Checklist of Issues in Drafting a contract between family members, a

General partnership agreement, corporate bylaws, or an operating agreement for an LLC.



1. What state will the business be formed under?
2. What will be the formal name of the business?
3. Does the proposed name conflict with the name

of another business or constitute a trademark infringement?

1. Where will the principal address of the business be?
2. What is the term of the business – how long will it last?
3. Do you have an exit strategy at this time? Do all the principals agree with this exit strategy?
4. What will be the “purpose” of the business? The reason the business is being brought into existence.
5. Will a fictitious name statement be necessary if the business has a marketing name?
6. Who will be the agent for service of process for legal matters?
7. What will be the initial capital contribution of the principals? Will the initial contributions be cash, check, assets, or time? If the assets are time, how will they be valued?
8. If the business needs additional capital, will the principals need to approve a loan or an outside injection of capital?
9. Will there be principals contributing services to the business? What are the specific services and time commitments? And how will these be valued?
10. Will there be interest paid on capital contributions? If so, what interest rate will be charged?
11. Under what circumstances can capital contributions are withdrawn from the business? How will the withdrawal be valued?
12. Can there be loans made by the principals to the business? What are the terms and interest rate?
13. How are profits and losses allocated among the principals?
14. When are distributions of profits to be made? Who decides? Are there profits that will be retained in the business and not distributed? Will the profits be distributed based on ownership percentages?
15. What is the fiscal year of the business? If it is different than the calendar year, when will the fiscal year start?
16. What is the accounting method for the business? Cash or accrual method?
17. How will the business be managed? Will there be Managed Partners? Who are the managers and their titles?
18. What acts will require the majority consent of the principals?
19. What acts will require the unanimous consent of the principals?
20. Who is authorized to handle the funds of the business?
21. What outside activities of the principals are freely permitted?
22. What outside or competitive activities of the principals are restricted?
23. Are the principals entitled to a salary? What is that salary for each principal?
24. How can new principals be added? Can a majority of the principals recommend a new principal or does it need to be a unanimous recommendation?
25. How can existing principals withdraw from the business entity





1. How can existing principals be expelled from the business? What actions would cause them to be expelled? Should the value of their ownership be penalized for such actions and how much penalty should be incurred?
2. If principals withdraw, what happens to their interest in the business?
3. What happens on the death of disability of a principal?
4. What happens on a bankruptcy or insolvency of a principal?
5. What happens in the event of a divorce of a principal’s spouse with respect to the business interest?
6. What restrictions are there on the transferability of a business interest?
7. Is there a right of first refusal on transfers of business interests?
8. What circumstances dissolve the business or cause the business ownership to be reallocated among the principals?
9. What circumstances result in termination of the business or create a reallocation?
10. On termination of the business, how are distributions made?
11. Is there indemnification by a partner who commits negligence or misconduct resulting in a business loss?
12. Do principal’s spouses need to consent to the terms of the business agreement?
13. How will business disputes be handled? Mediation? Arbitration? Internally? Externally?
14. What legal competition limits can be placed on a departing partner?
15. What kind of buy out right should the business or the principals have in the event of the death, withdrawal or expulsion of a principal?
16. Who shall have the authority to authorize charitable contributions and does a vote between the principals need to be taken?
17. What are the operating hours of the business?
18. How many hours per week should the principals work?
19. How many holidays will the business observe?
20. How many vacation days, sick days, and personal leave days shall each principal accrue? And what type of longevity do they need to work to accrue those days off?
21. Be sure to make a vacation calendar that the principals need to sign on before they can take a day off.
22. Have the principals keep a Black Book of benefits provided by the business, and bonuses will be adjusted according to the Black Book. Ken will show an example of this.
23. Be sure to define the job responsibilities that each principal will be accountable for. Be specific in this area and try not to overlap responsibilities. However, establish some kind of checks and balance system to make sure each principal is accomplishing the work he is supposed to.
24. Names and legal addresses of the principals and cell phone #’s.
25. How can additions, deletions, and modifications be made to this agreement between the principals? Can a simple majority force these changes or does it have to be a unanimous vote of all the principals?
26. What type of perks should each of the principals be able to receive?

