

Agreements All Business Owners Should Have In Black And White

So you and your friend / associate / family member have decided to start a business. And you have already decided on what type of business entity you want (corporation, limited liability company, limited partnership, etc.) and have gotten it properly filed with the Secretary of State. You are now ready to start doing business because you've done all the prep work, right? Not so fast my friend. You may have planned how to start your new business venture, but have you specifically planned out how to run your business? What happens when it is time for the business to end, for whatever reason, good or bad? You don't plan a vacation without planning what to do and how to get back home. Thus, you need to plan for all the circumstances that a business can encounter in its life cycle, and get that plan agreed to in writing and signed by all of the owners.

It's necessary to have this agreement so that everyone involved knows, from the start, how things are going to go with the new enterprise. And if someone forgets, all you have to do is look to the agreement, which is a binding legal contract, for the answers. What happens if one owner gets an offer to buy their part of the business? What happens if one of the owners dies? What happens if one of the owners gets divorced? If there are only two of you, what happens when you disagree? These questions, and others, should be answered in these agreements.

Who Is An Owner And Who Is In Control?

The entity that you have started should have complete and accurate records as to who owns what part of the business. With a corporation, you should keep diligent records as to who owns how many shares. Since profits and losses, and usually voting, are decided on a per share basis, these records and agreements should clearly show who owns what shares. And the agreement should clearly set out the voting rights of each class and series of stock. With a limited liability company or a limited partnership, you should keep records as to capital contributions and ownership percentages or units. The agreements that you have in place should clearly describe how profits and losses are allocated, and if any additional capital contributions required of any owner or owners.

There should be provisions in the agreement as to who will direct the business of the company, as well as who will be in charge of day to day operations. In many small business settings, these will be the same people. In a corporation, the directors make the larger business decisions, while the officers run the day to day business. In a limited liability company, the managers make the larger business decisions while the officers handle the day to day operations. The agreement will cover the major business decisions such as selling all the assets of the business, buying a new business, entering into loan agreements, etc., which will require either a majority or supermajority (more than 50% +1) of the ownership's approval.

Who Gets To Be An Owner?

Owners can agree to restrict the transfer of ownership of the company, so that the owner, or owners, can have the option of stopping ownership interests being transferred to an unwanted outsider without their consent. This agreement typically will require the consent of all the owners, and if there is a prospective new owner, that person will have to agree to the terms in order to buy into the company. Most of the time the agreement gives either the company, the ownership, or both, a right of first refusal to purchase the ownership interest on the same terms and conditions as offered by the outside party. This allows the ownership to retain control of the company, if they so choose.

What Happens If An Owner Gets Disabled, Gets Divorced, Files Bankruptcy, or Simply Retires?

The ownership agreement should cover all these possible situations, and any others that may pertain to your unique business situation. Usually, there are buyout provisions that give the other owners the opportunity to buy out another owner should he or she have one of these situations arise. Be careful when planning these provisions, and make a clear plan as to what events will give rise to the buyout option, and how the buyout will be carried out.

What Happens If An Owner Dies?

In the event that an owner dies, do the other owners want to leave it to the deceased owner's will as to who will own his or her part of the business? If the deceased owner has no will, then most likely the probate code of the state will make those decisions for you. You may suddenly be in business with the spouse or children of your deceased partner, and they may not have the skills and/or character that the other owners may be comfortable with, or even the desire to work in the business. That is why the owners should have an agreement with provisions that require a buyout of the deceased owner's heirs, either by the company or by the other owners, at a fair price that has been predetermined by a selected method. This buyout should also be governed by a provision in the agreement that states how the buyout will be funded. Many times this is done by the company purchasing life insurance on the owners' lives.

How Much Is The Ownership Interest Worth?

Business owners should agree that for any buyout provision there will be an orderly process and a way to fairly value the company and their percentage of ownership in order to determine the buyout price. In any buyout situation, there should be ample notice provisions to all parties involved so that any right of first refusal may be properly and timely exercised pursuant to the terms of the agreement. Additionally, there should be an agreed upon formula or procedure for valuing the ownership interest that is to be transferred. You can do this in a variety of ways. One is getting an appraisal from a business appraiser, or from multiple appraisers. Make sure that the agreement provides

for who chooses and who pays for the appraisal. Another way is using a formula such as using a multiple of earnings over a specified period of time and multiplying that by the percentage of ownership. Another method is using the book value of the company, which is done by deducting the company's liabilities from its assets, and then multiplying that by the percentage of ownership.

Who Owns This? Me Or The Company?

Business owners may need to have agreements as to who owns intellectual property (patents, trademarks, copyrights), trade secrets, and proprietary information (things like customer lists, pricing, etc.). These agreements should clearly define who owns what, and what rights the company has to the property. Additionally these agreements should require that the owners keep the information confidential, not disclose it except under certain circumstances, and not use it for any purpose other than the company's business purposes. These agreements can keep an owner from walking away and starting a competing business with the property that was being used in your business. This type of agreement should be signed by all owners, as well as all employees who have access to this type of information.

Are We Stuck With This Agreement Forever?

While all businesses should have agreements that at a minimum address these issues, if you don't have one in place, don't fret. It's not too late. And if your circumstances have changed, you aren't always stuck with the agreements you have in place. Your business documents need to be reviewed at least as often as you review your business plan. And if you need to, and you can get the other owners to agree, you can change the rules.

When you don't have an agreement like this in place, sometimes bad things happen and parties get in a dispute. Those disputes often end up in litigation. And litigation is a process that no business owner wants to be in. It is costly, both from a time and money standpoint. Once you have these agreements in place, you will have peace of mind knowing that you have planned for the good times and the bad times, and have most likely avoided a litigious dispute in the process.

How Do I Get These Agreements In Place?

Get advice from a good, experienced business lawyer. They draft these agreements all the time. And a good business lawyer will listen to your ownership group, and draft agreements tailored to fit your specific situation. The investment that you make with your business lawyer now will be far less than the legal fees you may have to pay a litigator in the future. It will also pay the benefit of peace of mind, knowing that you have a plan in place.

This article was written by Seth J. Hinkley. Mr. Hinkley has been advising business owners on multiple aspects of corporate and business law since 1997. This is not legal

advice and does not give rise to an attorney-client relationship. If you have any questions regarding the issues discussed in this article please contact Mr. Hinkley at:

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