

ISSUES CHECKLIST

Re: Going into business with others

A '**common business enterprise**' is created when two or more people go into business together. This can happen when a new business is started, two existing businesses come together, or when a part of an existing business is sold to someone.

The purpose of this checklist is to help you think about the issues that are likely to become 'negotiating points' when you go into business together. The idea is that you talk through these issues now, to avoid potential misunderstandings and arguments in the future.

(This checklist can also be used to update the governance structure for an existing business. However, in this context several questions may not be directly relevant.)

Agreement on the issues raised below are then recorded in a *Partnership Agreement*, *Shareholders' Agreement*, *Unitholders' Agreement*, *Owners' Agreement*, *Company Constitution*, or *Trust Deed*. The appropriate agreement will depend on the legal structure you choose for your enterprise.

What are your key objectives?

1. What will your new enterprise do? What are its products and services – now and in the future?
2. Is the enterprise a new enterprise, an existing enterprise, or a combination of new and/or existing enterprises?
3. Why are you going into business together? Have you considered the alternatives?:
 - (a) Doing it on your own;
 - (b) Raising debt;
 - (c) Employing someone; or
 - (d) A joint venture, etc.?
4. How did you find each other?
 - (a) Have you done your due diligence on each other?
 - (b) Have you tested the water with a smaller joint project?
5. Are you friends? Have you considered the possible impact on your friendship and family if things don't work out?
6. Do you have a clear idea of what you expect from each other – from both a macro and micro sense? Have you made a clear list of these things?
7. Do you have a clear idea of what you each expect to achieve from the enterprise? Lifestyle, money, promotion?

Issues Paper – Going into business with others

8. Do you have a written *Strategic Plan*, a *Business Plan* and *Financial Budget*?

Preliminary issues

Term of the enterprise

9. What is the **proposed term** of the enterprise:
- (a) Perpetual (ongoing – most common);
 - (b) Set term (fixed time-period); or
 - (c) Until some defined event (completion of a project).
10. Is the anticipated term the same for each owner? For example, does one of the owners expect to retire or leave the enterprise at an earlier time than others?

Legal structure

11. For a new enterprise:
- What **legal structure** will the enterprise adopt (e.g. company, trust, partnership, etc):
- (a) Are 'limitation of liability' issues relevant?
 - (b) Are there any legal restrictions on the type of legal structure than can be adopted? (For example, some businesses can only be carried on in your own personal name or through a company, rather than a trust.)
12. For an existing enterprise:
- (a) What legal entities make up the enterprise;
 - (b) Who are the owners of the legal entities, and what is the nature of their ownership interests?
13. If trusts are involved:
- (a) How will you define the 'beneficiaries'?
 - (b) Who will act as the trustee?
 - (c) If the trustee is a company, who has a right to own equity in the trustee and be appointed as a director?
14. How will each owner own their equity in the enterprise?
- Each owner needs to consider their own personal circumstances and existing structures to determine the best way to hold their equity in the enterprise.

Regulatory aspects

15. What **licenses** and other **permits** will the enterprise require to operate its business?
16. Who will be responsible for obtaining and renewing the necessary licenses and permits?
17. Who will need to be **'key persons'** on the licenses and permits? Do you have a back-up plan if that person departs, either voluntarily or involuntarily?

Initial contributions

Main types of contributions

18. What has been/will be the **initial contributions** of each owner to the enterprise?
 - (a) Equity contributions;
 - (b) Debt contributions; and
 - (c) Non-monetary contributions (see below).
19. What non-monetary contributions will each owner make to the enterprise?
 - (a) Real property;
 - (b) Plant and equipment;
 - (c) Goodwill (existing business or opportunities);
 - (d) Ideas and intellectual property;
 - (e) Industry or personal contacts; and
 - (f) Time and energy.
20. How will the non-monetary contributions be valued? Now and/or in the future?

