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KI Innovations

Shareholder agreements, sweat equity & incentive programs

KI Innovations 2024-11-12

Ulf Lindén and Sandra Jona

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13.00-13.50	**Founders - shareholder agreements**
Break	
14.00-15.00	**Team - incentives & models**
Break	
15.15-16.30	**Workshop Exercise – incentive models**
16.30	**Summary together**

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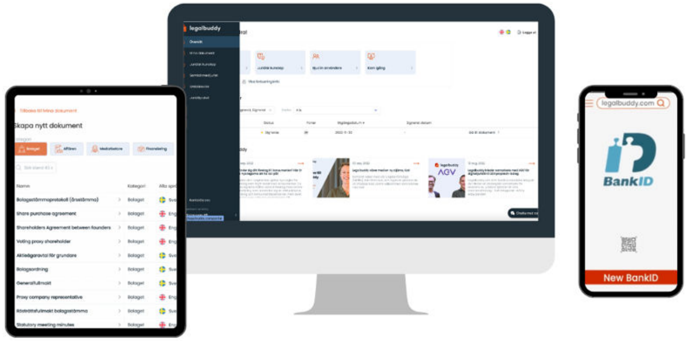

TESTA 30 DAGAR

- AVTALSMALLAR (40+)
- E-SIGNERING
- AVTALSHANTERING & LAGRING
- JURIDISK KUNSKAP
- FRIA FRÅGOR TILL JURISTER
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Ulf Lindén - experience as business lawyer from law firm, large international companies in life sciences and being advisor to start-ups, expert in corporate law

Leif Frykman - experience as a business lawyer for large Swedish companies, US IT companies in Silicon Valley and as an advisor to start-ups in the digital sector,

Maria Sandstedt - great expertise in IPR and research law, background from IP agency and former general counsel at RISE

David Ericsson - great expertise in IT law, data protection and general business law, former AstraZeneca, Bird&Bird and Magnusson Advokatbyrå

Petter Edfeldt- experienced pharma lawyer with backgropund from Abbott, Abbvie and Kry. Advisor and board member to start-ups .

Axel Tandberg - expert in GDPR and marketing law, member of the Advertising Ombudsman's Opinion Board, DPO for hire

Linda Ekborg - expert in mergers and acquisitions and company law, former Roschier law firm

Sandra Jona - advisor to start-ups with a focus on corporate law, shareholder agreements and incentive programs, responsible for the KPO offering

Shareholders' agreement
13.00-13.50

1. Why should you have a **shareholders' agreement**?
2. What are the **key terms** of the shareholders' agreement during the different phases of the company?

Why shareholder agreements?

1. **The Companies Act (ABL) only covers certain areas**
    - Company structure/capitalization
    - Decision-making mechanisms - board and general meeting

2. **Minimize the risk of disputes between shareholders**

3. **Getting investment ready!**

No shareholders agreement?

Decision making power according to Companies Act (ABL)

- The <u>board of directors</u> has the decision making power (BoD appoints the CEO and makes decisions on important issues)
- Chairman has a casting vote
- The <u>general meeting</u> appoints the board of directors, adopts the financial statements and decides on profit distribution
- Simple majority at general meetings and in the board (exceptions: private placements, amendments to articles of association, etc.)

Loyalty

- No agreement = no duty of activity, loyalty, confidentiality or non-competition for shareholders
- Board member has a duty of loyalty and confidentiality

Triggering/Redemption

- No right/obligation to redeem shareholders except minority redemption (at least 90%)

The life cycle of shareholder agreements

Founders

Alignment

Commitment

Decision making power between the founders

If someone leaves...

Early investors (seed/series A)

How much influence?

Guarantees for IP

Founders Commitment

Late investors (series A-C)

"Protective provisions"

Founders' shareholder agreement

1. Founders' handshake

- Definition of the business
- Business plan
- Actions/activities of the parties
- commitment, time period?

2. Finances

- Financing - obligation?
- Distribution of profits

3. Power

- Composition of the board
- Chairman's casting vote
- Who should be the CEO?
- Decisions at general meetings and board meetings - important issues require consensus
- Deadlock

4. Ownership

- Prenuptial agreement
- Personal guarantee for those acting through companies
- Right to transfer to holding company

Founders' shareholder agreement - key terms

- Pre-emption - cannot sell shares to third parties
- Redemption in case of breach of contract - discount to the shares
- Redemption in case of founder's death and illness - normal market price
- Drag-along/tag-along - regulates what happens if there is a offer for the company
- Non-compete clause - for the term of the agreement + 1-2 years - a penalty to make it useful
- Confidentiality - penalty

Typically the same provisions for all
Make sure you get it signed!

Agreements between founders and early investors (angels)

What does the investor want?

