



Entrepreneur Venture Agreements A Primer

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Overview

- **Entrepreneur Venture Agreements (EVAs):**
 - **Purpose**
 - **The foundation of a successful joint venture between two or more “partners”**
 - **Avoids and referees controversy in the case of unsuccessful ventures / “bad” events**
 - **Positions the venture for third party financing and exits**
 - **No such thing as a “form” EVA agreement**
 - **Requires careful and unique thought**
 - **Questions are the “same”**
 - **Answers are never the “same”**

Overview *(continued)*

- **EVA is the agreement of the partners throughout the venture life cycle**
 - **Forces partners to think through:**
 - possible, probable, and remote events
 - whether they even want to be partners
 - **Deals with not only the “expected” but, more importantly, the “unexpected”**
- **Relevant to ANY type of entity (corporation, partnership, limited liability company)**
 - **For convenience we will refer to “partners”**
- **The EVA can always be amended if all (or a designated percentage) agree**

Key Components

- **Business Purpose**
- **Contributions**
- **Economic Interests**
- **Management**
- **Distributions**
- **Transfer Restrictions**
- **Activity Restrictions**
- **Dissolution**

Business Purpose

- **What will the venture produce, achieve ?**
 - **Should match with business plan**
- **What is scope of venture's activities ?**
 - **Must delineate what is and is not a business purpose**
 - **Avoid “all things that a corporation can do”**
 - **Bears on the issues of:**
 - **“Corporate Opportunity” (see below)**
 - **“Noncompetition” (see below)**

Contributions

- **What will each partner bring to the table?**
 - **Money**
 - **How much? When?**
 - **What if additional \$\$ needed?**
 - **Services**
 - **Part time**
 - **Full time**
 - **Tangible property (real estate, etc.)**
 - **Intangible property (customer lists, know-how, etc.)**
 - **Carefully articulate and define WHAT is being contributed**

Contributions *(continued)*

- **Important in determining exactly what the venture owns**
 - For purposes of exit event
 - In the event of a “blow up” that leads to liquidation- who gets what?
- **How will each partner “contribute” ?**
 - Loan or outright contribution of \$\$
 - Lease or outright contribution of real property
 - License or outright contribution of intangible property
 - Services
 - Must be exclusively rendered to venture ?
 - What “quality” of services ?
 - Possibly set forth in separate “services agreement”

Economic Interests

- **How will each partner be economically rewarded ?**
 - **Share of overall profits (common equity)**
 - **What proportion ?**
 - **Relative values of contributions**
 - **Priority share of profits (preferred equity)**
 - **Interest for lending partner or “interest-like” priority for \$\$ partner**
 - **Wages or wage type payments for service partner**
 - **Royalty or rental payments**
 - **Some combination (common and preferred)**

Economic Interests *(continued)*

- **How will economic interests be affected by subsequent events?**
 - **Admission of new partners**
 - **Additional non-pro rata contributions**

Management

- **Who will carry on day-to-day activities ?**
 - **A partner(s) or an outsider(s) or both**
- **What is scope of day-to-day / ordinary course activities ?**
 - **What “major” decisions must be put to all partners ?**
 - **Loans above certain thresholds**
 - **Contracts above certain thresholds**
 - **Sale of all property**
- **How will management be compensated ?**
 - **Outsider - wages**
 - **Partner – wages or share of profit ?**

Distributions

- **When will partners receive economic rewards ?**
 - **Common profits – annually, quarterly, etc.**
 - **Wages – periodically**
 - **Rent/Royalty – periodically**
 - **Interest – periodically**
 - **Preferred return – periodically**
 - **Will preferred return be paid out of profits only ?**

Transfer Restrictions

- **General thoughts**
 - **Partners want to choose who they are partners with**
 - **Avoid involuntary or “accidental” partners (divorcing spouses, bankruptcy trustees, etc.)**
 - **A multitude of events can happen to a partner over venture life cycle**
 - **Death is only one of many**
 - **“Right of First Refusal” and “Buy-Sell Agreements” are simplistic terms that belie complex considerations**

Transfer Restrictions

- **General thoughts (*continued*)**
 - **What order should options (right of first refusal) be exercised?**
 - **Company**
 - **Related partners**
 - **All partners or just certain partners**

Transfer Restrictions

- **Overview of possible triggering events**
 - **Death**
 - **Disability**
 - **Divorce**
 - **Bankruptcy / Insolvency / Change in Control**
 - **Retirement (or laziness)**
 - **“Bad Acts” – morals clause**
 - **Offer from outsider**
 - **Deadlock or other irreconcilable differences**

Transfer Restrictions – Triggers

- **Death**
 - **Funding – buy-sell life insurance**
 - **Is purchase of interest mandatory ?**
 - **Who can force the purchase (deceased's representative or surviving partners) ?**
 - **Should family of partner be able to continue ownership of interest ?**
 - **Probably different considerations for active versus inactive partner**