Intellectual property (if relevant)

21. How will intellectual property be **contributed** to the enterprise?
 - (a) By licence, or by transfer?
 - (b) Will the contributor get these rights back if the enterprise dissolves, or have first option to do so – and at what value?
22. Who will own the intellectual property **developed** by the enterprise? What happens to these intellectual property rights at the end of the enterprise?
23. Does the enterprise require any third party intellectual property to carry on its business? If so, are your rights to this IP secure and enduring?
24. On what basis will the IP be valued?

Use of assets by enterprise

25. Will any assets be retained by owners and made available to the enterprise? If so, on what terms will they be made available? Is this properly documented?

Equity ownership

Ownership proportions

26. What are/will be the initial and on-going **relative ownership proportions** in the enterprise?
 - (a) Interest in recurrent annual **profits**; and
 - (b) Interests in longer-term **capital gains**; and
 - (c) Interests in **specific assets**.

Issues Paper – Going into business with others

27. Under what circumstances do you see that this may change in the short to medium term?
 - (a) Will people lose some or all their equity if they fail to make their agreed contributions or cease to be involved in the enterprise?
 - (b) Options, dilution, new owners, etc.

Employee ownership/equity

28. Will any employees hold equity in the enterprise?
29. Will employees holding equity in the enterprise be required to sell their equity if they cease to be employed on a full time (or part time) basis?
30. At what value (or valuation methodology) will employees take up and sell down equity in the enterprise?

Funding – how will the enterprise be funded?

Initial funding

31. How will the enterprise be funded, i.e. how will it pay its bills?
32. Basic funding options include:
 - (a) **Equity** – risk capital contributed by the owners. This may take a number of forms, spanning equity to quasi-debt, preference shares, and partly-paid shares.
 - (b) **Debt** – ranks before equity on a winding up of the enterprise. May take the form of secured and unsecured. This can come from the founders, family and friends, or third party banks.
 - (c) **Guarantees/security:**
 - (i) Who will be required to provide guarantees for any third-party obligations, like debt and leases?
 - (ii) Under what circumstances will the guarantees be lifted, i.e. if an owner ceases to be involved in the enterprise?
33. Is there any target or capped **gearing ratio** for the enterprise?
 - (a) ‘Gearing’ refers to the relative contributions of equity and debt. ‘High gearing’ implies high debt relatively to equity. This is something you should discuss with your accountant and financial adviser.
 - (b) Will the enterprise first look to fund working capital requirements through third party debt, then related debt, then equity?
34. **Timing** of contributions of debt and equity – When will the parties be required to make initial and additional contributions of equity and debt?
35. Will anyone be repaid part or all their contributions in priority to other people? Sometimes the initial founder may have put in seed capital or debt, which is expected to be repaid from contributions by later founders.
36. **Financial Failure** – What arrangements will be put in place, or rules of conduct followed, if the venture fails financially? In what circumstances will one or more parties be required to continue to contribute funds if things start going badly (if any)?

Issues Paper – Going into business with others

37. How will the value of equity be determined? What methodology will be adopted to determine market value?

Ongoing funding

38. If the enterprise requires more funding, how will it be sourced? Options include:
 - (a) Related-party equity and debt;
 - (b) Equity from outsiders; and
 - (c) Third-party debt (i.e. banks).
39. Will the enterprise first be required to raise debt capital ahead of further equity capital? If so, to what extent and on what terms? You may wish to agree on a target gearing ratio.
40. If an owner does not contribute further equity or debt capital, will the other owners be able to dilute their equity holding and/or expel the owner from the enterprise? At what price will the dilution or expulsion take place? Often this occurs at some level of 'discount' to the full market value, to reflect the fact that the departing owner has not held up their end of the bargain.
41. How will the value of new equity be determined? What methodology will be adopted to determine market value?

