THE LEGAL FRAMEWORK OF THE STARTUPS AND THE VESTING CONTRACT

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1. STARTUP COMPANIES IN THE BRAZILIAN ENVIRONMENT: PRELIMINARY REMARKS

While being informally used on a daily basis in the most diverse environments — especially when referring to new companies usually tied to digital entrepreneurship —, the word *startup* is rarely conceptualized thoroughly.

Seeking to clarify what in fact is a startup, Eric Ries — founder of the *Lean Startup* movement — conceptualizes it as "*a human institution designed to create new products and services under conditions of extreme uncertainty*"[3].

In the national scope, Yuri Gitahy — entrepreneur, investor and founder of Aceleradora, a company which supports this kind of venture — points out a few requirements for a given business to be so called. According to him, "*a startup is a group of people in search of a business model that is repeatable and scalable, and who work in conditions of extreme uncertainty*".[4]

Seeking to bring this concept to the legislative environment, the Supplementary Law 167/2019, responsible for the regulation of the so-called Simple Credit Company, has defined startup as (Section 65-A, paragraphs 1 and 2):

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[3] RIES, Eric. **A startup enxuta**: como os empreendedores atuais utilizam inovação contínua para criar empresas extremamente bem-sucedidas. São Paulo: Lua de Papel, 2012. p. 13.

[4] GITAHY, Yuri. **O que é uma startup**? Available on: <http://aceleradora.net/2016/09/22/o-que-e-uma-startup/>. Accessed January 23, 2019.

> 1st A startup is considered to be a company of innovative character that seeks to improve systems, methods or models of business, production, service or products. These models, if already existent, characterize startups of incremental nature, or, when related to the creation of something completely new, characterize startups of disruptive nature.
> 2nd Startups are characterized by developing their innovations in conditions of uncertainty, which require constant experimentation and validation, through, among other things, provisional experimental commercialization before proceeding to full fledged commercialization and acquisition of revenue.

Seeking to unify all of the aforementioned characteristics, the core traits bound to this doctrine identified as such: (a) holding a business model; (b) in an uncertain environment; (c) which is repeatable and scalable.

In the Brazilian context, the hallmarks of our people — true born entrepreneurs — have caused the domestic market to grow exponentially in the last few years[5]. And, it is worth mentioning, this is in spite of the obvious bureaucratic obstacles that have always characterized the country.

These obstacles become clear as it is established that Brazil ranks 124th in the World Bank's *Doing Business* annual report, which gauges business environments in 191 (one hundred and ninety-one) countries. This data unambiguously shows that the Brazilian environment is still endowed with uncertainty, excessive bureaucracy and lack of legal security, undermining the investment of venture capital.

And considering that — as seen above — uncertainty is at the base of the concept of *startup*, investors of this kind of business certainly try as much as possible to mitigate possible risks related to their contribution, especially in regard to the environment in which the investment will take place.

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[5] In mid June, Nubank, a Brazilian financing startup, announced two extensions of the so-called "G-series" — the round of investments that was carried out in January and raised US$400 million — receiving two further contributions. With that, the company reached US$1.15 billion, making it the largest round of investments ever carried out by a private technology company in Latin America.

It was precisely with the goal of stimulating new businesses, enhancing legal security, and promoting innovation, that Brazil regulated most of the aspects related to the startup market, establishing the so-called Legal Framework of the Startups and of the Innovative Entrepreneurship.

2. THE LEGAL FRAMEWORK OF THE STARTUPS AND OF THE INNOVATIVE ENTREPRENEURSHIP

As seen above, despite the pitfalls of the internal environment — which, as it will be looked into, are being overcome —, Brazil has seen, in the last few years, an important surge in its number of startups, altering the previously existent paradigm and allowing this business model to be envisioned under a novel perspective. In other words, the experience from elsewhere in the world — notably from the Silicon Valley — has brought a new (and more serious) view to the emerging technology companies.

Nowadays, according to data from the Brazilian Association of Startups, the country has over 13,000 (thirteen thousand) companies that fall into this category[6], pointing to the development of the national innovative environment.

The discussion about the theme, especially in this context, has become the agenda of several investment funds, new businesses and companies seeking rapid innovation.

On this path, as of 2018, the first Brazilian symposiums started to take place, giving way to discussions on themes involving the regulation of this new type of venture market.

Following this, in 2019, the first edition of the Complementary Bill No. 146 was proposed after the carrying out of several public consultations to address the matter. The Bill advanced swiftly, coalescing usually opposing political parties that nonetheless

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[6] Avaliable on: <https://veja.abril.com.br/economia/brasil-avanca-aquem-do-esperado-com-marco-legal-das-startups/>. Accessed June 16, 2021.

wished to see the startup regulation happening, putting their trust on the development of the domestic market.

