

MODEL JOINT VENTURE AGREEMENT

CHECKLIST

INTRODUCTION

- Joint ventures (“JV”) may take a number of forms, but the basis on which they are formed is always a commercial collaboration in which two or more unrelated parties pool, exchange, or integrate some of their resources with a view to mutual gain, while at the same time remaining independent. This checklist provides a basis on which to consider the issues surrounding the formation of the JV and the ongoing legal rights and obligations between the parties.
- Much of this checklist relates to a limited liability company form of JV but many of the issues raised will be equally relevant to the corporate form. In addition, there are tax and regulatory issues that will impact the structure and operation of the JV and they are not addressed in any great detail here.
- As this is a generic checklist it does not take into account any specific national or state requirements. To the extent that the JV is international, local law may mandate additional considerations, as will industry specific issues particularly in the context of regulatory concerns.
- **Note also:** this checklist generally contemplates a two-party JV. Multi-party JV’s are more complex, particularly with regard to corporate governance supermajority requirements, dilution and exit rights.

PLANNING

1. **Scope/Purpose of the Joint Venture (“JV”)**

- Identify scope/purpose of the JV—consider implications of such scope in connection with:
 - what activities does the JV expressly intend to do or refrain from doing
 - corporate opportunity issues (i.e., what are the existing and potential future conflicts with each party’s non-JV businesses)
 - this will lead to a conclusion on the scope of the non-compete covenants and the confidentiality obligations of each party
 - is there any core technology or other intellectual property (“IP”) either to be transferred to the JV or to be granted by the parties to the JV

- are there other intercorporate arrangements that either will be required for the JV to operate or that are required to make the investment in the JV meet the business case
- what due diligence must be completed before the JV is actually effective—in this case the level of due diligence is generally no less than that required for an acquisition, and in many cases may need to be more thorough to ensure a comfort level with, for example, the corporate culture of the co-venturer

2. **Form of Joint Venture**

- identify form of the JV:
 - jointly owned corporation or group of corporations
 - partnership—either general or limited
 - LLC
 - contractual (non-equity)—the contractual or non-equity JV can either be a co-ownership model or simply a contract between the parties whereby they retain all their own assets and agree as to their separate rights and obligations. Most “partnering” arrangements, strategic alliances and outsourcing services arrangements fall into this category. It is this category that also gives rise to structuring concerns to ensure that even though the parties wish the JV to be structured as a contractual JV, the actions of the parties do not result in it being, in fact, a partnership.
- issues affecting which form will be used include tax, limited liability, regulatory, banking, labor and employment, benefits, IP ownership, third party consents and exit strategies, among others

3. **Regulatory**

- identify current and any anticipated changes to regulatory issues (including industry specific regulatory issues and general foreign ownership, antitrust, export control issues, etc.) on:
 - ownership and control of the JV, its assets or the operation of its proposed business
 - dilution, exit and liquidation rights

4. **Implications of JV on Existing Operations and Reporting Requirements**

- review accounting treatment of investment in JV—will the investment be consolidated, and the implications of the accounting treatment on financial statements. Consider impact that particular control mechanisms proposed for JV may have on desired accounting treatment
- review existing contractual obligations to ascertain what third party (bank and other) approvals will be required for the implementation and ongoing operation of the JV, including debt covenants and other non-compete or confidentiality obligations
- consider whether any restructuring of existing operations is required before entering into JV

5. **Tax Considerations**

- begin consideration of tax consequences of the proposed structures:
 - for example, is flow-through or consolidation required?
- this exercise should be started as soon as possible with the other party to ensure both parties' tax objectives are met

6. **Internal Preparation**

- identify all other subsidiaries in corporate group as well as internal divisions and departments that may have a material interest in any particular aspect of the JV transaction and put in place process to ensure appropriate flow of necessary information and ability to obtain required input in a timely fashion for negotiation and implementation of JV
- it is always preferable to agree on the business plan at the outset of the JV. Work should begin early on the appropriate financial modelling so that the parameters of the business plan are thought through before negotiations commence

7. **Confidentiality Agreement**

- consider whether confidentiality agreement needs to be signed and if so what else it will cover; non-solicitation? Will it remain stand-alone or be superseded by the binding letter of intent or the JV agreement?