Additional equity:

42. Will owners be **required** to provide additional equity? If so, on what triggers and to what extent?
43. Will **pre-emption** rights apply to any **new** equity created? A 'pre-emption right' is the right or opportunity to take up further equity in proportion to your existing equity holding. For example, if you already hold 15% of the enterprise and new equity is issued, then you have the right to take up 15% of that new equity, so that your ownership interest is maintained at 15%.

Related-party debt:

44. Will owners be required to provide additional debt? If so, on what triggers and to what extent?
45. Will an **agreed gearing ratio** apply, in that an owner will be required to provide debt in the same proportion in which they hold equity? So, if an owner held 15% of the equity in the enterprise, they would also be required to provide 15% of the debt. So, if the total debt was \$10,000, they would be responsible for providing \$1,500 of the debt.
46. Will **pre-emption** rights apply to the raising of new debt, i.e. the opportunity to provide loan funds must first be offered to the existing owners, and in proportion to their existing equity?
47. When will the debt be repayable? It is not a good idea to have it repayable 'at call', as an owner can then cause cash-flow issues by demanding repayment.
48. Will **interest** be paid on loans provided by the owners to the enterprise? (Usually a good idea for tax purposes.) If so, at what rate? (X% above RBA target cash rate.)
49. Will the debt be **secured** in any way? Security is a good idea to give priority to the owner's debt over other unsecured creditors to the enterprise.

Issues Paper – Going into business with others

50. Must owners provide **personal guarantees** for related-party debt? If guarantees need to be provided it is only fair for all the owners to be responsible for these.

Dilution and ratchets:

51. Will any **anti-dilution rights** apply, i.e. the right of one or more owners to have their percentage interest maintained if further equity is issued to other parties? This can be achieved through an anti-dilution right or options. Most enterprises do not use this strategy.
52. Will any **equity ratchets** be in place, i.e. the right of one or more owners to have their equity percentage *increased* under certain circumstances, e.g. management meeting (failing to meet) performance targets?

Control over the enterprise and the business of the enterprise

Decision making forums

53. What type of decisions will be made and in what forum:
- (a) Equity holders (Owners);
 - (b) Board/Committee (Directors - strategy); and
 - (c) Management (Workers – day-to-day).
54. What is the **quorum** for a valid meeting of each forum, i.e. what percentage of people need to be present?

Will any one or more people be required to be present to constitute a quorum – so a valid meeting cannot take place without them?

55. What **limits** apply to decisions and authority at each level?
- If these limits are to be exceeded, then the decision or authority would need to be referred to the decision making forum higher in the order of priority, e.g. Management to Board, Board to Owners, etc.

Composition of the board

56. Who will be the initial board members?
57. Who may appoint additional board members?
- (a) A **simply majority** of owners having the power to appoint and remove all directors. This position favours a majority shareholder; or
 - (b) **Proportional representation** among owners, i.e. one or a group of owners having the right to appoint one director per [20%] of equity held in the enterprise. Proportionate representation is more favourable to minority shareholders holding less than 50%.

We generally recommend some form of proportional representation.

58. Will there be any **external directors** or an independent chairman?
- Who can appoint external parties, i.e. the owners or the appointed board members? We prefer the option of having the directors themselves appoint an external director or chairperson.

Issues Paper – Going into business with others

59. What is the **quorum** for a valid meeting of the board? Will the attendance of any particular board member be required?
60. How much will each board member be paid?
Will board members be entitled to reimbursement of out-of-pocket expenses?
61. How often will board meetings take place? Monthly, quarterly, annually?
62. Are there any issues over which one or more directors (or members) may have a **veto** with respect to certain board decisions? For example, a veto over the issuing of more equity and the raising of debt, etc.
63. Who can dismiss a director, the owners generally, or only the owner(s) who have appointed the director under the proportionate representation mechanism?