- Right to participate in new rounds
- Right to appoint board member
  (founders should keep majority)
- Veto rights for decisions affecting investment
  (avoid consensus requirements)
- Right to transparency
- IP assignment
- Activity obligation for founders and key persons
- Tag-along
- Certain exemptions to non-compete obligations
  (investment listed companies)

What do the founders want?

- Majority in the Board
- Non-consensus for important decisions (2/3 majority is better)
- Option pool (e.g. QESOs/KPO)
- Right of the Board to admit new shareholders to the agreement
- Right of founders to transfer founder shares to key persons
- Drag-along

Different rules for founders, key persons and investors

Agreement with later investors (VC)

What does the investor want?

- Right to appoint board member
  (founders must be prepared to give up power)
- Right to transparency/reporting requirements
- Lock-in/lock-up
- Vesting of founders' shares
- Liquidation preference - the investor ”gets his money back first”
- Anti-dilution - investor is compensated at low valuations
- Right to act in conenction with exit
- Exemptions for non-compete agreements

What do the founders want?

- Veto rights for founders

Different rules for founders, key employees, "the 'angels' and the new investors

The investor’s SHA template

Team incentives & models - Founders, co-founders, board members, advisors

Building teams
(with limited budget)

14.00-15.00

1. Employees or consultants?
2. Sweat equity
3. The co-founder model
4. The consultant model
5. QESOs/ KPO model
6. Selling shares to the team
7. Questions → workshop

Building the team

Employees vs consultants

Employees:

- Comprehensive regulation in law (LAS)
- Extensive employer liability
- Company responsible for taxes and contributions
- All benefits are taxed as income
- Written employment contracts
- Type of employment - indefinite or fixed term (up to 1 year) Probationary period?
- Include a confidentiality and IP clause

Strong commitment to the company and employees!

Consultants:

Have their own company

The consultant is responsible for taxes and fees (F-tax certificate)

The contract is important! Consultancy agreement checklist:

- Services & quality requirements
- Payment model - fixed monthly fee/per hour?
- Confidentiality
- The client owns the results (IPR)
- Non-compete clauses
- Contract duration and termination clauses

Flexible – scope and services

Sweat equity - key principles

Employees: Can you pay employees with shares?

- In theory yes, but each benefit must be taxed as salary (income tax + social security contributions).

Solutions:

1. Transfer of shares at market price
2. Qualified employee stock options (QESOs/KPO)

Consultants: freedom of contract as long as you invoice and account for the services correctly

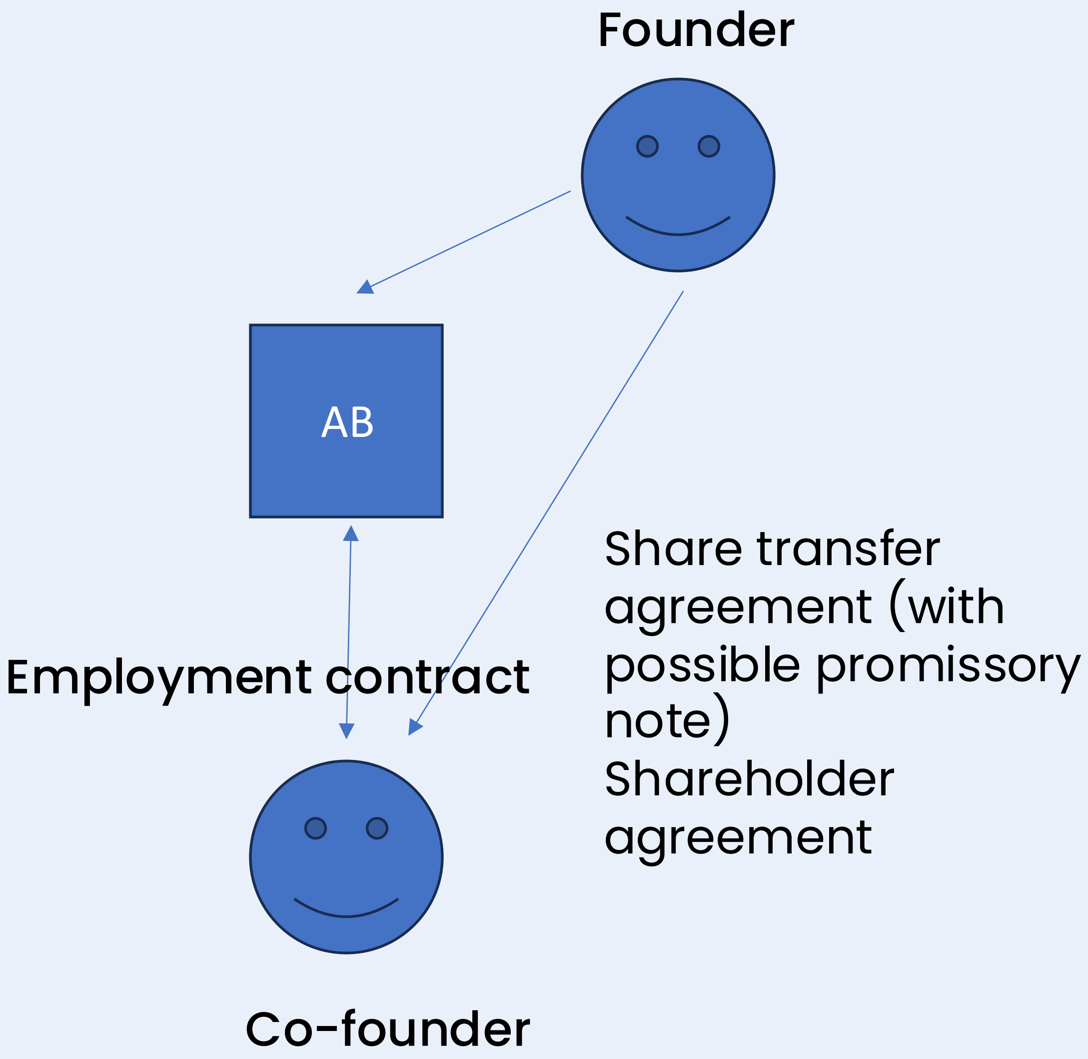
- Fees can be exchanged for shares in new issue of shares
- More flexibility to combine remuneration with shares or warrants

