

# Net Profits Agreements

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UT LAW CLE 32nd Annual Course on LLCs, LPs and Partnerships

July 2023



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## Net Profits Agreements

Working together as a group, more often than not, yields better results than working alone.

When working collaboratively the group will often benefit from:

- *a more expansive skill sets*
- *diverse perspectives*
- *greater collective experience*
- *shared resources and*
- *diversification of risk*

Through the years legislatures have assisted the process of collaboration in commerce by codifying laws to better define the expectations of the parties involved.

But.....sometimes the parties want to merely share in profits and “*expressly*” do not want relationship burdened by the imposition of a statutory legal structure.

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# Net Profits Agreements

## *WHERE ARE NET PROFIT AGREEMENTS USED - EXAMPLES*

- ❖ Employment Relationships
- ❖ Consulting Agreements and Independent Contractors
- ❖ Earn Out Agreements From The Sale of a Business
- ❖ Buy Outs of Ownership Interests
- ❖ Strategic Alliances
- ❖ Real Estate Leases
- ❖ Divorce Settlements
- ❖ Oil and Gas Transactions

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# Net Profits Agreements

## *THE ELEMENTS OF THE AGREEMENT*

“revenues minus expenses,”

This rather simple statement, when broken down into its elements, has a lot of moving parts.

What are revenues?

- All sources of revenue or just those from operations
- Do you include sales of capital asset
- Recovery from casualty losses or condemnation
- Lawsuit recoveries for business losses, lawsuit recoveries from personal injury

What are expenses?

- Non-reoccurring expenses which are unrelated to operations, such as capital losses
- Reserves for liabilities
- Amortization charge for depreciating capital assets

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### **REVENUES**

The first step - determine the stream of revenue which is to be a part of the calculation.

This may be as simple as stating the participation will be based on “all revenues from operations”, or

It might designate specific lines of revenue from the operations.

If revenue streams are segmented this will make more challenging the identification and allocation of expenses which are used to generate the stream of revenue.

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### **EXPENSES OR CARVE OUTS FROM REVENUE**

Once the revenues have been identified determine which expenses will be charged against the revenues for the purposes of determining the “*net*” results.

Much like the calculation of revenues this may be as general as “all expenses” (in particular if the revenues are to include all revenues).

In those cases where the revenues are not all inclusive - identify those costs which relate to the generation of the identified revenues to complete the calculation.

This may also include an allocation of expenses which help to generate the revenue stream but are not directly related such as general overhead or other administrative expenses.

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First appeared as part of the conference materials for the  
32<sup>nd</sup> Annual LLCs, LPs and Partnerships session

"Drafting Net Profit Agreements"