

Business Transactions Solutions § 249:157

Business Transactions Solutions
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Part X. Joint Ventures and Strategic Alliances

Chapter 249. Formation of Joint Ventures

III. Master Forms and Clause Library

A. Shareholders' Agreement

3. Drafting and Review Checklists

§ 249:157. Drafting checklist

The following checklist enumerates information which should be collected to draft a comprehensive form of shareholders' agreement for a joint venture. The checklist covers almost all of the major areas of negotiation and discussion with respect to a joint venture company, including formation, capitalization, representations and closing matters, management and control, operations, and termination. The drafter or reviewer should also review the articles or certification of incorporation for the joint venture and any ancillary agreements (e.g., services, manufacturing, licensing, or distribution agreements).

1. Background

1.1. Identify the parties.

- The parties include the venturers, who are referred to as the shareholders. See clause to Master Form at [§ 249:55](#) and the joint venture corporation itself.
- The shareholders and joint venture corporation are each referred to as a “party” throughout the agreement. See clause to Master Form at [§ 249:52](#).
- Entities controlled by a party will be called a “subsidiary.” See clause to Master Form at [§ 249:56](#).
- Full legal names and addresses should be used.

1.2. Describe the background for the transaction.

- The agreement should describe the purpose of the joint venture, the goals and objectives of the venturers, and the assets which they intend to contribute to the joint venture company. See clause to Master Form at [§ 249:44](#).
- It is useful to have a detailed statement of the business purpose of the joint venture. See clause to Master Form at [§ 249:67](#), although the parties should retain the flexibility to adapt to changing circumstances over the term of the venture.

2. Formation and Organization

2.1. Include provisions relating to formation and organization of the joint venture company. See clause to Master Form at [§ 249:60](#).

- The parties will agree to cause the formation of the company prior to the chosen closing date, and should agree upon the state of incorporation, the name of the corporation, and the principal business purpose of the corporation.

2.2. What is to be the name of the company? See clause to Master Form at § 249:61.

2.3. What is to be the principal office of the company? See clause to Master Form at § 249:62.

- At the time of formation, the principal office of the corporation may be located within, or near, the offices of one of the venturers.
- Once the joint venture grows and matures, it may seek its own separate facilities.

2.4. Who is to be the company's agent for service of process? See clause to Master Form at § 249:65.

2.5. What is the company's fiscal year? See clause to Master Form at § 249:66.

2.6. What provision should be made for reimbursement of expenses associated with incorporating and organizing the company? See clause to Master Form at § 249:68.

- Expenses associated with the formation of the corporation (e.g., franchise taxes, filing fees, legal fees for drafting basic corporate documents, etc.) will usually be reimbursed out of the funds contributed to the joint venture as preincorporation expenses.
- The expenses of negotiating the terms of the transaction must be borne by the venturers themselves.

3. Capitalization and Financing of the Company

3.1. What is to be capital structure of the company?

- The company's authorized stock may consist of only common stock. See clause to Master Form at § 249:46.
- The company's authorized stock may consist of common stock and preferred stock (e.g., Series A Preferred Stock). See clause to Master Form at § 249:54.
- The preferred shares may convert into common shares upon the occurrence of specified events, such as satisfactory completion of certain development work. See clause to Master Form at § 249:47.

3.2. Include procedures for the issuance of the initial shares.

- The agreement should describe the shares to be issued to each shareholders, as well as the consideration to be paid for the shares.
- One venturer may be issued preferred shares in exchange for contributing cash and technology to the joint venture. See clause to Master Form at § 249:70.
- Another venturer may receive common shares for contributing cash to the joint venture. See clause to Master Form at § 249:71.

- As a general rule, venturers are prohibited from making any withdrawal of capital after it is contributed to the joint venture. See clause to Master Form at § 249:73.