NOTE! It is important that the consultant is not a "employee in disguise " - i.e. a consultant who is to be equated with an employee!

Model 1: Co-founder

How does it work?

- "Co-founder" work on the same terms as **founders**
- Co-founder buys shares directly from founder
- Recipient joins shareholder agreement - regulation in shareholder agreement on when to start paying salary/co-founder's contribution
- Shares are valued based on <u>market value</u> at the time of acquisition.
- Recipient pays for the shares with cash or promissory note (market interest rate - basic interest rate + 1.5%)
- The right to keep the shares is earned during a so-called "vesting period"
- *Good leaver* vs *Bad leaver*



Model 1: Co-founder

Tax implications?

- valuation - how to value the company? indication: latest external valuation, not below net asset value
- Sale at below market value to employee = taxable benefit
- Taxable benefit = income tax for employee + social security contributions for company + tax surcharge
- Capital income taxation occurs when the shares are sold
- 3:12 rues (sw. Fåmansföretagsreglerna) often apply to a sale of shares

When to use the co-founder model?

- Early stage when the value of the company is low
- When you want to include the person as a shareholder in the company - co-founder

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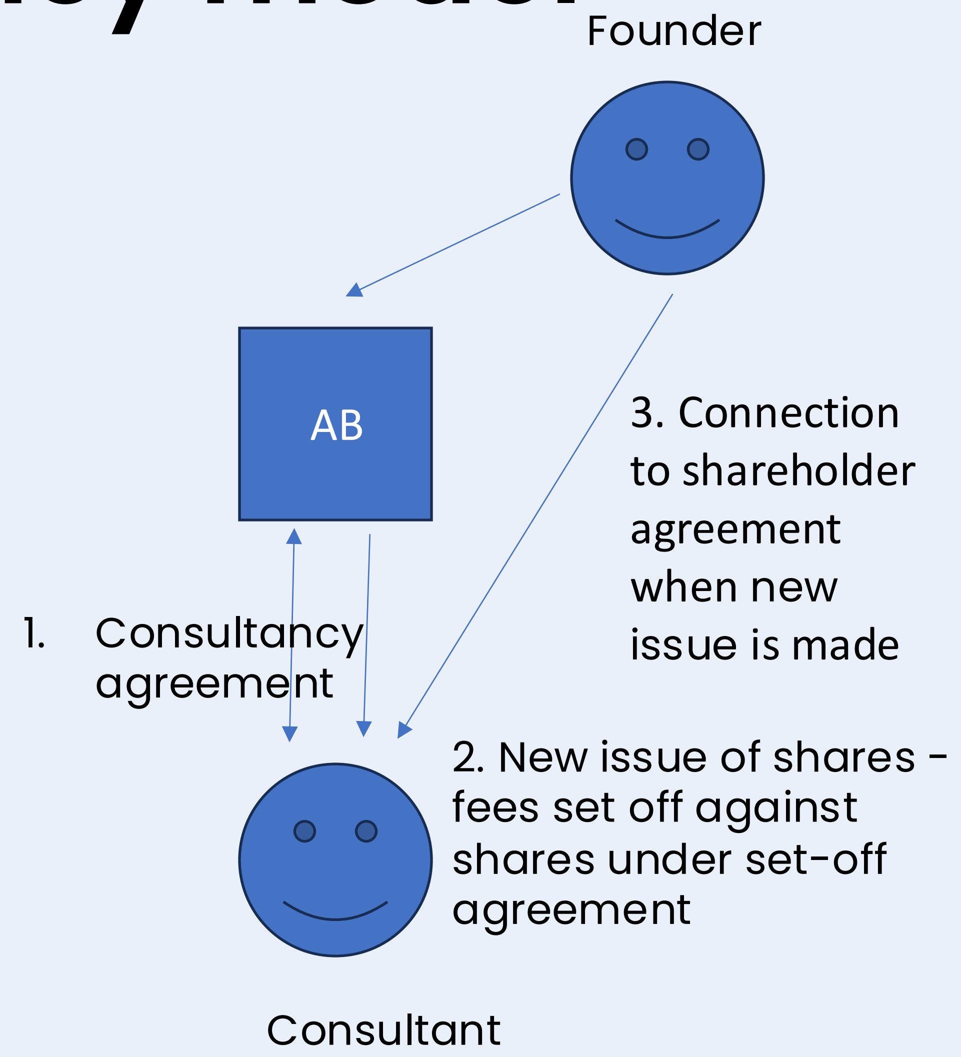
Model 2: The consultancy model

