SHOOSMITHS

Early stage documentation

What legal documentation should a company put in place at the outset?

FOR WHAT MATTERS

Incorporation

At the outset of a company's life cycle, founders should have a clear vision for the way in which they hope to grow the company. When a company is incorporated, constitutional documents will be adopted to regulate the way in which the company is run.

Bespoke articles of association

The articles of association are a public document filed at Companies House at incorporation. The articles in their basic form should cover the administrative and company law procedures relating to the company. They should also deal with the share rights for different classes of shares, the rights to vote, dividend entitlements and return of capital on a winding up of the company.

Model articles of association are the default position for companies who fail to provide a set of articles for adoption at the time of incorporation. The model articles are a generic set of articles and therefore may not be suitable for each company.

Founders should think about whether tailored articles would be beneficial to adopt from the outset, as this would ensure there is a good level of governance in place from the beginning, be company specific and provide a clear procedural roadmap for the company's early stages.

Given the public nature of a company's articles of association, many prefer to include certain provisions in a shareholders' agreement.

Shareholders' agreement

A shareholders' agreement is a private document between the shareholders of a company. The shareholders' agreement further regulates the running of the company by setting out the obligations, rights and responsibilities of each shareholder and providing a framework for how shareholders should come to certain business decisions. In this respect, there may be some overlap with the information contained in the articles of association.

In co-founder scenarios, entry into a shareholders' agreement is important when starting a new company. The contract is beneficial to all shareholders and, often more importantly, the company, as it ensures that everyone's interests are clearly aligned and that all parties are in agreement about key business decisions. In pulling the shareholders' agreement together, it allows all parties to tackle issues early on and can prevent lengthy and costly disputes further along the company's life cycle.

Company registers

Under the Companies Act 2006, companies are legally required to keep an up to date and accurate set of company registers from incorporation. The register of members is evidence of who the members of a company are and on what date they became a member. It is important for a company to have these in hand from an early stage and ensure they are kept up to date upon any new allotments. Indeed, nearly all investors will request to review the statutory registers before proceeding with any investment.

VC funding stage

A company may seek investment at the early stages of its life cycle. At this point there will be key documentation which investors will expect to have in place.

Heads of terms / term sheet

The term sheet is generally prepared by the lead investor. It is a critical part of a company seeking investment as it sets out the proposed terms of the deal and introduces a level of formality to the investor(s) offer. The term sheet will also refer to important details such as the pre and post money valuation, the investors liquidation preference and whether they expect to receive board or observer rights or anti-dilution protection.

Amended articles of association

Generally, new or amended articles will be adopted at completion of a funding round. This is in order to facilitate investor requirements surrounding board representation, dividend and participation rights and also create share rights for new classes of shares (if required).

New shareholders' agreement

At the point a company is seeking investment, if there is already an existing shareholders' agreement in place, it will be commonplace to terminate this and enter into a new agreement with the inclusion of the new investors. This will introduce new operative provisions for the running of the company and facilitate things such as entitlement to a seat on the board or observer rights. This will link back to the terms agreed at the beginning of the deal pursuant to the term sheet.

Subscription agreement

A subscription agreement sets out the terms of the respective commitments of each investor in the deal such as the amount or class of shares to be subscribed for, the aggregate subscription amount and any conditions to completion. Consent rights may also be listed within the subscription agreement, which will place restrictions on the directors from making certain decisions without investor consent.

Investors will expect the subscription to contain warranties associated with the investment. In early stage funding rounds, is it often expected that the founders will give the warranties with the company. By doing so, the investor is able to bring a claim against the founders and/or the company should they have relied on a warranty which was untrue.