3.3. Should the agreement include procedures relating to additional contributions?

- If additional capital is necessary, each of the parties will usually be obligated to make the contribution in proportion to their then-existing interest in the income and assets of the venture. See clause to Master Form at § 249:72.
- The agreement should include a description of the consequences of one venturer being unable to make additional contributions. See clause to Master Form at § 249:74.

3.4. Should the agreement provide for borrowing by the joint venture from commercial lenders? See optional clause to Master Form at § 249:75.

- The venturers may be required to guaranty the repayment of loans by the joint venture.

4. Closing Procedures

4.1. What is to be the date, time and location of the closing?

- The date and time of the closing should be established by the parties in advance, and all necessary documents (e.g., assignments, share certificates, legal opinions) should be ready for signature and delivery well in advance of that date. See clause to Master Form at § 249:76.
- The key exchange at the time of the closing is the shares for the consideration that is described in the agreement. See clause to Master Form at § 249:707.
- The parties will also deliver various documents See clause to Master Form at § 249:78 and arrange for the transfer of any technology being contributed to the joint venture by a venturer. See clause to Master Form at § 249:79.

4.2. What conditions must be satisfied in order for the party contributing only cash to the joint venture to be obligated to fulfill its obligations at the closing?

Closing conditions generally include:

- Accuracy of the other venturer's representations and warranties (see 5.1 below). See clause to Master Form at § 249:89.
- Satisfaction of the other venturer's preclosing covenants. See clause to Master Form at § 249:90.
- Absence of litigation relating to formation and operation of the joint venture. See clause to Master Form at § 249:91.
- Delivery of satisfactory opinion from the other venturer's counsel. See clause to Master Form at § 249:920.

- Proper composition of the board of directors as provided in the agreement (see 6.1 below). See clause to Master Form at § 249:93.
- Delivery of a compliance certificate executed by an officer of the other venturer. See clause to Master Form at § 249:95.
- Satisfaction with all documents and proceedings. See clause to Master Form at § 249:96.
- Receipt of all necessary regulatory approvals (e.g., Hart-Scott-Rodino review). See clause to Master Form at § 249:97.

Closing may also be contingent on the delivery of various other documents. See clause to Master Form at § 249:104 including:

- Confirmation that the monetary contribution from the other venturer has been received in the joint venture company's bank account;
- An executed copy of the documentation necessary to effect any required transfer of technology by the other venturer to the joint venture company;
- Certified copies of the joint venture company's charter documents and organizational minutes and actions;
- The share certificate(s) for the shares to be issued to the venturer; and
- Executed copies of any ancillary agreements required for the formation and operation of the joint venture (e.g., development agreement, license agreement, services agreement, etc.).

4.3. What conditions must be satisfied in order for the party contributing cash and technology to the joint venture to be obligated to fulfill its obligations at the closing?

Closing conditions generally include:

- Accuracy of the other venturer's representations and warranties (see 5.1 below). See clause to Master Form at § 249:89.
- Satisfaction of the other venturer's preclosing covenants. See clause to Master Form at § 249:90.
- Absence of litigation relating to formation and operation of the joint venture. See clause to Master Form at § 249:91.
- Delivery of satisfactory opinion from the other venturer's counsel. See clause to Master Form at § 249:92.
- Proper composition of the board of directors as provided in the agreement (see 6.1 below). See clause to Master Form at § 249:93.
- Delivery of a compliance certificate executed by an officer of the other venturer. See clause to Master Form at § 249:95.
- Satisfaction with all documents and proceedings. See clause to Master Form at § 249:96.

- Receipt of all necessary regulatory approvals (e.g., Hart-Scott-Rodino review). See clause to Master Form at § 249:97.

Closing may also be contingent on the delivery of various other documents, including those described above in connection with the other venturer (see 4.2 above). See clause to Master Form at § 249:94.

5. Representations and Warranties

5.1. What representations and warranties are to be provided by the venturers?

Representations will be required from both the venturer that is only contributing cash (see clause to Master Form at § 249:85), and the venturer that will be contributing cash and technology. See clause to Master Form at § 249:80.

