ISSUES AND DRAFTING TIPS
WHEN OWNERS' SITUATIONS DIFFER

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The views expressed in this paper are those of the authors and do not necessarily reflect the views of their current or former employers or law firms.



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John Ale is Senior Vice President, General Counsel & Secretary of Southwestern Energy Company, an energy company listed on the New York Stock Exchange whose wholly owned subsidiaries engage in natural gas and oil exploration, development and production. Additional information on the company can be found at *www.swn.com*.

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Frank Ruttenberg studied business finance and tax law before entering the practice of commercial and real estate law in San Antonio, Austin and Central Texas. This pragmatic combination of disciplines forms the foundation for an extensive representation of businesses and joint ventures.

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Frank's real estate practice includes negotiating and preparing documents relating to the financing, lease, sale, purchase and operation of income producing properties; the finance, acquisition, development and day-to-day operations for apartment and commercial-use complexes; landlord/tenant relations; commercial transactions with governmental agencies; and the redevelopment and preservation of historic structures.

Frank is involved in assisting development clients with the purchase, sale or lease of groundwater and surface water rights, the development of diversion facilities, and other water development and water supply agreements.

ISSUES AND DRAFTING TIPS WHEN OWNERS' SITUATIONS DIFFER

I. Introduction

Those coming together to start a business typically are enthusiastic about its prospects and aligned on its future. Yet experience tells us that at some point their views may diverge. This is more likely to be the case if the parties' situations differ. For example, one investor or group may own a larger percentage of the business than another. One may have greater access to funds while another knows more about the business by working in it day-to-day. An owner working in the business may value the enterprise providing that owner with a long-term, full-time job, while a financial investor may be looking only to returns and to exit if and when advantageous. When your client or clients are forming a new business or entity, as a lawyer you should encourage them to consider what happens if, in the future, they no longer see eye.

II. What If They Do Nothing?

A. Basic Voting and Contribution Rules

The "default" rule in most situations under Texas's and most other states' business organizations statutes—i.e., what the law provides if agreements or governing documents for an entity are silent—is majority rule: decisions are made by a majority of directors on a corporation's board, a majority of a limited liability company's managers if it has managers, or a majority of the equity interests in a partnership (held by the general partners if a limited partnership) or limited liability company (or LLC).[1] Relatedly, entity statutes compel an equity owner to contribute funds to the entity only if, to the extent, and subject to the conditions to which that equity owner agrees.[2] Parties have great freedom to change these rules,[3] and thus they need to understand what other options they might have as well as what happens if their agreement is silent.

B. Supermajority Voting

Parties rationally may conclude that, regardless of percentage ownership, some decisions are so important that they should require consensus from a broader group of owners than a simple majority. There is no right or wrong list of matters or percentage to be required; rather, the parties should consider the individual owners' relative ownership percentages, whether some are naturally aligned (financial investors vs. those working in the business, family or other relationships outside the business), how their perspectives on the business may differ ("It's may job" vs. "This is a financial investment to be exited based purely on financial criteria").

Common topics where parties require more than a simple majority interest include:

- selling all or substantially all assets
- merging with another entity
- liquidating the business
- undertaking significant new business, such as new geographic areas, new product lines, or requiring investments over a specified amount
- requiring or requesting equity contributions or loans from members, perhaps beyond agreed levels
- admitting new partners or members, including through transfers outside agreed permitted transferees

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[1] *See, e.g.,* TEX. BUS. ORGS. CODE §§ 21.415(a) (corporate board), 101.355 (limited liability company), 152.209(a) (general partnerships as to matters in ordinary course); 153.152(a)(1) (general partnership provisions apply to general partners of limited partnerships). As most of Texas's Business Organizations Code parallels uniform or model acts, other states' provisions usually are similar. The principal exception is that, under the Revised Uniform Partnership Act, each partner has an equal vote rather than voting based on equity ownership. *See* UNIF. PARTNERSHIP ACT § 401(k) (amended through 2013).

[2] *See, e.g.,* TEX. BUS. ORGS. CODE §§ 21.167(a) (written commitment to subscribe to shares), 101.151 (LLC members' contributions), 153.202(a) (limited partners' contributions). The rule is more nuanced for general partners or partners in a general partnership, who can be compelled to contribute to losses, *id.* §§ 152.204(a), 152.708.

[3] *See, e.g., id.* §§ 21.415(a) (corporate board), 101.052(c) (limited liability companies), 152.002(a) (general partnerships); 153.152(a)(1) (limited partnerships).

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