Checklist of Issues in Drafting

General Partnership Agreements

1. What state will the partnership be formed under?
2. What will be the name of the partnership?
3. Does the proposed name conflict with a name of another business or constitute a trademark infringement?
4. Where will the principal places of business be?
5. What is the term of the partnership?
6. What will the “purpose” of the partnership be?
7. Will a fictitious name statement be necessary?
8. Who will be the agent for service of process?
9. What will be the initial capital contributions of the partners?
10. If the partnership needs additional capital, will the partners be obligated to contribute it? In what proportion? Subject to a cap?
11. Will there be partners contributing services to the partnership? What are the specific services and time commitments?
12. Will there be interest paid on capital contributions?
13. Under what circumstances can capital contributions be withdrawn from the partnership?
14. Will there be loans made by the partners to the partnership? What are the terms and interest rate?
15. How are profits and losses allocated among the partners?
16. When are distributions of profits to be made? Who decides? Are there profits that will be retained in the business and not distributed?
17. What is the fiscal year of the partnership?
18. What is the accounting method for the partnership?
19. How will the business be managed? Will there be a Managing Partner?
20. What acts will require the majority consent of the partners?
21. What acts will require the unanimous consent of the partners?
22. Who is authorized to handle the funds of the partnership?
23. What outside activities of the partners are freely permitted?
24. What outside or competitive activities of the partners are restricted?
25. Is any partner entitled to a salary?
26. How can new partners be added?
27. How can existing partners withdraw?
28. How can existing partners be kicked out of the partnership?
29. If partners withdraw, what happens to their interest in the partnership?
30. What happens on the death or disability of a partner?
31. What happens on a bankruptcy or insolvency of a partner?
32. What happens in the event of a divorce of a partner’s spouse with respect to the partnership interest?
33. What restrictions are there on the transferability of a partnership interest?
34. Is there a right of first refusal on transfers of partnership interests?
35. What circumstances dissolve the partnership?
36. What circumstances result in termination of the partnership?
37. On termination of the partnership, how are distributions made?
38. Is there indemnification by a partner who commits negligence or misconduct resulting in a partnership loss?
39. Are there spouses that need to consent to the terms of the partnership agreement?
40. How will partnership disputes be handled? Mediation? Arbitration?
41. What legal competition limits can be placed on a departing partner?
42. What kind of buy out right should the partnership or the partners have in the event of the death, withdrawal or expulsion of a partner?

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The law does not require a partnership agreement (also known as the articles of partnership), but it is wise to work with an attorney to develop one that spells out the exact status and responsibility of each partner. All too often the parties think they know what they are agreeing to, only to find later that no real meeting of the minds took place. The partnership agreement states in writing all of the terms of the partnership for the protection of each partner involved. Every partnership should be based on a written agreement because, as one attorney says, business partners become part of a “very intimate, intense relationship.”

 When a partnership agreement does not exist, the partnership will be governed by the Uniform Partnership Act, but its provisions may not be as favorable as a specific agreement hammered out among the partners. Creating a partnership agreement is not costly. In most cases the partners can discuss each of the provisions in advance. Once they have reached an agreement an attorney can draft the formal document. Banks will often want to see a copy of the partnership agreement before lending the business money. Probably the most important feature of the partnership agreement is that it resolves potential sources of conflict that, if not addressed in advance, could later result in partnership battles and the dissolution of an otherwise successful business. Spelling out details – especially sticky ones such as profit splits, contributions, workloads, decision- making authority, dispute resolution, dissolution, and others – in a written agreement at outset will help avoid damaging tension in a partnership that could lead to a business “divorce”. Business divorces, like marital ones, are almost always costly and unpleasant for everyone involved. One experienced entrepreneur says, “I’ve been divorced, in both business and matrimony, and I don’t know which was more wretched – or costly.”