8. **Letter of Intent/Term Sheet**

- binding or non-binding
- if binding

- ensure all key provisions covered; may be difficult to introduce new business points after signing
- can be binding unless and until replaced by a definitive agreement agreed to by the parties within a specified time; no material changes without further Board approval. Same concern as above. See also conditions precedent below.
- consider use of arbitration if parties cannot agree on definitive agreement or if there is a dispute as to interpretation of letter of intent. **Risks:** Matter in dispute may not be proper subject of arbitration and risk of uncertainty of outcome
- consider whether to include covenant to negotiate in good faith definitive agreement. **Risks:** No clear guidance as to what that means—may already be some duty in the context of a binding letter of intent to negotiate in good faith. Also, some risk attached because should negotiations fail one party may assert lack of good faith negotiations in order to revoke the binding letter of intent
- ensure all appropriate approvals received before signing. This will include all approvals necessary to enter into a definitive agreement as this agreement will be binding regardless of whether or not a definitive agreement is entered into and would include such matters as board and stockholder approval, regulatory approval, third party contractual consents, etc. If approvals not obtained in advance, letter of intent could provide that it becomes effective once the necessary conditions precedent have been met.
- will it contain a no-shop provision? Consider whether to leave confidentiality agreement in place or replace it with confidentiality obligations in letter of intent. If latter will need to ensure that letter of intent is in fact binding and that confidentiality covenants survive termination of the letter of intent.
- will require disclosure in context of public company
- if not binding
 - can structure so that it becomes binding upon Board approval within a specified time and/or subject to signing a definitive agreement acceptable to both parties. In the context of the former approach note all the requirements set out in the preceding paragraph as regards approvals, etc.
 - will need to draft very carefully to ensure non-binding letter of intent or term sheet cannot subsequently be found to be binding. See ABA

Model Stock Purchase Agreement or *Model Asset Purchase Agreement* discussion on letters of intent.

- be aware of disclosure obligations in context of public company
- if no separate confidentiality agreement, ensure that while most of letter of intent is non-binding, confidentiality and non-solicitation covenants are intended to be binding.

9. Parties

- consider which parties should be parties to the JV—if holding companies are to be used should parent entities be parties or simply guarantors – how far up the corporate chain is it necessary to go—not only to ensure performance of the obligations of the JV parties but to enforce non-competition covenants, etc.
- consider whether the JV entity should be a party. If JV is a party, it may be able to enforce obligations of co-venturers in a bankruptcy situation where there is a receiver or trustee in bankruptcy. On the other hand, if it is not a party, it will be difficult to get specific enforcement of obligations. It may only result in the possibility of a damage claim.

SPECIFIC TERMS

Governance

10. JV's governance structure will depend largely on the actual structure chosen. However whether it is a board of directors or, in the partnership context, either a managing board or simply representatives of the partners, there will need to be a management vehicle to direct the JV. In the context of the management vehicle, it will be necessary to consider:
 - the extent of the authority given to the management vehicle compared to reserving significant decisions to the joint venturers (shareholders, members or partners). Fiduciary duties at different levels will factor into this decision.
 - the choice of appointees to the board or management committee and, where there are not already prescribed levels of accountability, setting out their accountability to the joint venturers
 - the authority to retain and remove senior officers, including the chief executive officer
 - the scope of protection for each joint venturer on fundamental decisions and changes—particularly where one of the co-venturers has a minority ownership interest

- the substantive standards and processes for dealing with non-arm's length transactions and other conflict of interest situations involving the JV and one of the co-venturers against the backdrop of applicable statutory requirements
- the process for developing, approving and updating the business plan and budget

11. **Management Board (Management Committee or Board of Directors)**

- proportionate board representation or formula. Consider whether representation should cease once ownership interest falls below certain level
- if a 50-50 board is established, will have to deal with deadlock possibility. Giving chair a casting vote in 50-50 situation effectively results in unequal representation on board
- any particular qualifications for members of management board (i.e., do parties want management board members to have certain skill sets or experience?) or any particular prohibitions on who can act
- removal and replacement of members of management board
- when and how often management board will meet
- notice requirements
- quorum for valid meeting
- can management board members be represented by alternates (generally not permissible in a corporate JV)
- who can call meetings
- under what circumstances can management board act without an in-person meeting; i.e., telephonic meetings or actions by signed consent
- determine what powers and duties the management board will have—JV agreement may specify that certain matters require approval of majority of management board and other matters require unanimity
- determine what decisions are not to be made by the management board but must be referred to the co-venturers