In 2020, the bill was approved by the Chamber of Deputies. Most recently, in 2021, the Complementary Bill was approved by the Federal Senate and, after the final vote in the Chamber of Deputies, taken to presidential sanction, which took place in June 1st, 2021.

Having come into effect 90 (ninety) days after its publishing (Article 19), the Complementary Bill No. 182/2021, despite leaving out several relevant themes, will certainly contribute to the legal security of the innovative ecosystem by characterizing an important normative framework and a milestone of foreseeability for future investors in the Brazilian market.

The new ruling sets the innovation agenda as a priority for the government and for the market, assisting in the mindset shift related to Brazil's venture capital and encouraging the highly important collaborative economies.

In sum, the following purposes for the *Legal Framework of the Startups and of the Innovative Entrepreneurship* are: (a) betterment in the business environment; (b) promotion of new business models; (c) enlargement in the offering of invested capital; (d) greater legal security; and (e) contracting of startups by the Public Administration.

Based in these purposes, the final edition of the Complementary Bill was grounded in three strategic axes, according to the Assistant Secretary of the Brazilian Special Bureau of Productivity, Employment and Competitiveness: 1. business environment; 2. facilitation of investments; and 3. State Actuation.

Regarding the first axis, the rules seek to allow greater access to the capital market, loosening of the management and reduction in the bureaucracy in the joint stock company scope. Originally — before the legislative amendments that altered and/or suppressed some of its points — there still was the purpose of granting more legal security to the utilization of stock options as a form of investment in startups. However, it was considered that the ruling should be verticalized in another normative instrument.

With respect to the second axis, the rules seek to allow for the enlargement in the offering of capital to be invested in innovative companies, the strengthening of legal security for all concerned players (with a reduction in the possibility of disregarding the legal personality of non partner investors) and the expansion of the contractual freedom of the angel investor. Regarding this last topic, it is true that the rules are still modest and fail to encompass some important matters related to this kind of investment.

In relation to the third axis, the following objectives can be mentioned: modernization of the relationship between the public sector and the startup ecosystem; an innovation testing program with an experimental regulatory environment (regulatory sandbox); and new procedures for the Public Administration to take when contracting with startups.

The approved text, despite not contemplating all the changes expected by the sector or including some of the tax incentives already present in other countries, characterizes an important paradigm shift, bringing greater legal security and making way for other technology companies — cherished as they are in the national market — to settle and grow in Brazil, with investments both domestic and foreign.

3. LACK OF SOLUTION TO THE IMPASSE REGARDING STOCK OPTIONS AND THE VESTING CONTRACT AS AN ALTERNATIVE

As mentioned above, one of the aspects whose regulation the startup market players had been waiting for was the treatment to be given to stock options, regulated in paragraph 3 of Section 168 of the Law No. 6,404, of 1976, notably regarding labor and tributary aspects.

The significance of the matter is tied to the fact that call options are one of the most widely used instruments to formalize the so-called "investments in services", regulating the juridical relationship between the startup and eventual collaborators whose talent/capability are of interest to the business owner. The instrument is commonly used, thereby, to attract qualified workers, since it is not always that these

emerging companies are able to generate enough influx to offer competitive salaries, especially when compared to large corporations.

The nature of stock options with labor and tributary purposes has not yet been definitely sorted out. From one side, there are those who understand that the instrument has a remuneration slant, therefore being a sort of salary. That would render the corresponding labor and pension duties demandable, thus making it a more expensive option. From the other, there are those who claim it to be an instrument of commercial nature — as if it were a financial transaction. In this hypothesis, profits earned through stock options should be taxed as capital gain.

The text originally referred by the Chamber of Deputies to the Senate settled the matter by defining that the call options had a remuneration nature. However, as stated above, the Senate has suppressed the handling of the topic, which will potentially be addressed in a more vertical manner by their own regulation.

In spite of the existence of a positive bias — since the remuneration character is not yet legally fixated — the lack of legal security surrounding the matter remains evident.

As an interesting alternative at the disposal of the startups stands the vesting contract.

After having elaborated on the theme, Oliveira and Ramalho[7] concluded that vesting:

> is a contract in which the parts agree on a distribution of the avaliable shares in an entrepreneurial company, in a gradual and progressive manner, taking specified productivity parameters into account.

To outline this concept, they stem from the need of two essential elements in the set of subjective obligations of the party interested in contracting with the company: (i) temporality; and (ii) productivity. In other words, they understand that, for the

[7] OLIVEIRA, Fabrício Vasconcelos de; RAMALHO, Amanda Maia. O Contrato de Vesting. **Revista da Faculdade de Direito da UFMG**. Belo Horizonte, n. 69, p. 184, Jul/Dec. 2016.

establishment of the "condition" of share distribution to take place, it will be necessary that a certain amount of time should have passed between that distribution and the contract signing and that, during this interregnum, the party/partnership should have yielded what was expected from the then holders of the share capital.

