%

Year 2: First financing phase

Financial needs: 50.000 Euros

Final capital: 100.000 Euros

Situation A: existing partners cannot contribute to the capital increase. The investor will subscribe the whole number of new stakes.

- Patrizia: 0	Total 10.000	10 %
- Carlos: 0	Total 10.000	10%
- PayMicro: 0	Total 30.000	30%
- Investor: 50.000	Total 50.000	50%

Situation B: the investment is divided in two parts. Only a reduced amount of the promised funds is considered capital contribution (10.000 Euros). The remaining part (40.000 Euros) is considered "premium" and is invested in the company in form of "patrimony" (reserves, retained earnings and similar). So, existing partners manage to

reduce the envisaged power of the investor in the company without loosing the investment.

Final capital: 60.000
Total company property: 10.000

- Patrizia: 0	Total 10.000	16 %
- Carlos: 0	Total 10.000	16%
- PayMicro: 0	Total 30.000	50%
- Investor: 10.000 (capital) + 40.000 (premium)		16%

2.2.6. Entry in and exit from the project

The entry of a new partner/investor is good news, but must be managed carefully to facilitate the transition. In fact, most of the legal implications for a new entry have already been covered. There are two ways in which the entry can be facilitated: by an issuance of *new* shares (the company gives the shares to the new shareholder), or a purchase of existing shares (the company, or a former shareholder / partner, sells shares / stakes to the investor). Consequently, it is in these two respects where the law (or the parties', through their documents) can facilitate/make harder the entry. The use of premiums is a method to prevent the dilution risks without losing the expected financial boost. The premium is added to the nominal value of each stake / share.

Initial Capital: 50.000 Euros
Number of Stakes: 500 (same class and same series)
NOMINAL VALUE: 100 Euros each
Minimum CONTRIBUTION must always be at least the NOMINAL VALUE
Can Contribution be higher than NOMINAL VALUE? Yes

CONTRIBUTION = NOMINAL VALUE + PREMIUM

Remember that Premium is not considered equity capital. Accordingly, the investor can only exercise its rights in relation to the part of the investment that has been considered capital contribution (10.000 Euros in our example).

Sometimes one of the original partners/investors may be interested in leaving the project altogether. This may be due to a situation of mutual agreement, or to a situation of conflict; but either way it is important to provide for a mechanism to facilitate the smooth exit from the project. Reasonably, in a successful business, the sale price (the exit price) will be higher that the Nominal Value. In those cases, the Market Value is used. In our example:

YEAR 1:
Initial Capital: 50.000 Euros
Number of Stakes: 500 (same class and same serie)
NOMINAL VALUE: 100 Euros each

YEAR 2: retained earnings (100.000 Euros)
Capital: 50.000 Euros
Patrimony/Property: 150.000 Euros
Value of the company: at least 150.000 Euros
MARKET VALUE: 300 Euros each

In the exit, some conflicts of interests may emerge. Those risks and conflicts should be anticipated and carefully regulated in the bylaws and/or in the investment agreement. Two popular clauses that used to be included in investment agreements are today a commonplace in the bylaws: "drag-along" clause, and a "tag-along" clause. Before studying the clauses and gaining a full insight into the situations they are facing, it might be well worth reminding the different implications of their inclusion in the bylaws or in an investment agreement.

Two main consequences distance the bylaws and the investment agreement from each other.

1). Firstly, bylaws' provisions bind all partners/shareholders of the company, no matter if they were founding partners or they joined the company afterwards. Every partner/shareholder has to abide by the bylaws' provisions as drafted and agreed anytime. Since partners/shareholders are entitled to decide and agree to modify the bylaws (with the required voting majority), it may happen that although a (minority) partner/shareholder might vote against (or not vote even) the decision to modify, the meeting would adopt, with enough support, the decision and proceed to modify the bylaws. In such a case, the dissenting partner or the absentee has only to options: stay and abide by the new bylaws; or leave the company. Both options, nevertheless, should be qualified. On the one hand, the general rules is that when a decisions if supported by the required majority, it is adopted and binds all partners. Exceptionally, the decision could have been adopted against the law, in nonconformity with the bylaws or detrimental to the company's interest and in favor of one or several partners or third parties. In such cases, should the partner stay, the decision could however be impugned on certain grounds as laid down by the law (Article 204). In particular, a decision can be challenged if it has been abusively imposed by the majority in its benefit and with an unjustified detriment of other partners and without being based on a reasonable need of the company. If the decision is contested, the Court will assess whether the decision is valid or invalid. Apart from these exceptional cases, a decision duly adopted at the meeting will bind all partners. Contrarily, an investment agreement is a contract. Accordingly, only contracting parties are bound by contract terms (*inter partes* effects). The investment agreement can be signed by the company as a legal person and the investor or by all or several partners and the investor. Hence, no-signing partner is not bound by the contract.