12. **Meetings of Co-venturers**

- when and how often co-venturers will meet
- notice requirements

- quorum for valid meeting
- who can call meetings
- under what circumstances can co-venturers act without an in-person meeting; i.e., telephonic meetings or actions by signed consent (Reality is co-venturers can always act by instrument signed by all of them)
- determine which decisions of co-venturers require approval of majority and which require unanimity (really only relevant where there are more than two co-venturers)
- whether chair has casting vote in case of tie

13. **Management**

- Officers may include President, CEO or general manager or other person responsible for the day-to-day operations of the JV's business as well as a Chair
- CFO
- consider whether one or majority of co-venturers have right to nominate which officers or whether the management board has that right. Certain venturers could have right to nominate certain officers. Right to nominate could rotate (often found with Chair)
- right to remove and replace officers
- limits on authority of officers, signing authority, etc.

14. **Managers/Directors' and Officers' Liability Insurance**

- verify existing coverage
- is JV coverage to be under each individual co-venturers plan or will JV have its own coverage

15. **Auditors**

- who the will auditors be—auditors of one of co-venturers or independent? How can firm be changed.

16. **Reporting and Access to Information**

- frequency of financial statements
- nature and frequency of other reporting requirements

- permitted access for co-venturers to books, records and employees—notice, during business hours, etc.
- consider whether right should be removed if co-venturer's interest falls below a certain threshold

17. **Actions Requiring Consent – Either Management Board or Co-venturers**

Consider which of the following actions should require management board or co-venturer approval. List will vary depending on level of autonomy proposed to be given to JV and level of decision-making already residing at co-venturer level:

- approval of annual business plan and budget or any change to any approved annual business plan or budget
- transactions outside the ordinary course of business [over a specified \$ annual threshold]
- change of name
- change in scope of the business
- investments outside the scope of the business in excess of a specified \$ threshold unless contemplated in annual business plan and budget
- creation of subsidiaries
- admission of new co-venturers (in the case of a corporate JV by issuance of stock)
- any transfer of ownership interests (unless contemplated in the JV agreement)
- issue, sale or transfer of shares or rights to shares of subsidiaries of JV company
- incurring debt, granting security or guarantees unless contemplated in annual business plan and budget
- payment of dividends (in case of corporate JV) or other distribution or return of capital except as contemplated in JV Agreement or annual business plan and budget
- change in management board, establishment or change in committees or appointment or removal of officers except to the extent contemplated in JV agreement
- insolvency-related actions

- certain types of contracts—for example those with competitors, that are not terminable on x days notice without payment, contracts that contain change of control clauses, etc.
- capital expenditures not contemplated in annual business plan and budget (or language relating to business plan may capture this prohibition)
- acquisitions, investments in third parties, strategic alliances or partnerships—either outright prohibition or subject to financial thresholds. In any event ordinary course acquisitions of assets would normally be excluded from prohibition if contemplated in business plan and budget.
- disposals of assets in excess of a specified limit or unless contemplated in business plan and budget
- consider whether any approvals required in connection with litigation or other proceedings
- creation of subsidiaries
- change in charter or organizing documents
- in the context of corporate JVs, will also need to consider such matters as corporate reorganizations, amalgamations, mergers, issue of shares and rights to shares in general or to third parties, including public offerings
- if not in ordinary course of business, commencing or making any significant decision relating to litigation, administrative or investigative proceeding
- **Note:** may wish to consider removing certain of minority venturer's veto rights if ownership drops below a certain threshold or if co-venturer is in material default (define material default and consider whether such loss of rights should only be during the default or whether certain cure period should be given)

18. **Business Plans and Budgets**

- consider what happens if approval not obtained for business plan
- consider multi-year rolling plan and annual budget process
- set out process regarding preparation of business plan and budget—who prepares and what time frame and to what extent do others participate in the process
- consider what happens if approvals for business plan and budget not forthcoming. Does prior plan continue—can some third party mediate or

arbitrate—does it go up the chain in each co-venturers organization before something happens.