That would work as an encouragement granted to the collaborator of the company, proportionally to their commitment and, therefore, with no financial compensation in cash on their part.

In that manner, if the conditions manifested in the plan outlined between the company and the collaborator are not complied with, the untying of the societal bonds would be the logical outcome, without either party being entitled, in principle, to any right to compensation.

In a decision executed by Minister Augusto César Leite de Carvalho, the 6th Panel of the Superior Labor Court brings the concept of vesting closer to the concept of stock option plan, especially regarding the grace period for the exercise of the right of opting for the acquisition of shares by the companies' employees.[8]

According to the Rapporteur:

> The stock option plan, an instrument which effectively orientates the shareholding participation of the employees, must always rest on the following factors: (...) ii) period for the attainment of eligibility to exercise the options (grace period or vesting) and iii) deadline for the exercise of the options (expiry of the option).

It can be said that there have been, in this case, according to the Labor Justice, some distinctions between their understanding and the concept introduced by Oliveira and Ramalho, especially regarding the *time* for the acquisition of shares (grace period).

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[8] TST-AIRR-7400-93.2009.5.02.0511, 6th Panel. Rapporteur: Minister Augusto César Leite de Carvalho. Avaliable on: <https://tst.jusbrasil.com.br/jurisprudencia/693372202/embargos-declaratorios-agravo-de-instrumento-em-recurso-de-revista-ag-ed-airr-74009320095020511/inteiro-teor-693372216>. Accessed June 16, 2021.

As per the decision, after the grace period, the employee's right to become a member of the society is one-sided and has a remuneration nature, thus having to integrate the labor rights calculation, which hurts, head on, everything that is preached by the defenders of vesting.[9]

According to the aforementioned doctrinal concepts, (i) the collaborator wouldn't have to pay a price for the shares acquired[10], which would be integrated to the their estate by the implementation of the conditions set in the contract; and (ii) if the conditions are not implemented, the parties would not have any pleas against one another.

However, admitting what is proclaimed in the above-mentioned decision, in the case of option for the acquisition of the shares, the employee (i) *will pay their employer for the latter's shares*; and this call option has (ii) *a remuneration nature, thus having to be included in the basis of calculation of every labor right*[11].

This decision dispels the conditional matter of the contract, since it does not entail the results to any future and uncertain matter. It takes labor rights for granted, thus creating serious problems in the utilization of this contract, especially for newly-created societies, craving to obtain collaboration of people with experience in their areas.

Therefore it's possible to say that there may have been misjudgment in the above-mentioned decision, as it confused two separate legal transactions, namely vesting and stock options.

Several works presented on startup companies which address the vesting contract fail to clarify the distinction between this legal transaction and the "stock option

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[9] TST-AIRR-7400-93.2009.5.02.0511, 6th Panel, Rapporteur: Minister Augusto César Leite de Carvalho.

[10] It is worth mentioning, however, that depending on the clauses of the vesting, considering that it is an innominate contract, it is possible to include the payment of a price for societal participation, although in a more advantageous figure than that asked of other suitors.

[11] TST-AIRR-7400-93.2009.5.02.0511, 6th Panel, Rapporteur: Minister Augusto César Leite de Carvalho p. 15.

plan". However, these are two separate concepts, despite being used for similar purposes in certain cases.

The stock option plan is "*a precontract concluded with the company, whose effectiveness has as premises the statutory provision and the existance of a plan approved by the general meeting*.[12]" That is to say, it doesn't seem to be a conditional obligation. It is defined on the basis of the authorized capital of the joint-stock company, being that the shares are destined to "*their managers or employees, or natural persons who may provide services to the company or to the partnership under their control.*"

In accordance with the applicable regulation, it wouldn't be possible to capture a third party for the company by seeking talent in the market, so as to increment the emerging startup. The usage of stock options, for this purpose, would have to focus on someone (i) already integrated in the (ii) joint-stock company, awarding them the right to (iii) acquire non-conditional equity interest on the basis of (iv) the society's authorized share capital, in (v) a previous provision of the articles of incorporation.

Therefore, while vesting is a conditional legal transaction, based on productivity and temporality, functioning for both partnership collaborators and third parties, the stock option plan is a mandatory pre-contract for the company, based on its share capital and in its statute, aimed at the joint-stock company collaborators.

