

## ARE YOU CONSIDERING A NEW JOINT VENTURE?

### Summary of Topics for Discussion

The topics covered are:

- Business plan
- Governance
- Funding
- Financial matters
- Distributions
- Officers
- Operations
- Dispute resolution
- Dissolution / sale
- Exit plan

### **Business Plan**

1. What are your goals for the company in 1 year, 5 years, 10 years, possibly 15 years? Clearly, the further you go out, the less solid those plans will be. However, it is important to be on the same page.
2. How many people (employees) will that take? Where will the clients come from and how will you get them? What additional space, technology, and expenses will there be?
3. What would be the proposed budget for each such year?
4. How much time will each of you commit to this venture?
5. Do you have the same values and commitment? E.g., one may say that “it is amount of time you put in that matters” whereas another may say “it is results that matter.” Neither is right or wrong. However, if this were true, the conflict is obvious. And there may be a further conflict that you have not thought about --- the one who says “results” are the key may not be willing to put in “full time” because they believe they are already performing.
6. What job duties would be filled by each of you? How might that change over time? How might your commitments change over time?
7. What is the proposed time when each of you might depart the business – i.e., selling out as an owner?

## **Governance**

1. How many people on the Board?
2. How will they be selected?
3. Who can remove Board members and why (e.g., for cause only)?
4. What decisions will be made by the Board? What decisions will be reserved to the owner? What decisions will be allowed to be made by the Officers and other operating personnel?
5. How will the Board act on decisions? If it is “one person – one vote” and there are two Board members then it is really unanimous agreement.
6. Are some decisions so key that each shareholder must agree or that you take a majority (or other) vote by ownership?
7. Will there be committees of the Board? E.g., compensation committee, budget committee, audit committee? These are often used for more complex structures and may not apply to you.
8. How often will Board meetings be held? How often are meetings of the owners held?

## **Funding**

1. What capital will be contributed by each to the company?
2. Will the capital be contributed in the same ratio as rights to profits and losses? If you want the rights to profits and losses to be shared other than on the same basis as ownership, then a more complicated structure is required (either by additional compensation or via some other entity structure than an “S” Corporation).
3. What additional capital should be provided for as being mandatory? How will the need to actually call that capital be determined?
4. What vote will be required for further additional capital calls? And who must vote on that?
5. If additional capital is provided other than on a pro rata basis, is additional ownership given and the non-contributing shareholder’s interest diluted? Is there an extra dilution (i.e., more than just pro rata) due to failure to contribute?
6. If additional money is provided by a loan from an owner to the company, what interest rate and payback terms and collateral will be given?
7. What approval is required to borrow money (from an owner or from a third party)? Is there a limit under which limited or no Board approval is required? Is there an amount that will require a supermajority approval?

8. Will guarantees of debt (e.g., bank loans, credit cards) be required? Will each owner carry the same risk (e.g., full 100% liability, or liability based on ownership percentage)? Will an owner providing more than his pro rata share of guarantee risk receive some additional payment?

### **Financial Matters**

1. How are additional budgets and business plans set? Who provides the initial draft? What vote of the Board (assuming that the Board approves the budget) is required?
2. What approval is required to exceed the budget? Is this on a line item basis or by categories?
3. What approval is required to change the business plan? What items require that approval and what items can be modified by Officers with limited or no approval?
4. How quickly / how often will financial statements be circulated? What types of financial and business information should be circulated?
5. Will there be a committee of the Board to concentrate on financial matters and business plans? Again, this may apply more when there are complex structures.

### **Distributions**

1. How will distributions of profits be allocated? Will losses be allocated in the same manner as profits? Again, if you want this to be different than ownership, then a more complicated structure is required (either by additional compensation or via some other entity structure than an "S" Corporation).
2. Is there some preferred return of capital or preferred return on capital? Is there some preferred requirement to pay loans made to the company by an owner first? Once again, if you want this to be different than ownership, then a more complicated structure is required (either by additional compensation or via some other entity structure than an "S" Corporation).
3. Will there be mandatory distributions to pay taxes on income allocated to owners? If so, can the company borrow money to make those distributions if necessary? Note that in an "S" Corporation and in an LLC taxed as a partnership, taxes on company income are paid by the owners even if they do not receive any distributions.

### **Officers**

1. What Officers will be appointed?
2. How will Officers be selected by the Board? What vote will be required? Will this be done by a Board Committee or the full Board?

3. What vote will be required to remove an Officer?
4. What method will be used to review Officers (e.g., a Board Committee, the full Board)?
5. What is the role and duty of each Officer? What will an Officer have the power and authority to do, what actions can they take, without Board approval?

### **Operations**

1. See re: Officer roles and duties above.
2. How will customers be accepted and “fired”? Is owner or Board or Officer approval required? Will an owner have the ability to push acceptance or non-acceptance, or “firing” of a customer?
3. What type of customer contracts will be used?
4. What insurance should be obtained?
5. What approval will be required for hiring, reviewing and firing employees?

### **Dispute Resolution**

1. If the owners disagree on matters, will there be some required mediation and/or arbitration of the dispute? Will there be a required face-to-face meeting?
2. If the owners disagree on matters that are not otherwise resolved, will there be some exit plan (see below)?

### **Dissolution / Sale**

1. What vote would be required to dissolve the company or to sell the company's business?
2. In dissolution, what happens to the company's intellectual property? Can any owner use it?
3. In dissolution, what happens to the company's name, phone numbers, website?

### **Exit Plan**

1. First, what is the expected departure time for each owner?
2. Second, in terms of a buy-sell agreement, are the terms the same for all owners or do some provisions apply to one owner but not all? For example, often a minority owner has fewer rights under a buy-sell agreement than a majority owner. Sometimes this is obvious because of the language, such as when a termination of employment causes a redemption of stock from a minority owner but not from a majority owner. Other times it is not obvious but is the practical

result (e.g., the same termination of employment language applies, but the majority owner cannot be fired).

3. Can any owner assign their equity rights - note that this is not common and usually there is some type of buy-sell arrangement? Is there an exception to non-assignment for assignment to family or affiliates (and what is the definition of "affiliate")? Do the other owners have a first right of refusal to match the offer or to buy at some other price and terms of payment (other than for family and affiliates, if applicable)? Do you want a "tag along/drag along provision"? This allows a minority owner to tag along in a sale with a majority owner, and allows a majority owner to force a minority owner to sell along with the majority owner.
4. Should a mandatory or optional purchase of stock occur on any of the following events: (a) death, (b) disability - and in that case, how long must a disability continue (to allow for a recovery period), and (c) termination of employment (and does it matter whether that is voluntary or involuntary?).
5. Is there some type of "texas shoot-out" or other method to split up if this does not work out and no one wants to or can force a separation some other way --- i.e., a business prenuptial agreement? A texas shoot-out allows one shareholder to require that the other shareholder sell their interest or buy the interest from the shareholder who triggered the event. What is the price and how is that price paid?
6. If an owner lost their interest in an involuntary transfer, e.g., bankruptcy or divorce, should the other owners have the right to buy? What are the price and terms of payment?
7. Is there a non-compete agreement from the departing owner? What is the restricted activity, for how long, and what is the remedy if the restriction is violated? (E.g., court action, liquidated damages, withholding money.)

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