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The Importance of a Written Agreement Among the Owners of a Family Business

By Marc C. Laredo

"We don't need an agreement – he's my brother." "How can I negotiate with my sister?" "My cousin and I grew up together." and I trust him completely.

MARC C. LAREDO

When it comes to family, we don't like the formality of a written agreement. Somehow, it makes everyone feel tainted, and too business-like. After all, if you can't trust a family member, who can you trust?

So what happens when a family member who owns part of a family business dies or is unable to work? What if he stops working hard? What if he marries someone the other owners do not like or trust?

In a family business, a written agreement among the owners can be critical to reducing family strife, especially when a family member dies or leaves the business. The terms of the agreement will vary from family to family and business to business. But whether the company is a corporation, a limited liability company or a limited liability partnership, certain issues – employment, day-to-day management and the process for making key decisions, death, and what to do if the owners can no longer work together – all need to be addressed. Ideally, the agreement will be created whenever the business has more than one owner (whether that occurs at the company's formation or at a later date). The terms of the agreement then should be revisited over time, as the company grows and the owners' responsibilities, needs and relationships change. An accountant or tax attorney also should be consulted regarding the tax consequences of the agreement, as should the individual owners' estate planning attorneys.

Employment

For many owners of family businesses, the rewards of ownership come through employment – salaries, bonuses and benefits. The terms and conditions of employment, including what happens when an owner is no longer doing his or her job, should be addressed in the agreement (or in separate employment agreements). The agreement also should state what happens if employment is terminated (whether voluntarily or involuntarily), including what rights, if any, the departing owner has to work for another company, and whether the departure will permit or require the company to repurchase the departing owner's ownership interest and how that interest will be valued.

Management

Not every owner can (or should) exercise control over a company's day-to-day affairs. The owners' agreement should address how day-to-day management will operate and who will be responsible for particular decisions.

Unlike with day-to-day affairs, most owners, even minority owners, will want some involvement in key company decisions such as whether to acquire another business, sell the company, or who will serve as the directors and officers. The agreement should address how these decisions are made – perhaps requiring supermajority approval.

Death

Death is inevitable. In many ways, it also is the easiest contingency to deal with in a written agreement. The owners need to ask themselves what happens if one of them dies. Does the ownership interest go to a spouse or children? If so, what happens to a child who does not get an ownership interest? Should the other owner(s) have an opportunity to buy out the deceased owner's interest? Should the company be sold? If so, how will the ownership interest be valued? How should a buy-out be funded (life insurance may play a critical role)? Whatever the answer (and there is no right answer), a well-crafted agreement will deal with this issue in a clear, direct manner. Since there may be interplay with an owner's estate plan and the owners' agreement, attention should be paid to making sure that the estate plan is consistent with the agreement.

Disagreements

Sometimes, despite everyone's best intentions, the owners find that they simply are unable to work together. Perhaps family strife at work is spilling over into the personal arena, one owner becomes less active in the company but still wants to reap the full benefits of ownership, or the owners' visions as to how to run or grow the business are at odds. In any of these situations, one should first try to resolve these differences, perhaps with the aid of an outside consultant. But if these efforts fail, the agreement needs to provide a clear, fair mechanism so that the owners can part. Of course, the best time to address this issue is when everyone is getting along.

A thoughtful, thorough agreement designed to meet the particular needs of the owners can help ensure that an exit is done gracefully, avoid legal disputes and related attorneys' fees, and, perhaps most importantly, keep the family relationship intact. ■

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