Notwithstanding the conceptual distinction between the two doctrines, both can be used to "*entitle the executives, employees, and service providers to a participation in the future appreciation of the company.*[13]"

With respect to the legal regime, building upon the teachings of Paula Forgioni, it is ascertained that the vesting contracts are true business contracts, given the *"profit scope of all parties involved, which conditions their behavior, their 'common will' and,*

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[12] CARVALHOSA, Modesto. Comentários à lei das sociedades anônimas – 4th ed. revised and updated - São Paulo: Saraiva, 2009, volume 3, p. 515.
[13] SANTOS, Ana Luiza Vieira. Análise jurídica de stock options e vesting para startups. In: **Revista Inovação Social**. v. 1, n. 2, Sep./Dec. 2019, 51/65, p. 52.

ergo, the economic purpose of the transaction, instilling in it a diverse and peculiar dynamics".[14]

Now, both the collaborator and the startup have the profit scope, which conditions their behavior, their will, instilling to the parties' behavior a dynamics that is much diverse from the dynamics of the civil law or even of the labor law.

In addition, if the Principles of Economic Freedom are applied to the case in hand, the negotiations between the parts will become much freer than if applied the elements of labor legislation, even if loosened by indicatives of corporation law.

For the vesting contract, what stands out from the intention of each party is, on the startup's side, the capture of the collaborator who holds a certain technology or a special attribute, who qualifies the company to face the future and that allows it to act in a certain way as to become repeatable and scalable (profit). When focus shifts towards the worker, they aspire to leave the employee role to attain the position of associate and investor. That way, the company wants to grow and move forward with lower or even without any fixed cost, and the collaborator wants to obtain the *status socii*, which contributes to their performance and leads to financial results from the distribution of the results (profit) and not from salaries.

Regarding this matter, Oliveira and Ramalho claim that with vesting, the collaborator is valued by "*their effort in favor of the company*"[15], so that the legal relationship to be highlighted is the corporate (business) relationship.

This shift in the collaborator's position is shown by Ueda and Polinário, who indicate that the collaborator starts to dedicate themselves to the company with the morale of "owner", which clarifies that the above-mentioned contract has the power to counterbalance and, moreover, to realign the interests between stakeholders and shareholders.

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[14] Idem.
[15] OLIVEIRA, Fabrício Vasconcelos de; RAMALHO, Amanda Maia. O Contrato de Vesting. **Revista da Faculdade de Direito da UFMG**, Belo Horizonte, n. 69, p. 185, Jul./Dec. 2016.

Highlighting this position, they mention that there is a transition from the previous category of employee, to the future category of partner of the enterprise, through *Cliff*.[16]

Advancing in the possibility of allowing the employment contract without an employment relationship, but with an examination of the existing relationships between the parties, the 23rd Labor Court of São Paulo, in a decision upheld by the Regional Appellate Labor Court of the 2nd Region, in the RTOrd 1000856-03.2017.5.02.0023[17], understood that the parties had contracted a partner, not employment, relationship.

In the case, the parties contracted the services of the former, so that, after the implementation of certain targets, the contracted would become a shareholder of the company. Recognizing the validity of the contract, but carefully examining the evidence produced in the issues — including the one that showed that the service provider had ascended to the condition of partner of the company — the first-degree judge understood it as "*lacking the requisites of Section 2 and 3 of the Consolidation of Labor Laws (CLT)*", which is why she rejected the claim for employment relationship.

And, upholding the first court's decision, the Regional Appellate Labor Court of the 2nd Region highlighted that what is important in the examination of the matter is the primacy of reality, being that the two main points for the non-recognition of the employment relationship were the lack of salary payment and the absence of hierarchical subordination.

That being said, it is important to mention, then, that the governing Principles of the relations between the parties of the vesting contract are determined by the Economic Freedom (Section 1, of the law 13.874, September 20, 2019), since they are among the legal relationships of business, civil, economic or labor law, in the context of the practice of the profession (Section 1, paragraph 1), and must be interpreted "*in*

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[16] UEDA, Andréa Silva Rasga; POLINÁRIO, Felipe Ramalho. **O Contrato de Vesting para Impulsionar as Startups**. Avaliable on: <https://www.jota.info/opiniao-e-analise/artigos/o-contrato-de-vesting-para-impulsionar-as-startups-13102019>. Accessed April 15, 2021.
[17] Rapporteur: Ricardo Verta Luduvice. Publication date: 5/23/2019.

favor of the economic freedom, good-faith, and respect to the contracts, investments, and propriety." (Section 1, paragraph 2).

Therefore, also applicable to the case is the ruling established in the above-mentioned law, especially in item VIII, of Section 3, that resolves:

> VIII - to have the guarantee that the parity business legal transactions will be the object of free stipulation between the covenant parties, thus applying all the rules of the business law solely in subsidiary ways to the consignor, except public policy norms;

Therefore, what the parties have contracted in good faith must be respected, as long as they, under the facts of the case, respect what had been laid down in the contractual instrument.

The legal regime to be applied in the vesting contract is of both business and corporate law, as long as the conditions outlined by Forgioni are observed: that the behavior of both parties is conditioned to the profit scope.

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