- this is often the most difficult area as co-venturers may have different views during the life of the venture as to what the business should look like and to what extent they are prepared (and able) to invest more funds or leave funds in the JV

19. **Disputes**

- mediation
- litigation or arbitration
- define mandate of arbitrators, i.e., is it any dispute between the party or only specified types of disputes or under specified clauses. Certain types of disputes may not be arbitrable. Ensure arbitrator has right to order specific performance and/or consider preserving right to go to court for certain types of breaches – e.g., breach of confidentiality, non-solicit or non-compete
- set out rules or cross reference to specific set of rules (e.g., AAA)
- consider whether there should be prohibition on arbitrator amending the JV agreement or granting punitive damages
- location
- applicable law
- arbitrators—number and how chosen
- costs—who pays what: consider providing that loser pays in claim involving breach of JV agreement. In the case where there is not a dispute but a determination of a particular value or payment is being made, may need different approach
- consider whether to set parameters around how arbitrators are to act

Business of the Joint Venture

20. **Scope of the Business**

- the definition of the scope of the business is often critical in terms of the ongoing operations of the co-venturers—particularly as the JV develops. It is difficult to know at the outset of a venture to predict what businesses the co-venturers will be in five years later

21. **Distributions**

- a fundamental decision will have to be made as to what extent it is proposed that profits be reinvested to grow the JV or to be distributed out to the co-venturers. Often it is provided in any event that there will be a period where no distributions will be made. It is useful to agree on a formula as regards distributions, subject always to change by the co-venturers

22. **Financing**

- agree philosophy as regards financing—is the intent to use mainly third party debt to the extent available?

23. **Third Party Debt Financing**

- generally the co-venturers will prefer that any third party JV financing be through non-recourse third party borrowing but in start-up situation this is almost never possible.
- if guarantees are to be given, the agreement may provide that to the extent possible they will be subject to an agreed limit and will be given severally pro-rata to the percentage interest in the JV. May need to be security granted.

24. **Financing Provided by the Co-Venturers**

- pro rata to interest in JV. Consider what happens if third party borrowing not possible—does it always go to co-venturers? Is it optional or a required capital call? What if one co-venturer does not have the necessary funds?
- agreement should specify maximum amount either in actual dollar terms or based on some formula. This ties back into business plan and budget
- agreement should also specify who can initiate capital call and who determines what type of capital call it will be; debt or, if applicable, equity
- consider fixing in advance all relevant terms of debt, including repayment terms, ranking of obligation to repay, etc.
- what happens if default in providing moneys once call has been made?
- on a default by one co-venturer, can the non-defaulting party withdraw commitment? Or take up defaulting party's obligation on terms either more favorable as to, for example, interest rate, or causing dilution of defaulting co-venturer's interest. At what point does failure to provide financing lead to exit rights, liquidation rights or rights to bring in third party investors?
- these provisions will always be hotly negotiated—especially if one of the co-venturers is not as well established or creditworthy as the other

25. **Co-venturer Support**

- consider to what extent each co-venturer is going to provide support or services to the JV—whether such support and services will only be for a start-up period or whether it will be ongoing. Pricing for such support and services should be determined at the outset and not left to be determined after the JV has been formed. Consider whether benefits can be obtained by using the purchasing power of the co-venturers

26. **IP or Technology**

- there is almost always some IP or technology to be transferred to the JV—generally by way of license rather than outright transfer
- consider whether license should be exclusive or non-exclusive, negotiate territory and royalties
- consider whether practically restrictions such as territorial restrictions will be enforceable
- license must deal with improvements and who gets ownership of other rights in those improvements
- consider what happens to IP and improvements on termination of JV or on exit of one co-venturer. This is absolutely critical.
- licences will need to be considered in conjunction with any non-compete
- on what basis is license terminable if IP or technology is core to business this area will be very hotly negotiated. Unfair leverage may be obtained if the IP owner can pull the plug on the license.
- value to be attributed to IP being contributed to JV is generally hotly negotiated
- consider any anti-trust issues related to licensing

27. **Corporate Opportunity**

- generally a co-venturer will be required to offer to the JV business opportunities within the scope of the JV's business
- consider, if JV turns a business opportunity down (whether a new business or an acquisition) permitting the other co-venturer to take up on same (or no more favorable) terms than those offered to JV

28. **Non-Compete/Non-Solicitation**

- generally the most difficult and sensitive part of a JV to negotiate
- consider whether the JV and/or the co-venturers should be subject to a non-compete and whether there should be any constraints on hiring JV personnel during the JV and for some period after one co-venturer has exited
- to what extent can the JV enter into arrangements with a competitor of one of the co-venturers?

