Hypothetical

November 13, 2013

Mary is an engineer who has invented a better, and faster Iphone type smart phone. Her niche is smart payment technology and envisions a small device that consumers carry with their car keys. Her idea is that consumers will use her secure product instead of carrying their wallet. John is a sales and marketing expert that knew Mary from graduate school. Mary and John form a partnership – MJ Enterprises – and invest their own money to develop a prototype product. They share costs equally but realize that to take their business to the next level they must raise significant funds to re-engineer the product and then to massively market the product both to consumers, to retail stores like Starbucks and to banks.

On advice from counsel, they incorporate into a C corporation in Delaware, USA and offer a term sheet to venture capital investors with the hopes of raising $2 million in exchange for 20%. Mary will be CEO and Chairman of the Board. After many rejections, they have found a boutique venture capital firm in Silicon Valley. They are told that the investors will require a seat on the board of directors, a liquidation preference as well as the grant of a warrant, the right to purchase additional shares at the Founder’s price. A large public pension has also shown interest in investment via a convertible debt arrangement. The terms of the convertible debt allow the public pension fund to convert debt to equity, in their discretion, but if MJ fails to make interest payments, accelerated conversion could result in the pension owning as much as 30% of MJ Enterprises.

It is the goal of the founders and the investors to take the Company public.

You represent MJ Enterprises, Inc. How will you resolve the competing desires of the original owners – Mary and John – and the subsequent shareholders?

What methods and techniques can Mary and John employ to retain control?

If you represented the Venture Capital Firm or the Pension Fund, what should you look out for to ensure that your client can maintain control?

What happens if and when the company goes public?

We must look at public companies and corporate governance to understand the answers.