UNDERSTANDING AN OWNERS' AGREEMENT

GETTING A COMPANY'S CO-OWNERS ON THE SAME PAGE

by **Phil** Josephson

For any company that has more than one owner, it's always a good idea to have a formal and solid owners' agreement in place. An owners' agreement may take the form of a shareholders' agreement, an operating agreement, a partnership agreement or other similar understandings between the owners. Regardless of the form or title, however, the owners' agreement is an integral part of the entity and its ongoing existence.

The owners' agreement can address a myriad of issues that may face the entity and its owners during the business life cycle, including how the entity will be managed, how the valuation of the entity shall be determined, and the rights and obligations that owners may have upon triggering events. For example, an owner may want to end his or her ownership of the entity for one or more of several reasons. In a well drafted owners' agreement, there will be provisions to address what occurs in this event. For instance, the agreement will address whether the owner may withdraw from the entity or not, and if permitted, who has the right or obligation to purchase the departing owner's interests. The agreement will continue to provide what price is to be paid to the departing owner if these sales are permitted or mandated. Conversely, the entity (or other owners) may want to rid themselves of an owner for one or more of several reasons. The owners' agreement will address if there is a right or obligation to purchase all of an owner's interests to accomplish this purpose and what price that owner should receive.

The owners' agreement should also address other triggering events such as death, disability or divorce of an owner. For example, in the event that an owner dies or becomes divorced, the entity and other owners should want to ensure a continuity of ownership. This can be accomplished in the owners' agreement by indicating who has a right or obligation to purchase the ownership interests and at what price. Likewise, in the event an owner provides work and service to the entity, the owners should address what is to happen to the ownership interest if an owner is terminated. In the event of termination, the owners' agreement should provide for different results if the termination is voluntary or involuntary.

If the owners' agreement has provisions for the purchase of ownership interests, then the agreement should specify how the valuation of the ownership interests will be determined. There are many ways to determine the value of a closely held entity, and the agreement should provide a mechanism to determine price that is clear and reasonable in light of the entity and the market.

The time to draft an owners' agreement is now, and in the future. In other words, drafting an agreement now – when (hopefully) owners are aligned and agreeable – is beneficial because the owners can work together in the entity's best interest. Then, the owners should periodically return to the agreement and revise the document in accordance with changes in the market, the entity and the owners themselves. A periodic review is important to ensure that the valuation mechanisms are appropriate and, if not, are revised accordingly.

An owners' agreement is an essential document for each closely held entity. The agreement may be plain and simple in execution, but it does require considerable thought and discussion. The process is beneficial to both the entity and the owners as it helps to understand and align the intentions and objectives of the entity and its owners. This will aid in drafting the agreement, which in turn will aid in how efficiently the owners and the entity will handle fundamental issues in the future.

Owners' Agreement Provisions

Examples of issues that may be addressed

• Sales of ownership to third parties	• Voting requirements
• Governance and Management	• Noncompete provisions
• Antidilution provisions	• Dispute resolution process
• Valuation procedures	• Insurance funding
• Minority interests	• Dividends and distributions

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