29. **Breaches**

- consider what acts or omissions should be classified as material defaults. It may be appropriate to have different classifications of breaches—classified by consequences; e.g., dilution, liquidation, puts, calls, etc. The following is a list of some of the types of acts or omissions to be considered:
 - failure to honor a capital call contemplated in the business plan or budget or agreed between the co-venturers
 - failure to honor a put or call right
 - breaches that are material to the JV of:
 - restrictions on disclosure or use of confidential information
 - the non-compete or non-solicitation
 - listed material intercorporate agreements including licences
 - breach of the corporate opportunity covenants in the agreement
 - change of control of co-venturer
 - transfer of ownership of interest in JV in manner not permitted by the agreement
 - insolvency, however defined
- possible remedies for a material default include:
 - loss of management board representation
 - dilution
 - imposition of mandatory call
 - discounted puts, calls and buy-sell valuation amounts

- termination of licenses and other intercorporate arrangements
- consider whether non-material breaches when aggregated or continuing should constitute a material breach and whether and which types of breaches should benefit from a cure period

Share Transfer Restrictions and Related Provisions

30. General

- agreement will usually provide that no transfers are permitted except as provided under the agreement (usually to affiliates) and that any transferee must become party to the agreement. Often the agreement will provide that under certain circumstances (particularly transfers to affiliates) transferor to remain liable on a joint and several basis with the transferee

31. Transfer to Affiliates

- consider definition of affiliate if affiliate transfers to be permitted transfers. For example, if transfers permitted to partially owned affiliates, concern will be under what circumstances can the ownership of that affiliate change. May wish to provide that permitted transfers only to special purpose wholly owned subsidiaries—i.e., wholly owned subsidiaries (wholly-owned all the way up the chain) that cannot do any other business
- consider providing that if affiliate ceases to be an affiliate must transfer back interest to parent or another wholly-owned affiliate of the parent
- avoid using the undefined term “affiliate.” If defined by reference to a statute make sure that definition works—for example, definition will go all the way up the corporate chain—and may include an individual or entity above the entity that has executed the agreement
- consider requiring any permitted transfer to be only of all the interest of the co-venturer. The agreement may need to be renegotiated if there is a partial transfer to ensure that there is block voting, etc.

32. Pledge of Shares

- consider whether there should be the ability to pledge interest in JV
- issue is that pledgee may end up being in shoes of co-venturer and usually will have right to sell interest
- if pledge permitted, consider limiting it to certain types of financial institutions

- will generally provide that pledgee must agree to be bound by certain specific provisions of the JV agreement, e.g., any call right, drag-along, rights of first offer and first refusal and other transfer restriction to which the pledgor's interest in the JV are subject
- think through what additional rights parties will want if pledge to be permitted—for example may want to add right of first offer/refusal on realization even if not otherwise provided in agreement
- consider requiring interest to remain in pledgor's name and confirming that pledgee has no veto, management board or other rights except right to sell
- may wish to include that realization by the pledgor is an act of insolvency for the purposes of the JV agreement. Depending on the consequences of the insolvency provisions of the agreement, this will make interest less valuable for purposes of pledge

33. **Exit and Termination Rights**

Agreement will generally make provision for the termination of the JV and/or the exit of one partner from the JV. If JV is for the purpose of establishing and operating a particular business, consider whether in fact there should be any exit or termination provisions. Even if it is acknowledged that the JV may not succeed, the circumstances of the failure will be impossible to predict at outset and the parties may wish to take the position that reasonable co-venturers will be able to negotiate a satisfactory termination at the time. However if one co-venturer is clearly stronger than other, then the weaker co-venturer will undoubtedly prefer to have exit rights clearly delineated in the agreement.