2). Secondly, effects of non-compliance are different. Should a decision be adopted failing to fulfill bylaws' provisions, the decision is not valid. However, it the decision is adopted in compliance to bylaws' provisions but in breach of the investment agreement, the decision is valid. Contracting parties who signed the investment agreement are only entitled to enforce the agreement against the non-fulfilling party on grounds of breach of contract. For example, if the investment agreement is not duly performed, the injured parties can ask for compensation or can enforce any penalty included in the agreement in case of default. But, the decision, despite the

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breach of the agreement, is overall valid, provided that it meets both legal requirements and bylaws' provisions. Considering that contractual penalties in case of default might lack enough deterrence effect to prevent the breach, a mechanism to discourage the noncompliance might be devised. Cleverly, the compliance to the investment agreement might be included in the bylaws as an ancillary obligation. Provided that all legal conditions to validly create an ancillary obligation are met, the noncompliance of the agreement may entail the expulsion of the partner from the company. Thus, a connection between the agreement and the bylaws has been created aimed at deterring from noncompliance. In effect, a "corporate" sanction is applied to discourage a "contractual" misbehavior.

In sum, should drag-along and tag-along clauses be included in the bylaws, they will enjoy all above-explained effects and legal consequences.

Drag-along clause

The situation that drag-along clauses are expected to deal with is the following one.
Partner A holds 75% of the company (the majority partner). The remainder is divided among three minority partners holding 10% (Partner B), 10% (Partner C) and 5% (Partner D), respectively. An investor appreciates the business value and its potential and shows his/her willing to acquire the company. The prospective investor wishes to avoid any dissension within the company and does not want to deal with minority partners. Therefore, the investor's offer is only to acquire the whole company (100%). Should the offer be attractive, the majority partner is decided to sell but the success of the deal is conditional to the acceptance of the minority partners as well. Against such a backdrop, the majority partner would like to protect his/her interests and secure the deal. Otherwise, the majority partner is a "prisoner" in the company. To that end, a drag-along clause should have been negotiated in advance and included in the bylaws.

Since the investor is only disposed to buy 100% of the company and is not interested in acquiring just a part of it, the majority partner needs to a legal tool to force the minority partners to sell as well.

As per a drag-along clause, minority partners commit to sell to the investor in the same conditions. Therefore, Partners B, C and D have the following alternative: either they decide to sell to the investor with Partner A; or they offer Partner A to buy his/her stakes/shares in the same conditions as the investor proposes – bylaws' provisions regulating transfer of shares/stakes are relevant here -. Given that the minority partners, despite their commitment, might be reluctant to comply with their obligation to sell or to buy, the drag-along clause should contain a precautionary measure to unblock the situation. Thus, the drag-along clause shall provide Partner A a call option (a right to buy) in those cases. Effectively, Partner A, in view of the refusal to sell of minority partners, exercises the call option. Under the call option, Partner A is entitled to buy all minority partners' stakes/shares under certain conditions. As a consequence, Partner A would hold the 100% of the company and be entitled to sell now to the investor in the agreed conditions. The call option can be shaped as parties wish. The price by Partner A is entitled to buy from minority partners could be either exactly the same as the investor is offering or a lower one as a punishment of minority partners' breach of their commitment.

Tag-along clause
The tag-along clause is a counterweight in favor of minority partners.

The conflict arises in a company where Partner A holds 75% of the company (the majority partner) and the remainder is divided among three minority partners holding 10% (Partner B), 10% (Partner C) and 5% (Partner D), respectively. In this case, however, the investor, who also appreciates the business value and its potential, is only willing to acquire part of the company. In the negotiations between Partner A and the investor, the latter confirms an offer for the 60% of the company at a very good price. Partner A could take advantage of that excellent deal and sell his/her 60% of the company. Minority partners would remain unprotected and "captives" in a company with a new investor holding a majority position together with the "disloyal" Partner A. Tag-along clauses anticipate those situations and provide a re-balancing solution. In order to protect minority partners, they should have the right to take advantage of the deal and sell in same conditions. It has to be remembered here that the investor is not willing to buy 100% of the company but just 60%. Therefore, all partners can only be benefitted in their corresponding proportion. Thus, all partners would be entitled to sell 60% of their shares/stakes – Partner A, 45%; Partner B, 6%; Partner C, 6%; Partner D, 3% -.

Should there be no conflict, Partner A is expected to notify the rest of the partners about the deal (price, conditions, number of shares/stakes, acquirer). Then, minority partners can decide on good ground whether they want to adhere to the deal and sell in the exact proportion.

Contrarily, whether Partner A does not disclose the ongoing negotiations and conceal the deal or simply the investor, who cannot be forced to buy shares/stakes other than the initially considered, refuses to acquire from minority partners, tag-along clause provides for a defensive mechanism in favor of minority partners: a put option.

Minority partners are entitled to exercise their put option (a right to sell) and sell the proportion of their shares to Partner A. It has to be recalled that the investor (third party) cannot be obliged to buy; hence, Partner A takes on the commitment to buy from minority partners in proportion. Afterwards, Partner A can complete the transaction with the investor in the agreed conditions.
Like drag-along clauses, tag-along clauses can be shaped as parties wish. Interestingly, the price by which Partner A must buy shares/stakes from minority partners exercising their put option could be fixed differently: either the same price as the investor is offering or a higher price to penalize Partner A's disloyal behavior.

Personalizing the organizational model

In the process of personalizing the organizational model for running the business activity a set of key elements should be previously discussed and carefully considered in the bylaws (or shareholders' agreements). The following table summarizes key elements to be into account when anticipating an investor's entry.

QUORUM at the Members' Meetings	VOTING MAJORITIES to adopt agreements	CLASSES AND SERIES of stakes and shares
LIMITS of voting rights per share	VOTING MAJORITIES based on number of partners	ANCILLARY OBLIGATIONS
TRANSFER CONDITIONS	EXIT CLAUSES	PREMIUM