Among the areas which are commonly covered by the representations are:

- Organization and standing;
- Due authorization;
- No conflicts with existing agreements;
- Litigation;
- Regulatory matters;
- Absence of misrepresentations;
- Title to contributed assets;
- Intellectual property rights;
- Agreements with third parties; and
- Employee agreements and relations.

The agreement should provide for survival of the representations and warranties following the closing. See clause to Master Form at § 249:86.

5.2. Should the agreement provide for mutual indemnification with respect to damages and liabilities suffered by the indemnified party from a material misstatement, error or omission contained in any of the representations and warranties delivered by the indemnifying party? See clause to Master Form at § 249:87.

- The documentation will set forth procedures with respect to the indemnification, including notice provisions and, in most cases, the indemnifying party will have the right to assume the defense of any action for which indemnification is available.

6. Management and Operations

6.1. What are to be the procedures for nominating and electing the members of the board of directors? See clause to Master Form at § 249:108.

- In some cases, vote switch provisions will be used which allow one of the venturers to elect a majority of the directors upon the occurrence of certain events. See optional clause to Master Form at § 249:109.
- If appropriate, the directors may delegate authority to a subgroup of directors called a management committee. See optional clause to Master Form at § 249:112.

6.2. What are to be the procedures for selecting the officers? See clause to Master Form at § 249:111.

6.3. What actions will require the consent of both venturers? See optional clause to Master Form at § 249:110.

- Arbitration provisions often will be included as a means for resolving any disputes that may arise with respect to the management of the joint venture business. See clause to Master Form at § 249:149.

6.4. What are the proposed business activities of the joint venture?

- Business activities are generally the subject of a business plan that is prepared and reviewed by the parties periodically over the term of the joint venture. See clause to Master Form at § 249:113.

In a full function joint venture, the agreement should address:

- Research and development activities. See clause to Master Form at § 249:114.
- Manufacturing activities. See clause to Master Form at § 249:115.
- Distribution activities. See clause to Master Form at § 249:116.

6.5. What provisions should be made for accounting and internal controls? See clause to Master Form at § 249:117.

6.6. What covenants should be included regarding the conduct of the joint venture's business? See optional clause to Master Form at § 249:118.

Covenants may cover the following:

- Operation of the venture in a manner which complies with all applicable laws and regulations;
- Prompt payment of all taxes, assessments and governmental charges;
- Maintenance of properties in good repair, working order and condition;
- Purchase and maintenance of appropriate types and amounts of insurance relating to its activities, such as property damage, public liability, worker's compensation and indemnity bonds; and
- Protection of intellectual property rights.

6.7. What provisions should be made regarding preparation and distribution of financial information regarding the activities of the joint venture? See clause to Master Form at § 249:119.

Among the financial information that might be required is the following:

- Audited annual balance sheets and statements of income and changes in financial position;
- Quarterly unaudited balance sheets and statements of income and changes in financial position, prepared in accordance with generally accepted accounting procedures;
- Monthly balance sheets and statements of income and changes, prepared in accordance with generally accepted accounting procedures and prepared in a manner which permits comparison to key objectives and milestones the period in which the monthly information is prepared; and
- A detailed annual plan which should include monthly capital and operating expense budgets, cash flow statements, projected balance sheets and profit and loss statements for each month and for the end of such year itemized in such detail as each of the parties may consider to be necessary.

6.8. What provisions should be included regarding distributions of income and application of funds? See clause to Master Form at [§ 249:120](#).

6.9. What provisions should be included regarding independent contractors and/or employees providing services to the joint venture?

- The long-term objective of the joint venture is for it to be conducted as an “independent enterprise” with its own employees. See clause to Master Form at [§ 249:121](#).
- One or both of the venturers may agree to provide certain services to the joint venture under the terms of services agreements. See clause to Master Form at [§ 249:122](#).
- The agreement might also cover incentives for its employees. See optional clause to Master Form at [§ 249:123](#) and the use of employment agreements. See optional clause to Master Form at [§ 249:124](#).