Transfer Restrictions – Triggers

- **Disability**
 - **Funding- disability buy-sell insurance**
 - **Clearly define “disability” – the threshold may be different for different ventures, depending on their business purpose.**
 - **Is purchase of interest mandatory?**
 - **Who can force the purchase (deceased’s representative or surviving partners)**
 - **Should family of partner be able to continue ownership of interest?**

Transfer Restrictions – Triggers

- **Divorce**
 - **Avoid interest ending up in hands of non-partner spouse**
 - **Avoid court action interfering with venture operations**
 - **Consider punitive/reduced buy-out price as “chilling” provision**

Transfer Restrictions – Triggers

- **Bankruptcy / Insolvency**
- **Change in Control of non-individual partner**
 - **Voting control**
 - **Example: Partner A is an LLC, owned by Husband and Wife (H and W). H and W decide to do some down-generational gifting to children, relinquishing majority ownership of LLC to their children.**
 - **Managerial control**
 - **Example: Partner A is a limited partnership, managed by its general partner. The ownership or voting control of general partner is transferred to another individual.**

Transfer Restrictions – Triggers

- **Retirement (or laziness)**
 - **Scaled purchase price based on years worked- must work**
x number of years to receive 100% agreed value of interest on buyout
 - **Determine “active” and “inactive” partners status**
 - **How many hours per week must a partner work for the venture to maintain active status?**

Transfer Restrictions – Triggers

- **Bad Acts – morals clause**
 - **May be more appropriately handled in detail in services agreement for service-provider partners, but there is still a place for it in the EVA, particularly if a partner is inactive and thus not necessarily a party to a services agreement.**

Transfer Restrictions – Triggers

- **One Partner Desires to Sell to Third Party**
 - **Drag Along**
 - **Forces other partners to sell along with certain % of selling partners**
 - **Tag Along**
 - **Forces other selling partners to allow remaining partners to sell; interests sold pro rata, unless purchaser agrees otherwise**

Transfer Restrictions – Triggers

- **Deadlock or irreconcilable differences**
 - **Consider efficacy of a “push-pull” or “Texas shoot-out”**
 - **One partner can force the other partner to either purchase first partner’s interest or sell second partner’s interest**
 - **Be wary of unequal economic strength**
- **Related:**
 - **Consider trusted third party mediator/board member/advisor**

Transfer Restrictions – Valuation

- **Fair Market Value**
 - Appraisal
 - Agreed Value
- **Book Value**
- **Formulae**
- **Consider “claw back” provision (aka “schmuck clause”) if exit occurs soon after triggered sale**

Transfer Restrictions – Terms

- **Down payment**
- **Promissory notes**
 - **Secured/unsecured**
 - **Length**
 - **Interest rate**
 - **Consider accelerated payment upon exit/dissolution**

Transfer Restrictions – Funding

- **Insurance**
 - **Buy-sell**
 - **Key man**
- **Sinking fund**
- **Term notes**

New Partners

- **Who decides that new partners can come in? When?**
- **What must new partners bring to table?**
 - **Service, property, or \$\$**
 - **What is price for new partners**
- **Preemptive rights**
- **Dilution/Anti-dilution**

Activity Restrictions

- **Also handled in employment agreement/services agreement**
- **Noncompetition**
 - **Geographic and time limitations**
- **Nonsolicitation/Nonpiracy**
 - **Existing customers**
 - **Existing employees**
 - **Consider geographic and time limitations**

Activity Restrictions *(continued)*

- **Noninterference**
 - **Vendor relationships**
- **Confidentiality**
 - **What is “confidential information”**
 - **Are trade secrets protected?**

Dissolution

- **Triggers**
 - **Time certain**
 - **Unachieved milestones**
- **What happens**
 - **Who gets what?**
 - **Does IP partner get back that IP?**
 - **Should other partners receive portion of royalties if one partner receives IP?**

Authors' Backgrounds

U.S. and International Tax Planning

A common denominator and distinguishing feature of GSRJ attorneys and other professionals is their deep and thorough understanding of U.S. and foreign tax and entity issues—an understanding that is essential to an effective estate, asset protection, and entity planning practice, both in the U.S. and abroad.

GSRJ professionals are trained and committed to understanding the intricacies and nuances of state and federal income tax, estate and gift tax, state franchise tax, and the various charitable tax regimes. This training and commitment allows them to work with clients to define their goals, and to design and implement creative strategies to achieve those goals, always with an eye on optimum tax results. The professionals at GSRJ strive to use their collective understanding of tax issues to meet each client's individual needs within the context of all relevant tax environments. Individual GSRJ professionals each specialize in distinct facets of tax law, but all maintain a broad-based understanding and appreciation of income, estate and gift tax matters. As a collaborative group, they can recognize, react to, and shape the universe of tax implications that arise from virtually any transaction in which their clients may engage.

A significant aspect of GSRJ's tax practice involves the representation of clients with tax controversies pending before the Internal Revenue Service and state tax agencies. GSRJ frequently deals with IRS examining agents and appeals officers in audits and administrative hearings. The firm's attorneys are intimately familiar with tax filing and other compliance requirements, including especially those arising from cross-border and international transactions, and are experienced in the preparation, examination, and appeal of various federal and state tax and information returns.

