

## BUSINESS

### CONTRACTS

# The ties that bind

*The value of agreements between business owners before a problem arises*

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When beginning a business, many co-owners prefer to spend time focusing on their common efforts rather than the risks associated with their business relationship. Some important questions are commonly (and understandably) avoided during this "honeymoon" phase. Unwillingness to focus on these issues while they are still hypothetical can leave the partnership on a shaky foundation during tough times.



James P. O'Sullivan

Business owners are well advised to take a proactive approach in addressing future risks through an owner agreement.



Kevin P. Nelson

What is an owner agreement? The name varies depending on the type of business entity, but the most common are titled "Buy/Sell Agreements," "Shareholder Agreements," "Partnership Agreements," "Operating Agreements," and "Joint Venture Agreements."

Whatever the name, there are some common provisions business owners should consider.

#### Key issues include:

**1} Working Capital** Prior to beginning any business, owners should agree how the owners will provide the company's working capital and whether the company will take on debt financing when cash needs press.

**2} Profit and Loss Allocations** When the company makes a profit, everyone will want a piece of the pie. Detailing who gets the profits,



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and when, will help avoid fights in the future or at least lessen their intensity. This can also be true for losses. For instance, who gets the potentially valuable tax benefits of a loss?

**3} Compensation for Services** How owners are paid is the most common trigger for disputes. An owner's ego can be easily bruised when other owners seek higher compensation for their services. It is imperative that the owners detail how services will be compensated at the start of the business and as the relative value of the owners' contributions change over time.

**4} Procedures for Business Decisions** Business owners should address when and where they will meet, when a vote on a business decision is required, who will be entitled to vote, and the duties and rights of the parties. Will one or more owners have a "tiebreaker" or "veto" right?

**5} Trigger of Buy-Out Rights** At some point business owners must consider what happens when an owner terminates employment, dies, becomes disabled, files bankruptcy, gets divorced, etc.

**6} Valuation of Ownership Interests** There are many methods that can be used to value an ownership interest. Regardless of the method used, we generally recommend using a single valuation method for all buy-out triggering events. We also suggest considering cash flow needs for the company by scheduling payment of the purchase price for the ownership interest over an agreed period.

**7} Dissolution** Upon dissolution, a company must consider how assets will be distributed, how debt will be satisfied, and who will be responsible for winding up the company.

**8} Dispute Resolution** Finally, and sometimes most importantly, owners should agree on how they will seek to resolve disagreements. Having an agreement to try to resolve disputes privately through informal negotiations, mediation, and arbitration can help avoid a lawsuit that is both costly and subject to public review by competitors, customers, vendors, and employees.

The bottom line is that business owners are wise to reach an agreement regarding the above-outlined issues prior to participating in substantial business dealings. However, even long standing businesses should consider adopting or updating an owner agreement. We can help address these and other important issues for new and experienced business owners.

#### WE'RE HERE TO HELP

For more information about Tiffany & Bosco's resources in this area, please contact Jim O'Sullivan or Kevin Nelson of our Business Solutions Department at (602) 255-6017, [jpo@tblaw.com](mailto:jpo@tblaw.com), or (602) 255-6028, [kpn@tblaw.com](mailto:kpn@tblaw.com).