

# Governance Best Practices for Private and Family- Owned Companies

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**Collaborative. Accountable. Authentic.**  
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June 11, 2025

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# Key Agreements for Closely-Held Companies

- **Governing Documents**
  - Bylaws
  - Operating Agreements
  - Partnership Agreements
- **Agreements between Owners**
  - Shareholder Agreements
  - Operating Agreements
  - Partnership Agreements
- **Agreements between Customers and Suppliers**
  - Service Agreements
  - Vendor Contracts
  - Supplier Agreements

# Governing Documents

**Closely-held business Bylaws, Operating Agreements, and Partnership Agreements serve the following purposes:**

- Establish the rules of operation, the details of ownership, management, meetings, and the roles of operations.
- Codify the governance and ownership of the organization through boards or management structures.
- Address transfer of ownership interests and the valuation of those interests.
- Provide a structure through which the organization can grow.
- Provide a last resort for conflict resolution if relationships break down.
- Protect the business' limited liability status.
- Clarify verbal agreements.

# Best Practices for Governing Documents

**Closely-held businesses have unique advantages when maintaining their governing documents:**

- Use annual meetings to assess the need to amend governing documents
- Embarrassing for business owners if governing documents are out of date when the entity seeks operational loans, is under audit, seeks new members, or is entertaining the sale of the business
- Use the opportunity to expand or contract boards or management roles, as necessary
- Continually think about transfer provisions and buy-out terms
- Update valuation terms, as necessary

# Governing Documents – Delaware Perspective

## Why Delaware?

- Court of Chancery: Premier business court; predictable and efficient resolution of disputes without juries.
- Contract Clarity: Decades of case law interpreting fiduciary waivers and other complex provisions gives businesses legal certainty.
- Freedom of Contract: Delaware statutes give maximum effect to LLC and partnership agreements, allowing bespoke governance structures.
- Privacy: Delaware doesn't require public disclosure of beneficial owners.



# Governing Documents – Delaware Perspective (Cont.)

## Why it matters even if you're not formed there:

- M&A Transactions: Acquirers often insist on Delaware entities, especially private equity firms, for tax or governance reasons.
- Investment Readiness: Investors prefer Delaware due to familiarity and legal predictability; it may be a condition to close.
- Growth Strategy: You may acquire or merge with a Delaware entity, or form one as a holding company.

# Litigation Bylaws / Articles Count The Votes

- What are the Rules?
- When can you make decisions?
- Who can make decisions?
- Pack the Board? Shrink the Board?
- Board Power or Shareholder Power?





# Agreements between Owners

## **Shareholder's Agreement:**

- An arrangement among shareholders that describes how a company should be operated and outlines shareholders' rights and obligations. The agreement also includes information on the management of the company and privileges and protections of shareholders.

## **Operating Agreement/Partnership Agreement:**

- An agreement that outlines the terms, conditions, and rules governing the relationships and responsibilities within a partnership or LLC. These agreements should address the transfer of interests, buy-sell provisions, and the management of the partnership or LLC.

# Best Practices for Agreements between Owners

- **Closely-held business shareholders and members should reevaluate their agreements on a regular basis.**
- **Ensure agreements have escalation procedures for resolving conflicts and making decisions**
- **Set boundaries for family involvement:**
  - *Define roles*
  - *Establish processes*
- **Agreements should address succession planning**
  - *Identify and develop future leaders*
  - *Provide sufficient time for training and knowledge*
- **Defining terms for transfer and exit**
  - *Processes and timing for selling shares and retiring*
  - *Determine valuation method*
  - *Describe payment terms for buy-out of shareholders/partners*
  - *Address in detail the restrictions on transfer*

# Delaware Perspective – Outdated Agreements Between Owners

## *Gatz Properties LLC v. Auriga Capital Corp.*, 59 A.3d 1206 (Del. 2012)

- Dispute involved LLC manager's breach of duty.
- LLC agreement lacked clear provisions governing self-dealing and valuation, leading to expensive litigation.
- Delaware Supreme Court emphasized that while fiduciary duties can be waived, the waiver must be **clearly and unambiguously stated**.

### Key Takeaways:

- **Ambiguity invites litigation:** The absence of updated or clear terms forces courts to infer intent—often at the business's expense.
- **Stale agreements fail in practice:** As business realities evolve (e.g., new members, leadership changes), the governance documents must evolve too.
- **Failing to define valuation terms and exit rights:** Led to claims of unfair dealing and breach of duty.
- **Lesson:** Regular reviews of governing agreements protect against internal conflict and litigation exposure.

# Ignore the Shareholder's Agreement at your Peril

- Reasonable Expectations
- Valuation Methods
- Who Picks the Valuator
- Fair Market Value or Fair Value
- Practicality



# Agreements between Customers and Suppliers

## **Vendor Contracts:**

- An agreement between a business owner and supplier, specifying terms for delivery of goods and services for agreed upon payment.

## **Customer Contracts:**

- An agreement between a business and its customers/clients that establishes terms of service or products provided.

# Best Practices for Agreements between Customers and Suppliers

- Review of contracts should be anticipatory and consistent.
- Use centralized storage for all contracts (Cloud-based) that allows relevant stakeholders access to documents.
- Be proactive in risk assessment and management
  - Financial risks: costs/budget overruns
  - Operational risks: quality/supply chain
  - Legal & compliance risks: industry regulations/data privacy laws
  - Reputational risks: poor services
- Reviewing contracts in a projected down economy
  - Identify unfavorable deals
  - Determine breaking point
  - Research counterpart and seek win/win solution; mutually beneficial solutions
  - Execute new agreement and avoid disputes

# Delaware Perspective – “Boilerplate” Provisions Matter in Customer/Supplier Agreements

- “Boilerplate” clauses (those standard ones in the “Miscellaneous” section of a contract) aren’t filler. Delaware courts enforce them just as strictly as core provisions.
- Even minor boilerplate language (e.g., notice rules, governing law, waiver) can upend your substantive rights, especially in disputes.
- Case in Point: *Mosaic Capital Partners v. Local Bounti Operating Co.* (Del. Super. Ct., Apr 2023)
  - Buyer sent indemnity notice at 10:04 p.m. on deadline; seller argued it was “after business hours” per boilerplate—triggering deemed late notice. The Court found a conflict between a specific survival clause (11:59 p.m. deadline) and a general notice clause (normal business hours rule). The Court deemed the contract ambiguous and refused to resolve it on motion, citing conflicting boilerplate
- Key Takeaways:
  - Treat boilerplate as core, subject to the same review as material terms.
  - Check for conflicts: e.g., between survival deadlines and notice mechanics.
  - Avoid ambiguity traps: clear drafting avoids costly litigation and interpretation battles.



# Great Terms May Not Be Enough



- Contract Formation Issues
- Battle of the Forms
- Course of Dealing
- Waiver

# Learn more about Lathrop's Closely Held & Family Business Practice