 Unfortunately, the tendency for partners just starting out is to ignore writing a partnership agreement as they ride the emotional high of launching a company together. According to one writer, “In the eager, hectic days of startup, when two people come together with a “brilliant idea”, they never imagine that someday, they may not want to be partners anymore. Instead, their thoughts race to marketing strategies, product development, sales pitches, and customer service.” The result? Every year thousands of partners find themselves mixed in irreconcilable disputes that damage their businesses because they failed to establish a partnership agreement.

 For example, Paul and Jim were best friends when they decided to go into business together – without creating a partnership agreement. They launched their courier service with a pledge to “share and share alike”. Before long, however, Jim began to help himself to company cash whenever he had a shortfall. Paul tolerated his partner’s “withdrawals” until he discovered the reasons for Jim’s perpetual cash shortages: Jim had a gambling problem! Paul didn’t discover this until two men camped out in the company foyer, refusing to leave until they collected $2,500 for Jim’s failed Super Bowl bet. Paul quickly locked the safe and hid the key from his partner in an effort to safeguard company assets. In retaliation, Jim returned to work with a very ferocious Doberman Pinscher, which he coaxed into Paul’s truck. He then had the company receptionist ask Paul to move his truck. Surprise!

 Generally, a partnership agreement can include any terms the partners want (unless they are illegal). The standard partnership agreement will likely include the following:

1. *Name of the partnership*. What is the name of the business? If the name is a fictitious one, the partners must register it with the state through an assumed-name certificate.
2. *Purpose of the business.* What is the reason the business was brought into being (e.g., to operate a construction company to build homes)?
3. *Domicile of the business.* Where will the principal business be located (e.g., 1200 South Kings Highway, St. Louise, MO.) ?
4. *Duration of the partnership.* How long will the partnership last?
5. *Names of the partners and their legal addresses.*
6. *Contributions of each partner to the business, at the creation of the partnership and later.* This would include each partner’s investment in the business. (For example, one partner may contribute a building, a second the needed tools, and a third the cash required to start the business.) In some situations a partner may contribute assets that are not likely to appear on a balance sheet. Experience, sales contacts, or a good reputation in the community may be reasons for asking a person to join in partnership.
7. *Agreement on how the profiles or losses will be distributed.* Will each partner’s share be equal? If not, be sure that each partner’s percentage is clearly spelled out.
8. *An agreement on salaries or drawing rights against profits for each partner.* Ordinarily, partners are not entitled to salaries or wages; their compensation is their share of the business profits. However, many partnership agreements specify salaries for partners who take active roles in operating the business or commissions for partners engaged in selling the company’s products or services, if so, how much and under what conditions? How will business expenses be handled? Can some partners be reimbursed for business expenses while others are not? These are some of the disputes that may strain partnership relations. It is always best to include these issues in the agreement to reduce later confusion. “Your partnership agreement needs to spell out the definition of profit, ownership percentages, allocation of income, and other factors that affect how the firm’s success is divided among the partners,” advises one business consultant.
9. *Procedure for expansion through the addition of new partners, if desired.* Must every partner agree? Many a partnership has hit the rocks over the proposed addition of new partners. The agreement should set procedures by which new partners are added to avoid alienating the original partners and reducing their profit with the addition of a new, unwanted partner.
10. *If the partners voluntarily dissolve the partnership, how will the partnership’s assets be distributed?* It is not unusual to find that the formula for the distribution of assets is quite different from the distribution of profits from the ongoing business. Suppose that one partner has $1million in cash and the other has a patent, the value of which is difficult to assess. The partners may decide to split the profits equally, assuming that the patent results in a product that produces a substantial return on investment. However, without a separate formula for the distribution of profits, the owner of the patent would be entitled to half the tangible assets (half of $1million) while relinquishing half of a patent of questionable value.
11. *Sale of partnership interest.* The articles of partnership should include terms defining how a partner can sell his or her interest in the business. Generally, this section will include a provision for veto of the sale to outsiders by any of the remaining partners. This prevents a partner wanting to sell his or her interest in the business from burdening the remaining partners with an unacceptable replacement. In some cases, the partner selling the interest must offer it first to the remaining partners. When this is the requirement, there must also be a clearly defined procedure for evaluating the partner’s interest. Such a procedure will reduce later conflict concerning what a partner’s share is worth.
12. *Absence or disability of one of the partners.* If a partner is absent or disabled for an extended period of time, should the partnership continue? Will the absent or disabled partner receive the same share of profits as she did prior to her absence or disability? Should the absent or disabled partner be held responsible for debt incurred while unable to participate? Although everyone hopes disability will never occur, the agreement should include provisions that protect all partners in the business.
13. *Alterations or modifications of the partnership agreement.* No document is written to last forever. Partnership agreements should contain provisions for alterations or modifications.