34. **Determination of Triggering Events and Exit and Termination Provisions**

- consider what appropriate triggering events are. Usually two categories—default and non-default. Exit or termination rights will be different depending on whether default or non-default.
- examples of default events would include those material breaches set out above—i.e., a default by one of the co-venturers in the observance of its obligations under the agreement or by the occurrence of specified events that have the same consequences, such as a change of control of a co-venturer
- no-default events may include such matters as:
 - events that reflect a frustration of the business intent such as the failure to achieve certain business/sales/operational targets, etc.
 - management deadlocks
 - third party offers for the interests of one or both of the co-venturers

- a change in business strategy or personnel of one of the co-venturers that has the effect of that co-venturer wanting to liquidate its interest in the JV
- in the case of both a non-default event and a default by one of the co-venturers, the usual remedies are dissolution of the JV or a buy-out of the defaulting co-venturer's interest by the non-defaulting co-venturer. The negotiation of the remedies in each of these situations will result in a determination of who may choose the applicable remedy and the way in which that remedy is accomplished in both default and no-default situations.
- consider whether there should be a period of time at the outset of the venture during which no transfers or exit rights (except on default) are permitted

35. **Put Right**

- if one party is in a minority position, it may wish to negotiate a put right in certain circumstances
- pricing can be based on:
 - a fixed price
 - fair market value with no minority discount
 - some discount from fair market value
 - a formula price
- specify date at which price is to be calculated
- the quid pro quo for a put right is often a call right (see below) in favor of the majority co-venturer
- the pricing of the put and call are not always the same
- puts can be used as a remedy as can cancellation of a put or a reduction in the price at which the interest can be put
- a put may be negotiated if there is a concern about a certain circumstance occurring, such as a change of law or regulation that materially adversely affects such co-venturer. If such provision is included, it is usually coupled with pre-requisite obligation on both parties to take all reasonable commercial efforts to remedy the event giving rise to the put right, including reorganizing the JV in an attempt to restore the party adversely affected to the position it would have been in had the change not occurred.

36. **Call Right**

- ability to purchase the other co-venturer's interest at a price based on:
 - a fixed price
 - fair market value with no minority discount or majority premium
 - some discount from or premium to fair market value
 - a formula price
- specify date at which pricing is to be calculated
- often given to a majority party to enable it to get rid of a minority partner no longer desired

37. **Right of First Offer and Right of First Refusal**

- a right of first offer generally refers to the right of a non-selling co-venturer to receive an offer from a selling party to sell all of the latter's interest in the JV and if such offer is not accepted by the non-selling co-venturer, the seller can offer for a specified period all of its JV interest for sale to a third party at a price equal to or better than that offered to the non-selling co-venturer.
- a right of first refusal is a right of the non-selling party to require the selling co-venturer to sell its interest in the JV to the non-selling co-venturer under the terms of a third party offer that the selling co-venturer is otherwise prepared to accept
- a right of first offer is less favorable to the non-selling co-venturer than a right of first refusal because the pricing will be higher, the non-selling co-venturer will not have a third party offer to confirm value and the non-selling co-venturer will not be able to control who its new co-venturer is if it passes on the selling co-venturer's initial offer
- from a selling co-venturer's point of view, it is difficult to name an acceptable price in advance of being able to negotiate it with a third party and under a right of first refusal, the selling co-venturer will find it difficult to obtain a good price from a third party who knows its offer is subject to a right of first refusal, particularly as there may be substantial costs involved in doing the necessary due diligence to enable the pricing of a firm offer
- need to consider these rights in the context of default exit/termination rights
- these rights and the interplay of the various default and non-default rights can become very complicated. Note that if the third party offer is for anything other than all cash, it becomes very difficult to match. If the third party

proposes non-cash consideration can the non-selling co-venturer “match” with cash? If so, how does valuation work? Who values? Also, “standard” language often does not catch collateral consideration.

- make sure that the non-selling co-venturer has a right to receive copies of all relevant agreements entered into between selling co-venturer and third party as soon as possible after they are entered into
- consider timing—both for period of time during which the right of first refusal can be accepted, and also the permitted sale period following the time when the non-selling co-venturer turned down the offer
- consider whether sale to third party should include drag-along or tag-along rights
- consider in light of intercorporate support and license agreements, etc.
- sometimes negotiate for a prohibition against sales to third parties who are competitors