Composition of day-to-day management

64. Who will be responsible for **setting and monitoring management objectives** (executive structure), the board, or the owners? The standard position is the board does this. But some high-level executive appointments may require owner approval or be subject to owner veto rights.
65. Who will have **day-to-day control** of the enterprise (e.g. MD, CEO, management team):
 - (a) **Appointment** – how will executives within the business be appointed, and how will their remuneration be set?
 - (b) **Term** – for what term will each executive be appointed, and what termination events will apply?
 - (c) **Areas of authority** – who will be responsible for what areas of the business?
 - (d) **Levels of authority** – what levels of responsibility/authority will managers have, and in what circumstances will they be required to get further input from other owners.
66. What **spending approval levels** will apply, e.g. expenses with value less than \$50,000 or X% of the enterprises gross assets?
67. What **contracting levels** will apply, e.g. contracts with value less than \$50,000 or X% of the enterprises gross assets?
68. What is the **material transaction threshold** for the enterprise, e.g. \$10k, \$50, \$1 million, or X% of the enterprises gross assets?

How will decisions be made?

69. What is the **default position** with regard to making decisions?
 - (a) Simple majority. This is usually the default;
 - (b) Special majority. This usually applies only to more material decisions; or
 - (c) Unanimity.
With larger boards or ownership groups, unanimity can be difficult and gives each director/owner significant influence over the enterprise that may not be appropriate.
70. Do any specific **veto rights** apply?

Issues Paper – Going into business with others

- (a) Over what decisions?
- (b) Who will hold the veto, i.e. a director or an owner?

Veto rights are more common among financial/private equity investors.

Personal interest of owners and directors

- 71. Can an owner deal with the enterprise, e.g. sell its goods, services, etc. to the enterprise, i.e. are **related party transactions** allowed?
- 72. What is the disclosure and approval mechanism for related party transactions.?
- 73. Can **family** be involved in the business? If so, under what circumstances?
- 74. Conflicts:
 - (a) Must an owner disclose personal interests or conflicts of interests?
 - (b) May an owner vote on a transaction in which he or she has a personal interest (e.g. making supplies to the enterprise, employing a relative)?

Dead-lock provisions

- 75. **Dead-lock provisions** – if the business has one or more equal owners, who will have the power to break a dead-lock, e.g.:
 - (a) Freeze – no specific mechanism for resolving deadlock other than time;
 - (b) Deciding vote on a rolling basis;
 - (c) Independent chairman; or
 - (d) External adviser/panel/expert.

Employees

- 76. Who may hire and fire employees?
- 77. Who will set and review salary levels (and how often)?
- 78. Related parties:
 - (a) Will **related parties** be allowed to become employees of the enterprise?
 - (b) Who will **set salaries** for related parties and family members (if any)?
- 79. What is the materiality threshold for executive salaries, (e.g. \$100k, \$150k, etc.)?

Distributions

- 80. Who makes decisions about profit distributions (directors or owners)?
- 81. Do you want to set a **minimum** periodic cash distribution amount/percentage? (Can this be varied/waived by agreement between directors/owners, and if so, by what majority?)
- 82. Will different owners be receiving different distribution amounts? If so, on what basis?

Budgeting and reporting

Budgeting

- 83. Will the enterprise adopt a budget?

Issues Paper – Going into business with others

84. How often will a budget for the enterprise be **set and reviewed** (e.g. annually)?
85. Who will be responsible for **preparation** of the budget (e.g. directors)?
86. Who will be responsible for **approving** the budget (e.g. directors, owners)?
87. When and to whom should **discrepancies** from actual to budget be reported (e.g. directors/owners)?

Financial reporting

88. What **information** will be incorporated into periodic financial reporting?
89. How often will accounts and management reports be prepared (monthly, quarterly, annually)?
90. Who will be responsible for **coordinating** financial reporting for the business?
91. Who will have **access** to the financial information of the business, (and for how long after ceasing to be an owner)?

