

CARDS ON THE TABLE

Agreeing things up front *By David Willbe*

The start of a new business venture between two partners can be an exciting time, but also a busy one with many different considerations that entrepreneurs will have to take into account. One key consideration that often gets overlooked in the rush is ensuring that the partners have agreed the key issues clearly in advance. In these cases agreement is based on very broad, general terms – with each side of the venture making assumptions, based on their own prior experience, as to how the details will be “filled in”.

The lack of clear agreement between the partners may cause a breakdown in the relationship further down the line - which at best will impede (and at worst could lead to the failure of) the business. These situations can be costly, distressing and acrimonious, and in the majority of cases can be avoided if the partners simply take the opportunity to record clearly and in detail, for example, how each of them expects the business to develop and what their respective roles in the business should be.

The same principle can be applied to any “new venture” that a company undertakes with a new person, whether that is a new commercial agreement or bringing in a new senior member of staff – but is best illustrated by a full-fledged joint venture.

Sticky Fingers Restaurant

In the late 1980s, the Rolling Stones’ Bill Wyman started to look for ventures to capitalise on his musical career. On 1 May 1989 he signed up to a business venture with an experienced restaurateur, Mr. Mitchell. The intention was to establish a restaurant, along the same lines as the Hard Rock Café, where Mr. Wyman’s rock memorabilia would be displayed. The restaurant was to be owned by a joint venture company (“SFR”). Both Mr. Wyman and Mr. Mitchell were shareholders in, and directors of, SFR - with Mr. Wyman

holding 66 shares to Mr. Mitchell’s 34. On its face, this is a classic joint venture scenario. One party has the expertise and experience required to operate the business, and the other has the cash – or, in this case, the memorabilia and name value - to get the business up and running. Reading the scenario it seems almost entirely certain that the business (meaning both the restaurant and the affairs of SFR itself) would be run by Mr. Mitchell, with Mr. Wyman as the proverbial “sleeping partner” – making his initial contribution of paraphernalia and then taking his hands off of the business.

Unfortunately, the agreement between the shareholders only stipulated that Mr. Mitchell would run the restaurant – there was little detail as to Mr. Wyman’s role.

Differing Expectations

For the first three years the restaurant ran successfully. Mr. Mitchell ran the restaurant, as had been agreed, and ran SFR’s corporate affairs. Mr. Wyman, however, did not fade into the background – although he was not involved in the restaurant itself, he did involve himself in some of the decision-making at board level and took an interest in SFR’s books and accounts. As time wore on, Mr. Wyman became uneasy with Mr. Mitchell’s conduct – certain irregularities that he had noticed in SFR’s books began to look to him as though Mr. Mitchell had his “hand in the till”. Unfortunately, discussions between Messrs. Wyman and Mitchell failed to address Mr. Wyman’s concerns.

It was at this point that the parties’ failure to discuss their respective roles in the joint venture became a major issue. Mr. Mitchell had assumed that the venture was to be run on the lines set out above, with him running the business and Mr. Wyman just collecting the cheques. Accordingly he resented what he saw as an intrusion onto what had been agreed to be his territory. Mr.

Wyman, on the other hand, saw himself as an involved business partner at board, if not operational, level – not full time, given his commitments as an international rock star, but taking an active role and certainly able to ask questions if he felt that the business was being badly run. The business relationship between the men broke down swiftly and irreparably.

Business Disruption

With the breakdown in the relationship between Mr. Mitchell and Mr. Wyman, the day-to-day management of the business became almost impossible. Having already suspected Mr. Mitchell of dishonest dealings, Mr. Wyman felt that his suspicions were confirmed by Mr. Mitchell’s obvious discomfort at having him involved in the business. Mr. Wyman decided that the time had come to find someone else to run the restaurant, and remove Mr. Mitchell. As the joint venture agreement provided for Mr. Mitchell to run the restaurant, this was a decision that could only be taken by SFR’s board. Both Mr. Wyman and Mr. Mitchell had to be present at a board meeting for any decisions taken at such meeting to be valid, as SFR’s articles of association required a quorum of two directors. Mr. Mitchell, knowing this, simply refused to turn up.

Unable to remove Mr. Mitchell at a board meeting, Mr. Wyman (as the holder of two thirds of SFR’s share capital) attempted to call a shareholders’ meeting to appoint two more directors to the board. This would have meant that Mr. Mitchell’s boycott could not have prevented a board meeting being held, so he could be removed as a director and as manager of the restaurant. The quorum for a shareholders’ meeting, however, was two members – and again Mr. Mitchell refused to attend.

The business, in the meantime, was suffering as Mr. Mitchell’s attention was naturally divided between his duties to the restaurant and this dispute. More than that, being unable to hold a board meeting meant that SFR could not deal



with its various statutory duties (filing accounts and returns) or address a VAT problem that had arisen.

Subsequent Costs

Both Mr. Mitchell and Mr. Wyman brought litigation against the other – Mr. Mitchell claiming that SFR was being run in a way that was prejudicial to him as a minority shareholder, and Mr. Wyman asking the court to make an order for a shareholder meeting of SFR at which one shareholder could count as a quorum, so that he could appoint the new directors.

Of course, the time and money involved in making those applications were considerable. As they worked their way through the courts, the parties in fact agreed that Mr. Wyman would buy Mr. Mitchell's stake in SFR to end the dispute. After some discussion as to the exact valuation (Mr. Mitchell arguing that he should be bought out on the basis of the pre-dispute value of SFR, Mr. Wyman asking for the lower post-dispute value), that was the conclusion of the matter.

Clearly-defined Roles

The SFR case underlines the importance of agreeing in advance and in detail what role each partner should play in a venture. Although it

was always agreed that Mr. Mitchell should run the restaurant, that skeleton was never adequately fleshed out and, in particular, it was never made clear whether Mr. Wyman's position on the board of directors was meant to give him a real voice in the board-level management of the company.

By the same token, Mr. Wyman's position as the majority shareholder was not given the level of protection that one would expect to see. It is very unusual, for example, for a shareholder with two thirds of the voting shares in a company to have to go to court to appoint a new director – or for a minority shareholder in effect to hold a veto over any board matter.

Much of what was discussed by the parties at the time is now the subject of debate and litigation, so the exact reasoning is not clear. It is safe, however, to say that plenty of people would have been happy to act as the "silent partner" that Mr. Mitchell was expecting – and plenty of restaurateurs would have been happy to work more closely with Mr. Wyman. Whether these parties would have worked together on the deal if they had seen each other's cards from the outset is not clear – but both parties would have saved themselves considerable time and cost if they had found this out straight away.

Conclusion

The lesson of SFR can be applied across any aspect of business that involves working with a new person or company. An entrepreneur should be careful to ensure that their expectations for a particular contract or role are communicated to their counterparty – because what your candidate thinks of as, for example, the role of the CFO may be substantially different to what you want them to do. The consequences of that misunderstanding, whilst not necessarily as dramatic as for SFR, may be damaging to the business.

By establishing and agreeing key matters such as the delineation of their responsibilities early on, partners in any venture can decide whether they are entering into the new venture with the right person, or whether it would be wiser for the parties to go their separate ways. As the SFR case demonstrates, this can save a significant amount of time, money and stress in the future, as it ensures that both partners are on the same page when embarking on their new business venture together.

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