7. Shareholders' Matters

7.1. What covenants should be included relating to the venturers' duties and obligations with respect to the joint venture?

- The agreement will typically include a covenant from the venturers to lend their full cooperation and support to the joint venture. See clause to Master Form at [§ 249:125](#).
- The agreement also will typically include a covenant to adhere to fiduciary duties in their dealings with one another during the term of the joint venture. See clause to Master Form at [§ 249:126](#).

7.2. Should the agreement include noncompetition provisions or restrictions on the other business activities of the venturers? See optional clause to Master Form at [§ 249:127](#).

7.3. What provisions should be included relating to expansion of new business opportunities? See optional clause to Master Form at [§ 249:128](#).

- The parties may agree to include a “right of first negotiation” with respect to the exploitation of new product opportunities in a specified technical or geographic area, either through the formation of a new joint venture or by expanding the scope of activities of the existing entity.

7.4. What procedures should be included relating to protection of confidential information used and developed during the course of the joint venture? See optional clause to Master Form at [§ 249:129](#).

7.5. What restrictions should be imposed on transfer of ownership interests in the joint venture? See clause to Master Form at [§ 249:130](#).

- As a general rule, the parties will typically agree to a strict prohibition on any sale or transfer of the shares for a specified period of time, usually corresponding to the initial term of the venture.
- After the restriction period has ended, the parties will usually agree to a “right of first offer” or a “right of first refusal.”

7.6. Should a venturer be permitted to withdraw from the joint venture prior to the end of its specified term? See optional clause to Master Form at [§ 249:131](#).

- Withdrawal may be permitted upon the occurrence of a fundamental change with respect to the other party, such as a change in ownership.
- Withdrawal may be permitted when the performance of the joint venture fails to meet with certain previously agreed objectives.

8. Term and Termination

8.1. What is to be the specified term of the joint venture? See clause to Master Form at [§ 249:132](#).

- The ventures should establish an initial term for the enterprise which fits within the realistic business horizon for each of the particular activities to be undertaken and provides the parties with a reasonable opportunity to achieve a proper return on their investment of time, capital and other resources.

8.2. What events will cause termination of the joint venture prior to the end of its specified term (see 8.1 above)?

- The parties will contemplate termination of the venture upon the occurrence of a fundamental change relating to one of the parties, a material breach by one of the parties of its obligations under the terms of the agreement, or the failure of the venture to attain specified milestones. See clause to Master Form at [§ 249:133](#).
- While early termination may lead to liquidation (see 8.3 below), it is also possible to provide for the nonterminating party to simply purchase the interest of the terminating party. See optional clause to Master Form at [§ 249:135](#).

8.3. What provisions should be included regarding liquidation of the joint venture and the responsibilities of the parties following liquidation?

- Liquidation procedures should be included in the agreement, including any specific requirements regarding the form and content of liquidating distributions to the venturers. See clause to Master Form at [§ 249:136](#).

- The parties must also deal with certain issues that survive termination of the relationship, including protection of confidential information and ongoing obligations to customers of the joint venture (e.g., warranties). See clause to Master Form at § 249:134.

9. Client and Transaction Information

- 9.1. Name of Client: [name of client]
- 9.2. Client Contact: [name of client contact]
- 9.3. Date of Interview: [date of interview]
- 9.4. Opposite Parties: [names of opposite parties]
- 9.5. Other: [other]

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Footnotes

- * Alan S. Gutterman is the founder and principal of Gutterman Law & Business (www.alangutterman.com) and the director of the GL&B Institute for Management Training and Studies. He received his A.B., M.B.A., and J.D. from the University of California at Berkeley, a D.B.A. from Golden Gate University and a Ph.D. in Law from the University of Cambridge in the United Kingdom.

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