Access to documents

92. Who will have access to what enterprise records (including accounting records, employee records, corporate records, etc)?
93. For **how long** will the right of access last to documents last after ceasing to be an owner?
94. Do other parties need to be notified before access is made to the documents, or can an owner simply access the documents as they see fit?

Service providers

Banking arrangements

95. Who will be the **banker(s)** to the enterprise?
96. Who may **operate** the bank account and at what levels?

Professionals

97. Who will perform the following roles for the enterprise?:
 - (a) Accountant;
 - (b) Solicitor;
 - (c) Insurance broker;
 - (d) Risk/OH&S/HACCP consulting; and
 - (e) HR consulting.

Insurance arrangements

98. Over what aspects of the enterprise (and its assets) will **insurance** be taken out (e.g. theft and fire, PI, business interruption)?
99. Who will be **responsible** for arranging and renewing insurance (keeping register etc, notifying of claims etc)?

Real property

100. Does the enterprise involve the use of any significant or special purpose real property?
101. Who owns the real property? Do you have secure tenure?
102. Does ownership of the enterprise entitle you to an ownership interest in the real property?
103. How is the real property funded?
104. How is the real property valued on a change in ownership?

New owners

105. Do you envisage that new owners will be admitted to the enterprise? If so, under what circumstances?
106. What majority of existing owners must approve the admission? Unanimous, two-thirds, or simple majority?
107. On what basis will the **value** of the new/transferred equity be calculated?

Confidentiality

108. What level of confidentiality obligations will be imposed on the owners, and for what period?
109. What exceptions to the confidentiality will apply:
 - (a) Ability to provide financial information to advisers and other associates?
 - (b) Ability to provide financial information to third parties in the context of a sale?
 - (c) Requirement to impose a legally binding confidentiality obligation on third parties before disclosure?

Exit scenarios

Operational participation

110. Does an owner (or an individual associated with an owner) need to perform certain functions to retain their equity in the enterprise?
For example, does the owner need to continue to work in the business on at least a 75% FTE basis?

Rights on exit

111. Will **pre-emption rights** apply, i.e. the right of existing owners to have the option to buy a departing owner's share of the enterprise?
 - (a) Will the enterprise have a first option to buy-back the equity? (This results in all the continuing owners increasing their equity proportionately, and may be easier to finance.)
 - (b) How will **value** be set, e.g. by formula or by exiting owner?
 - (c) Will a last right of refusal apply?
112. Will **co-sale rights** apply, i.e. the right to participate proportionally in a sale of equity organised or originated by another owner?

Issues Paper – Going into business with others

113. Will **drag-along rights** apply, i.e. the right of a majority of owners to require a minority to sell their interest to a third party in the context of a sale of the whole of the enterprise (to avoid a minority blackmailing the majority by refusing to sell)?
- (a) At what threshold does this apply, (i.e. 50%, 75%)?
 - (b) Can the acquirer be a related party?
 - (c) Is there a valuation minimum?
 - (d) Can a 'matching notice' be served by the minority acquiring all equity from the majority?
114. Will **tag-along rights** apply, i.e. the right of a minority owner to require the majority of owners to procure an offer for their interest of at least the same value as the offer to the majority (i.e. so the minority shares in any “control premium”)?
- (a) At what threshold does this apply, (i.e. 50%, 75%)?
 - (b) Does this apply to the sale of less than the threshold, e.g. if someone wants to sell 25% of their interest, must they procure a similar proportional disposal for the other owners?
115. Will a change in **ultimate underlying ownership** provisions apply, i.e. the right to acquire a party’s equity after a change in ultimate underlying control of that party?
116. Will anyone have an **exit right**, i.e. a right to be bought out? If so:
- (a) When can this right be exercised?
 - (b) At what value does the exit take place? (Will a discount to full market value apply?)
 - (c) How will this exit right be funded by the continuing owners?

