

Stockholder Agreements and Other Corporate Arrangements

Based on Presentation for
NCET2 Course on Researcher
Commercialization

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corporate securities tech transfer

My Legal Practice

- Outside counsel to major national research institutions for more than 15 years.
- Independent practice focuses on representation of research institutions, emerging companies and venture funds in corporate, securities and licensing matters.
- Former partner at Squadron, Ellenoff and Hogan & Hartson.



Context: Other Organizational Arrangements

- Founder(s), perhaps other personnel, investors
- Business plan
- Planning for IP
 - Trademarks, urls, branding
 - Patents, copyrights, trade secrets
 - Employee arrangements
 - Third-party arrangements
- Planning for financing
- Planning for key contractual arrangements, including IP, lease, insurance, other business arrangements



Context: Other Organizational Arrangements (cont'd)

- Retention of professionals
- Decisions about choice of entity, jurisdictions of incorporation and qualification
- Other organizational steps
 - Filing of charter
 - Organizational resolutions and by-laws, including election of directors and officers, issuance of stock
 - Decisions about ownership, control, roles of founder(s) and others



Context: Equity/Financing Stages

- “Lifestyle” or venture-backable company?
- Founders
 - Inventors
 - Management
 - Backers
- “Friends and family”
- Academic or research institution



Context: Equity/Financing Stages (cont'd)

- First professional financing round
 - Angel investors
 - Venture capital funds
 - Private placement through broker-dealer
 - Corporate VC
- Later financing rounds
- Family/succession planning
- Relevance to agreements governing other types of entities



Corporate Governance Without a Stockholder Agreement

- Governing Documents
 - Certificate of Incorporation
 - By-laws
- Stockholders elect directors
- Stockholders vote in situations specified by corporate statute or certificate of incorporation, generally those involving an “organic change”
 - Merger or other business combination
 - Sale of all or substantially all of the corporate assets
 - Amendment of Certificate of Incorporation



Corporate Governance Without a Stockholder Agreement (cont'd)

- Directors manage the corporation and appoint officers
- Officers run the day-to-day (ordinary course) business
- Directors and officers are bound by fiduciary duties and law governing “interested transactions,” protected by business judgment rule
- Generally, majority of stockholders can elect all directors, no allocation of voting power among constituencies
- Limited minority protections
- Limited stockholder control over decisions, especially business decisions



Corporate Governance Without a Stockholder Agreement (cont'd)

- Stockholder access to information may be limited
- Directors make most decisions, including decisions about major business changes, financings and compensation and other insider matters
- Stockholders may transfer shares to “outsiders,” subject to securities laws
- Lack of clarity about “exit” mechanisms
- Risks of disputes



Components of Stockholder Agreement

- Voting agreement
- Decisional and informational rights
- Restrictions on transfers of shares
- Regulation of transfers
 - Rights of first refusal
 - “Tag-along”
- Regulation of exits: “drag-along”
- Other investor rights (not covered here)
- Dispute resolution mechanisms



Voting Agreement

- Stockholders agree on board size and composition
- Stockholders agree to vote for specified persons or designees of specified stockholders or groups of stockholders
- May include class or series rights to appoint directors, *e.g.*, Series A Preferred has right to vote separately for a certain number of directors
- May specify number or identity of independent directors
- Some directors may be jointly approved by different constituencies or classes of stock (often, swing vote)
- Officers may also be specified, though this often handled in other documents



Decisional Rights

- Mechanisms
 - Board level
 - Stockholder level
- Rights covered
 - Short list: Organic changes, insider transactions, major business changes
 - Longer list: Includes decisions involving specified dollar amounts or qualitative changes, often includes budgeting and planning and departures from budget or plan
 - Still longer list: Most matters that would be province of board (“partnership” and some professional investor scenarios)



Informational Rights

- Financial information
 - Monthly or other periodic reports
 - Formal financials
 - Frequency, timing, level of review or audit
- Budget and/or business plan
 - Review/approval process
- “Occasional” information (e.g., defaults, lawsuits, etc.)
- Access rights
 - Books and records
 - Management
- Board observer rights



Stock Transfer Restrictions

- “Blanket” restriction
 - Indirect transfers
 - Liens
- Exceptions
 - Family estate planning
 - Affiliates
 - Fund owners and managers
 - Preferred stockholders
 - Liquidity exception
- Compliance with securities laws



Right of First Refusal (ROFR)

- Alternatives
 - Right of first negotiation, right of first offer
 - Blanket restriction on outsider sales
- Mechanics – “all or some,” notices, time periods, termination, etc.
- Applies to sales by:
 - All stockholders
 - Common stockholders
- Who has right?
 - Company
 - All or specified stockholders
 - Preferred stockholders
- Allotment issues



“Tag-Along”

- Right to participate in sales to third party
- Mechanics – relationship to ROFR, notices, time periods, number of shares, termination, etc.
- Applies to sales by:
 - All or specified stockholders
 - Common stockholders
- Who has right?
 - All or specified stockholders
 - Preferred stockholders
- Allotment issues



“Drag-Along”

- Mandatory participation in sale transaction
- Who drags whom? Initiated by specified super-majority of:
 - All stockholders
 - Preferred stock
- Other agreements
 - Covenant to enter into agreements
 - Proxy
 - Agreement not to contest; no appraisals
- Limitations
 - Equal treatment
 - Limitations on reps
 - Limitations on indemnification and liability
 - Other limitations (no restrictive covenants, etc.)



Dispute Resolution

- Governing law
- Jurisdiction
- Arbitration
- Mediation and “cool-down” periods
- Buyout (in non-venture situations)
 - Formula price
 - “Shootout”



Form of Stockholder Agreement

- One or multiple agreements
 - Voting Agreement
 - ROFR and Co-Sale Agreement
 - Investor Rights Agreement
 - Other documents (charter, Stock Purchase Agreement, personnel agreements)
- Amendment mechanics
 - Supermajority
 - Class rights
 - Limitations – equal treatment, rights reserved, legal limitations
- Iterative process



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Questions?

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