

GUIDE TO GOING INTO BUSINESS WITH OTHERS



Imagine the All Blacks running onto the field to play a test match with no referee and no rule book. It is inevitable that the game would quickly deteriorate into an unruly scrap.

People going into business together (or buying a property together) without recording the rules are running the same risk.

We believe prevention is the best cure. If the rules are fixed, recorded and signed in an appropriate agreement then the risk of dispute is reduced, if not removed. If there is a dispute, the time and cost involved in resolving this is likely to be far less.

INTRODUCTION

This is a guide to help you understand the potential issues of going into business with others and how to prepare an agreement that will reduce the risk of issues occurring between the parties in the future.

What Structure?

Whether you are going into business or just buying a property with others, you need to consider the ownership structure. It is likely that you are creating a partnership, whether you have agreed to do so or not. Any partnership must have rules, usually known as a partnership agreement. With the relatively low cost of forming a company you should consider avoiding the partnership and forming a company which is easier to operate, control and sell shares in. A company also provides some protection from personal liability.

A company must have a constitution that records how the company is to be governed and the rights of shareholders. Unfortunately companies are often formed without personalised constitutions and you should take care to avoid this. In addition to the constitution, in most cases it is important to have a shareholder's agreement documenting how the company will function, the rights and obligations of the shareholders and how a dispute would be resolved.

There will however be cases where a partnership is the most appropriate vehicle and a partnership agreement should be documented to carefully record the parties' intentions.

There are other entities such as Trusts and Incorporated Societies, if you are interested in these you should discuss your requirements with a Lawyer.



What Should Be Agreed?

Whether you proceed with a partnership, a company or some other entity you must document the terms of your agreement. The type of agreement will differ depending on the entity you use, however a partnership agreement or shareholders agreement for a company will have rather similar provisions. In our experience the following are the important areas that need to be recorded:

- a) **Background and Intention** – Explain what the parties intend to achieve.
- b) **Term and Termination** - Record whether there is a fixed term and how the agreement is to be terminated, possibly include how the business or individual interests shall be sold.
- c) **Share Structure and Funding** - For a company, the initial capital structure and shareholding should be documented. This will include how the shares are paid for. There must be a policy on how dividends are paid to shareholders. There should also be provision as to how the company is to be funded. Normally shareholders lend funds to the company, rather than increase their shareholding and control of the company. This can be very important in the long term. There should be a provision regarding the rights of each party to encumber their shares. Similar issues apply to a partnership.
- d) **Control and Management** - Who holds the power and how are voting rights exercised, the right to appoint directors and whether there are to be any independent directors etc. Important matters may require special resolutions of shareholders or unanimous approval of directors or unanimous agreement of all partners. This should be documented. There should be provision to deal with conflicts of interest e.g. doing business with one of the shareholders or directors. Once again similar provisions will apply in a partnership agreement.
- e) **Business** - If shareholders or partners are transferring assets into a business, this needs to be recorded; as will the eventual ownership of these on termination. Any other rules regarding the business will need to be documented. If there are to be contributions made in labour or expertise, these should be recorded as should shareholders or partners obligations to work in the business, the ability to take holidays, leave etc.
- f) **Accounts, Records and Budgets** - The responsibility to prepare statements, budgets, forecasts etc. should be allocated. Agreement as to how profits and losses are to be allocated must be documented.
 
- g) **Restraint of Trade** - Will there be restraints on shareholders or partners entering into other similar businesses whilst in the business or after termination.
- h) **Shareholders or Partners, Entry or Exit** - The ability to transfer shares or interest in the partnership, the rights of existing shareholders or partners to purchase these and the introduction of new shareholders or partners needs to be covered. In some cases there may need to be an ability to force people to sell shares if certain conditions are not being met.
- i) **Miscellaneous** - Depending on the nature of the business, there may be other issues, e.g. assignment of rights or franchise agreements, confidentiality provisions, professional qualifications, intellectual property rights etc.
- j) **Disputes** - There needs to be a protocol for the resolution of disputes, particularly dealing with deadlock situations, which can occur, in small businesses. Mediation and/or arbitration provisions are becoming relatively standard.

- k) **Amendment** - The ability to change the rules needs to be discussed. Should this be only by unanimous agreement.

How Do We Proceed?

Costs are always an issue when setting up a business. However it is essential that an agreement is completed to avoid serious problems later. Do not be fooled by the “rosy glow” that surrounds a business start-up; partners, friends and family do fall out, avoid a disaster by fixing the rules first. If a business is failing, there needs to be rules as to how this is dealt with. There also needs to be rules to cover a run-away success and all the issues between these two extremes.

Those involved need to sit down and draft an outline for a set of rules. We can then help by preparing a formal document. If the outline is available, the costs will be reduced substantially.

We suggest that the appropriate Lawyer in Law North is approached for guidance before you start drafting the outline.

The Lawyers in our firm that deal with business law and can assist you are Dennis McBrearty, Simon Dominick, or Richard Ayton.

S U M M A R Y

The above information is a brief summary of the considerations you may wish to take before commencing your business journey with another party. In our experience if the work is done upfront with a strong agreement there is much less chance of issues occurring later.

It is important to remember that although you are entering into business together, you have individual rights and responsibilities. A law firm cannot give independent advice to all the business partners. If our firm is acting for the business, it can prepare a draft agreement, however, each party may require independent advice regarding their own position and this must be taken independently of our firm.



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