



Questions Every Family Business Owner Needs to Ask

Jack K. Holland

One of life's sad ironies is that the owners of family businesses often end up having far more acrimonious business relationships than people who are unrelated. This happens simply because of the family relationships and because there aren't appropriate barriers put in place to prevent them.

One of the ways to prevent these fights is to have a well drafted shareholder or operating agreement in place before the problem(s) arise. Other than one's Will, a shareholder or operating agreement may be one of the most important documents one has to protect the family business and prevent the discord. If properly drafted, these documents can be a critical vehicle to protect both one's family and business from events such as those listed below.

How can I?

- a. Transition shares in the business and make gifts to my family while keeping voting control of the business
- b. Protect my spouse and descendants in the event of my death
- c. Protect the ownership of the business in the event of (a) divorce, (b) death of a shareholder/member, (c) disputes among partners or (d) claims of creditors against a shareholder/member
- d. Balance and recognize the contribution of active family member(s) versus passive family members
- e. Make distributions to family members and balance it against liquidity issues facing the business, including financial covenants in credit agreements and the need to cover tax distributions
- f. Determine the fair market value of the Company and its shares, which includes dealing with the conflicts between creating a value for estate tax purposes versus providing a fair market value to family members
- g. Incentivize my employees
- h. Balance the role of life insurance as a part of my planning

What happens if?

- a. I die or become disabled, or if a shareholder/member dies or becomes disabled
- b. If a shareholder/member quits or retires from the business
- c. If a shareholder/member has made loans or guarantees the Company's loans and he dies or leaves

Would I want any of the following individuals owning units/shares in my business?

- a. My former spouse or a shareholder/member's **former** spouse
- b. A shareholder/member's current spouse or his/her children (especially minor children)
- c. A shareholder/member who is terminated for cause and now works for a competitor
- d. A creditor, or a creditor of a shareholder/member
- e. Children by a former marriage (or current marriage) where the business is being run by other family members
- f. The Internal Revenue Service

We have dealt with all these issues at one time or another.

We often find that our clients prepare a shareholder agreement, then don't review it for years, and find that when they are called upon to enforce it, many of the terms and provisions in it are outdated, don't address their issue(s) or provide for an unintended result if implemented. This is particularly true when formulas are created to determine the fair market value of the Company and aren't reviewed on a regular basis.

If your Company is facing any of these issues, we would be delighted to discuss them with you.

Authors and Contributors

Jack K. Holland

Partner, Atlanta Office
404.873.8610
jack.holland@agg.com

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Atlanta Office

171 17th Street NW
Suite 2100
Atlanta, GA 30363

Washington, DC Office

1775 Pennsylvania Ave., NW,
Suite 1000
Washington, DC 20006

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