Expulsion rights

117. Can a certain majority of owners **expel an owner** without cause?
- (a) When can this right be exercised?
 - (b) What majority is required?
 - (c) At what value does the expulsion take place? (Full market value?)
 - (d) How is the value determined? (At least 2 independent values?)

Other exit scenarios (see other more specific checklist)

118. Will **insurance** be taken out to cover the death/disability, etc. of one or more owners (e.g. to enable other owners to buy-out estate, cover costs etc)?
119. When will owners have the right to dissolve the enterprise?
120. At what price may one or more owners purchase the interest of another owner (agreed, independent valuation, discounts, etc)?

Restraints of trade and restrictive covenants

121. Can a **director** be involved in a business that may compete with the enterprise?
122. Can an **equity owner** be involved in (or have an interest in) a business that may compete with the enterprise?

Issues Paper – Going into business with others

123. For **how long** after an owner leaves the enterprise will they not be able to compete with the enterprise?
124. In respect of what areas will an owner not be able to compete with the enterprise?

Dispute resolution mechanism

125. What mechanism must the owners use to **resolve disputes** among themselves?
- (a) Mandatory negotiations;
 - (b) Mandatory mediation;
 - (c) Binding arbitration; or
 - (d) Other.

ANDREYEV LAWYERS

Phone: 1300 654 590

Appendix – Decisions

Decision matter	Decision forum	Decision threshold
Business and transactions		
General operational matters	Management	As delegated
Risk management and regulatory issues (including OH&S/HACCP);	Board Management	As delegated
Any material change to the nature of the business.	Owners Board Management	Simple majority Special majority Unanimity Veto
Approving the Strategic Plan.		
Approving the Business Plan.		
Approving the annual Budget.		
Setting the Materiality Threshold for the enterprise.		
Entering into any transaction or contract that is:		
<ul style="list-style-type: none"> not proposed on a commercial arm's length basis; 		
<ul style="list-style-type: none"> of an unusual or onerous nature; or 		
<ul style="list-style-type: none"> outside the ordinary course of the business as carried on by the Company. 		
The making of any capital expenditure or the incurring of any liability above Materiality Threshold outside of the Budget.		
Financial obligations		
Provision any new loan, or extending any existing loan, from the enterprise to a third party exceeding the Material Threshold.		

Issues Paper – Going into business with others

Obtaining new, or increasing existing, external borrowings in excess of the Material Threshold, (other than trade debt on normal commercial terms and in the ordinary course of the business).		
The giving of any guarantee, indemnity or other security to a third party in respect of an obligation of the enterprise.		
Granting an encumbrance over some or all of the enterprise's assets or uncalled capital in excess of the Material Threshold.		
The giving of any guarantee, indemnity or other security in respect of an obligation of a third party.		
Appointments		
The appointment or removal of the enterprise's accountant.		
The appointment or removal of the enterprise's solicitor.		
The appointment or removal of the enterprise's financial/corporate advisers.		
The appointment or removal of the auditors of the enterprise.		
Entering into (or varying) any service, employment or consultancy contract with a term exceeding 12 (twelve) months or a financial commitment exceeding the Materiality Threshold per annum.		
Opening any bank account or signing or varying any bank mandate.		
Policies		
Any material changes to the accounting principles applied in the preparation of the accounts of the enterprise, other than changes required by law or by accounting policies generally accepted in Australia.		

Issues Paper – Going into business with others

Any change in the constitution of the enterprise.		
Distributions		
The distribution of the profits (other than in accordance with the agreed distribution policy).	Board	
M&A		
The merger or amalgamation of the enterprise with any other entity.		
The sale or disposal of the business (or any substantial part of it).		
The closure or substantial scaling down of the business.		
The relocation of the business (or any substantial part of it) outside Australia.		
The winding-up of the enterprise (other than as a result of the insolvency).		
Equity capital		
A reduction in the capital in the enterprise.		
The issue of new equity in the enterprise.		
A change in the rights attaching to equity in the enterprise.		

Area of responsibility		