Authors' Backgrounds

Emerging and Established Business Ventures

GSRJ not only assists its clients in maintaining and protecting their wealth—GSRJ helps them create it. In this regard, GSRJ professionals readily apply their own business and legal expertise to counsel and advise their entrepreneurial clients in planning, structuring, and implementing corporate and partnership investment and business entities, and provide legal counsel for their recurring and nonrecurring transactions, such as: Buy-sell agreements, Angel and later round debt and equity financing (investor and investee), Executive compensation, Equity compensation, Vendor/customer relationships, Strategic joint ventures, Succession planning, Mergers and acquisitions, Corporate reorganizations, Private exit and other liquidity transactions

GSRJ delivers these services to clients in a variety of industries from real estate investment and development, to technology and other services, to manufacturing and distribution of consumer tangible products. For their clients' start-up entities, GSRJ professionals apply their tax, legal, and business expertise to ensure their clients conceive and incubate their entrepreneurial ventures on sound footing. As to those entities entering mature operational and exit phases (or those already there), GSRJ professionals assist their clients in maintaining the course through both the expected and unexpected occurrences along the path to wealth creation. When significant monetization and liquidity events occur, GSRJ can summon its specialists in the estate, insurance, and asset protection areas to ensure that resulting wealth is maintained and protected in a tax-efficient manner.

When clients expand internationally, GSRJ professionals assist them with proper planning and structuring of in- and out-bound cross-border transactions, as well as with strategic offshore placement of business assets for asset protection and tax planning purposes. In a global marketplace, almost any client can find themselves faced with the prospect of tapping foreign markets. GSRJ stands ready to prepare for and guide those efforts. With the assistance of GSRJ's many foreign contacts and peers, GSRJ is optimally positioned to provide prompt, efficient, and effective guidance.

Authors' Backgrounds

Steven L. Phillips

Steve Phillips is a seasoned and experienced tax and transactional lawyer, guiding and advising closely and publicly held entities and their entrepreneurial principals in a variety of industries from real estate investment and development, to technology and other services, to manufacturing and distribution of tangible products. From start-up, through mature operational and exit phases, Mr. Phillips plans, structures, and implements corporate and partnership entities, and their recurring and nonrecurring transactions, such as buy-sell agreements, negotiated angel and later round debt and equity financing, executive compensation, strategic joint ventures, succession planning, and mergers, acquisitions and other exit transactions. When his clients expand internationally, he assists them with proper planning and structuring of in- and out-bound cross-border transactions, as well as with strategic offshore placement of business assets for asset protection and tax planning purposes.

A significant component of Mr. Phillips' practice focuses on individual estate and income tax planning for active and retired entrepreneurs, and the delivery of legal and tax services to private clients and their family offices. When the need arises, he represents his individual or corporate clients in federal and state tax controversies, both administratively and in court.

Mr. Phillips is and has been Board Certified in Tax by the Texas Board of Legal Specialization since 1995.

Education

University of Texas School of Law (J.D., with honors, 1985)

University of Texas at Austin (B.B.A., Accounting, with highest honors, 1983)

Authors' Backgrounds

Cindy L. Grossman

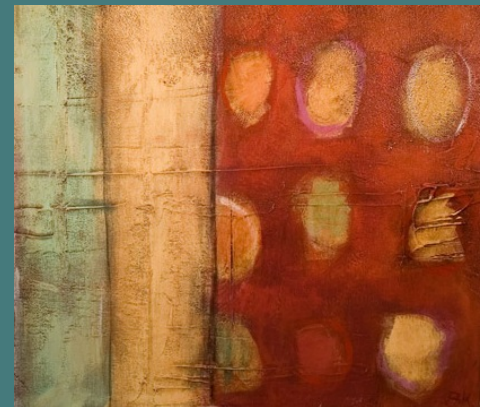
Cindy Grossman's practice encompasses a wide variety of corporate and partnership transactions with international, federal, and state tax implications, including stock and asset acquisitions, partnership freeze transactions, planning, structuring, and implementation of mergers, real estate transactions, and other recurring and non-recurring business transactions. Ms. Grossman has a breadth of experience in corporate and partnership formation and operation, entity conversion and reorganization, business planning, business succession planning, and asset protection planning. She represents business clients at all stages of their ventures, from establishing start-ups and negotiating and structuring angel and later round debt and equity financing, to growth planning and implementation, to devising and implementing appropriate exit strategies, including equity and asset sale transactions. Ms. Grossman also assists clients with proper planning and structuring of cross-border transactions, as well as with strategic offshore placement of business assets for asset protection and tax planning purposes. Ms. Grossman utilizes her expertise in tax-efficient entity planning to assist individual clients in the establishment or maintenance of complex estate planning structures involving partnerships, limited liability companies, and other entity types. In addition to her experience with entities, Ms. Grossman has represented clients in federal and state tax controversies.

Education

University of Texas School of Law (J.D., 2004)

University of Tennessee at Knoxville (M.A., Philosophy, Concentration in Medical Ethics, 2002)

Emory University at Atlanta (B.S., Biology, B.A., Religious Studies, 2000)



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