



FORMING A BUSINESS

Critical Questions For The Entrepreneur Before Forming a Partnership or Engaging an Attorney



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The ability to collaborate with other individuals to develop an idea is critical to the success of thousands of products, services and even artistic endeavors. However, not all relationships start like a fairy tale or end “happily ever after.” Before starting your venture, take some time with your partner or partners to answer some basic questions regarding structure, decision-making and dispute resolution. Spending time on these issues before commencing your project will save all sides important time and money should problems, as they most certainly may, develop later on.

Getting Started - Determining Roles

The first question to be asked which requires an answer is “Who’s in Charge?” and “What is the scope of their authority?” Even if one individual is to own the majority of the equity of the enterprise, will he or she be able to make all decisions, regardless of the wishes of the other owners? If yes, do the minority owners have options to sell his or her stock to the majority owner? If so, at what price and how is such price determined?

While many decisions, including day to day operations, may be left to the discretion of the majority owner or a manager, often, “fundamental” decisions require the approval of a super-majority of the owners. Alternatively, an individual who funds the majority of the enterprise, even if less than the majority owner, may have “veto” rights over certain decisions.

These fundamental decisions may include, as examples, the following:

1. Sale of the Company or its assets;
2. Sale of additional equity (including convertible debt) in the enterprise or any bank borrowing;
3. Entering into a significant contract of greater than a certain amount;
4. Entering into a related party transaction or change the salary or benefits of one or more owner; or
5. Allowing one of the owners to transfer his or her equity to a third-party.

Planning for Departures

Another critical issue that should be discussed among the partners is how to account for one or more of the partners electing to leave the enterprise and work on a different venture, perhaps even in a different city. It is not unusual for a partner to lose enthusiasm for a project, particularly one that has yet to generate any revenue and therefore any or significant income for the individual. If such individual leaves the venture, is his or her equity forfeited or subject to repurchase by the Company or remaining owners? Since the venture may not have sufficient funds in its early years to purchase the equity, generally, any purchase occurs over a number of years.

Planning for Disputes

In addition, a mechanism should be established to resolve disputes among the partners. Often, an individual who has served as a mentor to one or more of the owners may be able to provide sound, business advice and suggestions. This individual may be the Jumpstart mentor. Many times early stage companies have a Board of Advisors to assist the Company in its development.

Hiring an Attorney

Only after the entrepreneur partners have discussed the above topics and others of importance to them, should they approach an attorney about documenting their agreements. While the attorney may have his or her own recommendations on the issues, having the partners forewarned of the issues will make a resolution quicker and easier. If the partners have discussed these issues ahead of time, the drafting of any agreement will be more cost efficient.

A note of caution—when meeting with an attorney, the parties must be aware that the attorney is able to only represent one of the partners or the enterprise as a whole. The attorney's fiduciary obligations preclude him or her from representing more than one partner in the negotiations among the partners. Since money is always an issue, this may result in one or more of the partners electing not to have its own counsel negotiate terms and is one of the reasons I strongly urge the parties to discuss the key issues among themselves, before the involvement of attorneys.

Finally, the entrepreneurs should have the selected attorney provide an estimate of the fees to be incurred in forming the enterprise vehicle and preparing the agreement among the parties. If the parties come to the attorney with a general agreement among themselves, most attorneys will be able to provide both an estimate of fees and, perhaps, a "cap" on fees to document the transaction.

While no document can anticipate all potential issues and it will need to be amended over time to take into account later investors or additions to management, there is a need even for early stage companies to have its structure documented to address issues common to most businesses.