1. **Consultancy agreement**
   - The consultant´s fees will be offset as a payment for the shares.
   - A model for the share price (x SEK per share or the same price as other investors pay).
   - The approval of the majority owners.
2. **New issue of shares (decided by the general meeting or the board of directors according to registered mandate)**
   - The consultant builds up a consultancy receivable for services rendered.
   - Before the new issue, the consultant issues his invoice with VAT.
   - Capital amount set off against payment for shares - set-off agreement
   - The board's statement (which is approved by the auditor) in connection with the general meeting (ABL 13:7)
3. **Shareholders' agreement**
   - The consultant adhere to the shareholders' agreement
   - VAT paid and declared as usual by the consultant/company.
   - Possible agreement on when to pay the VAT part of the invoice.



Model 3: Qualified employee stock options, QESOs (*sw. KPO*)

Option = *a right to buy a certain number of shares at a fixed price (strike price) during a certain period of time (exercise period)*

How does it work?

- Contract between employee and company
- Specific conditions for the company, program and employees must be met for tax exemption - if conditions are met = tax exemption
- The vesting period must be at least 3 years
- Minimum salary 28 575 SEK/month (2024)
- QESOs can be issued free of charge (exempt transaction under the Income Tax Act)
- Strike price can be set freely - not governed by company valuation (quota value as minimum)
- Requires that new shares are created through a new issue- by a future general meeting (shareholders must support the program)

Specific conditions for QESOs

Not sure if you meet the conditions?

Do a free self-assesment at:
https://lwadvisory.se/sjalvtest/

The option issuer (company)
- Max 150 employees/280 million SEK in net sales
- Max 10 years old company
- The company does not conduct exempt activities, e.g. in finance, legal advice, accounting or auditing.

The option holder
- Works at least 30 hours a week for 3 years
- Salary at least 13 income base amounts = 28 575 SEK/month
- Max 5% of shares in the company
- Maximum options worth SEK 3 million.

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Selling shares with redemption rights – "vesting"

How does it work?

- Recipient buy shares directly from founders
- Shares are valued based on market value at time of acquisition
- Sale at a price lower than ”market value” = taxable benefit
- Recipient pays for the shares in cash or promissory note (with market interest)
- The right to keep the shares is earned during a "vesting period"
- *Good leaver* vs *Bad leaver*
- Recipient joins shareholder agreement

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Workshop exercise
15.15-16.30

Make a plan for expanding your team the next two years:

1. Describe your team today (number of staff, founders, employees, consultants, key persons, who has equity?)
2. What are the planned immediate actions with regard to staff (things you need to fix now) – new hires, allocation of equity, incentive programs etc?
3. How do you envision the team to develop for the next two years? How many new employees? How many new key persons?

Summary & questions

1. Fill in staff year 1 and 2
2. Allocate which incentive models to use:
    1. Early staff - buy shares (market price)
    2. Sweat equity (contractors)
    3. Options to buy shares (KPO) (minimum salary employees only)

Do's and don'ts

1. When selling shares to employees, you need to put a market value on the shares.
2. When paying through promissory note, you need to set a market interest rate.
3. Easier to find models with independent consultants, but formalities need to be handled
4. KPOs are a good model to compensate a low salary with equity
5. Make sure all new shareholders adhere/sign the shareholder agreement.
6. Update your share ledger
7. Avoid "special deals" - inappropriate sweat equity and incentive programs can be a showstopper for investment + tax risks
8. Don´t wait to take action – it will be more expensive and complicated if you wait until business takes off

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Thank you!

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4 dec: The legal road to investment

Legal road map for start-ups – getting investment ready. The session will cover the key aspects of legal preparation before an investment and also the legal aspects of the investment process and different investment models.

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