38. **Tag-along**

- right of a co-venturer, especially a minority co-venturer to tag along on any sale by the other co-venturer—or only on a sale of a control block which would result in the majority party ceasing to have control
- another variant is a provision giving co-venturers the right to participate in any sale on a pro rata basis
- tag-along rights raise a number of issues, but especially if co-venturer permitted to sell less than all of its interest
- again, consider interplay of tag-along and drag-along rights with other exit/termination provisions—particularly if minority co-venturer is in breach
- request for tag-along often results in request for drag-along from other co-venturer

39. **Drag-along**

- right of co-venturer, under certain circumstances, to require other co-venturer to sell its shares into a third-part offer
- minority investor will always resist this unless there is a tag-along right
- again, consider precedence of various rights

40. **Buy-Sell Right or Shotgun**

- each co-venturer has the right to offer to buy or sell the interest of the other co-venturer at a named price. Because the recipient of the offer can buy or sell, the theory is that the pricing at which the buy-sell will be issued is a fair price.
- however, this is generally disadvantageous to any co-venturer in a weaker financial position, if the enterprise value is large and also to a co-venturer (often the minority co-venturer) who may not be interested in being a buyer. In both of these cases, the co-venturer that wishes to sell may take the risk and issue the buy-sell offer at a lower price
- becomes very complicated where it is not a 50-50 joint venture. Can be included where the co-venturers are in an equal ownership position and are matched financially as a way of providing a mechanism to break a deadlock—or, depending on the facts, to provide an incentive to resolve disputes because the stakes are so high
- As these buy-sell rights are considered draconian, there is often a period of time at the outset of the JV when they may not be used

Other Issues to Think About in Drafting Exit Rights

41. **Treatment of JV Debt**

- where co-venturers have financed the JV by debt or by guaranteeing debt, consider whether the purchasing party (co-venturer or third party) should be required to purchase the debt of the exiting co-venturer.
- Issues may arise in context of non-pro rata debt—e.g., if one co-venturer failed to pay up on a capital call and the agreement provides that the other can put up the “defaulting” co-venturer’s share so under certain circumstances, it may be appropriate to provide that the third party or the buying co-venturer is not required to purchase the exiting co-venturer’s debt.

42. **Regulatory Aspects of Exit Transactions**

- all exit transactions must be subject to regulatory compliance conditions
- timing issues may arise where regulatory approvals are required to complete an exit transaction
- to the extent there may be conditions on the sale imposed by the approval agency, cannot force acceptance but consider requiring third party buyer or buying co-venturer to act in commercially reasonable manner

- consider impact of any known (at time of entering into agreement) regulatory approval requirements on each type of possible exit scenario

43. **Pricing; Valuations**

- As stated above, pricing can be based on:
 - a fixed price
 - fair market value with no minority discount
 - some discount from fair market value
 - a formula price
- consider the effect of any applicable termination of intercorporate support and other agreements and licences on pricing
- set out whether any valuation should take into account the effect of breaches and defaults by either co-venturer on the pricing.

44. **Closing Process**

- need to put into place clear closing process so that rights and obligations under agreement as regards sale of interest can be enforced
- selling co-venturer's nominees on the JV management board should deliver resignations
- third party or co-venturer buyer acting on selling co-venturer's behalf should have the right to apply the proceeds of sale to pay down indebtedness of selling co-venturer to the JV
- make provision for guarantees given by selling co-venturer
- selling co-venturer should warrant good and marketable title free of all claims, encumbrances and security interests to the JV interest being sold
- may need same representations from third party as from original co-venturer whose interest is being sold
- need provision to deal with situation where selling co-venturer defaults often that buyer, at its option, and without limiting its other rights, can elect to complete the purchase by depositing the proceeds of sale without interest with a trustee to be held pending delivery by selling co-venturer of whatever it is required to deliver to evidence sale and buyer should have right to complete, as agent for the selling co-venturer, the transfer on the books.

45. **Termination/Dissolution**

- the JV agreement should specify under what circumstances the JV will be dissolved and whether the commencement of the process is automatic or at the option of one of the parties. It is risky to provide for automatic dissolution in case some unintended situation arises where the parties would not want the dissolution to occur, particularly in the context of a contractually based JV
- triggering events for dissolution often include insolvency of one of the co-venturers, material breach or default to comply with covenants, failure to meet certain critical targets or other situations which result in the original purpose of the JV being frustrated

Miscellaneous

- consider what post termination confidentiality covenants should be included (unless already included in separate stand-alone confidentiality agreement)
- include usual boilerplate