Duvall & Associates, Inc.

Taking Care of Business

AGREEMENTS OF COMPANY OWNERS

"From a distance you look like my friend, even though we are at war." The Byrds

Partners – business buddies for life. Or so it seems in the beginning. But within this financial genesis, when relations are cordial, lies a defining opportunity to forge lasting agreements between owners.

Without written contracts, minority owners of small businesses cannot force a company to redeem their stock. Likewise, companies cannot force owners to sell, thus creating a potential Mexican standoff usually accompanied by legions of attorneys.

Owners should draft written covenants (buy-sell agreements) to map out contingency plans which kick start during times of company crises such as death, disability or job termination. And "right of first refusal" rights should be documented to prevent owners from transferring stock to non-related third parties.

Since there is no readily available public market for closely-held companies, it can be difficult to develop a formulaic price for owner share acquisition.

Beware of arrangements wherein each owner chooses an appraiser - and even a third may be employed to break a logjam – unless you wish to prime the economy by paying numerous professionals.

Many businesses simply use a buy-out formula equal to the buy-in formula. For example, if new partners originally acquire their shares at "net book value", their shares are likewise redeemed by the company at "net book value" price.

Other firms require periodic independent appraisals, the per share value to apply to purchases until a new appraisal is adopted. The challenge in this scenario is to generate a valuation methodology which is comprehensible, predictable and capable of withstanding the evolving elements of time. Understandably, a valuation formula reasonable at company inception may wither in usefulness at later stages of business life. Therefore, a constant reevaluation of the model is recommended.

An interesting concept analogous to blind man's poker is becoming increasingly popular. Some contracts provide that if one owner desires a business divorce, he/she must bring an offer price to the table. Upon disclosure, the receiving owner may opt to either buy or sell shares at the proffered price - thus forcing the original party to present a reasonable figure.

Get it in writing – it's safer that way.

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