**UNIFORM PARTNERSHIP ACT.**  The Uniform Partnership Act (UPA) codifies the body of law dealing with partnership s in the United States. It was first passed in 1914 by Pennsylvania, and since then all states except Louisiana have adopted it to replica the common law relating to partnerships. Under the UPA the three key elements of any partnership are common ownership interest in a business, sharing the business’s profits and losses, and the right to participate in managing the operation of the partnership. Under the act each partner has the right to:

1. Share in the management and operation of the business.
2. Share in any profits the business might earn from operations.
3. Receive interest on additional advances made to the business.
4. Be compensated for expenses incurred in the name of the partnership.
5. Have access to the business’s books and records.
6. Receive a formal accounting of the partnership’s business affairs.

The UPA also sets forth the partners’ general obligations. Each partner is obligated

to:

1. Share in any losses sustained by the business.
2. Work for the partnership without salary.
3. Submit differences that may arise in the conduct of the business to majority vote or arbitration.
4. Give the other partners complete information about all business affairs.
5. Give a formal accounting of the partnership’s business affairs.

Beyond what the law prescribes, a partnership is based above all else on mutual trust and respect. Any partnership missing these elements is destined to fail. A partner in an architectural design firm claims, “What you need is mutual respect so you can work together.” Table 4.1 lists twenty-five attributes of an ideal partner.

TYPES OF PARTNERS. Not all partners are necessarily equal owners of the business. When partners share in the ownership and management of the business, they are general partners. All partnerships must have a least one general partner. Each general partner has unlimited personal liability and is expected to take an active role in the management of the business. Limited partners have limited financial liability; they can lose only what they have invested in the business. Essentially, limited partners are financial investors who do not participate in the day-to-day management of the business. There may be any number of limited partners, but they cannot take an active role in the management of the firm. If limited partners are “materially and actively” involved in a business’s operation, they will be treated as general partners and will lose their limited liability protection. Limited partners who put five hundred or more hours per year into a business will probably lose their limited status.

TABLE 4.1 Twenty-five Attributes the Ideal Partner

Should Possess

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 Based on studies of partners and partnerships,

 business therapists, Mardy Grothe and Peter

 Wylie have compiled a list of twenty-five

 attributes the ideal partner should possess.

1. Is a good team player.
2. Does his or her job competently and skillfully.
3. Is a genuinely likable person.
4. Is good at giving feedback to others.
5. Is a good listener.
6. Is open and receptive to feedback from others.
7. Treats people with dignity and respect.
8. Looks for “win-win” solutions to disagreements.
9. Is good at facing up to tough problems.
10. Is a person you can trust.
11. Will “go to bat” for other people.
12. Gets along well with almost everybody.
13. Uses time efficiently and effectively.
14. Will admit it or apologize when wrong.
15. Has what it takes to be a good manager.
16. Is a good problem solver.
17. Speaks his or her mind, even when it’s unpopular.
18. Is well organized.
19. Treats people fairly and equitably.
20. Is good at giving compliments or positive feedback.
21. Is enjoyable to be around.
22. Is open to other people’s ideas and opinions.
23. Is levelheaded, even under stress.
24. Presents ideas clearly and articulately.
25. Has good people skills.

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Source: Robert A.Manis, “Partner Wars,” In., June 1994, p. 38.

Silent partners and dormant partners are special types of limited partners. Silent partners are not active in the operation of the business but are generally known to be members of the partnership. Dormant partners are neither active in the partnership nor generally known to be associated with the business.

Two other terms are sometimes used in discussing limited partnership – secret partners and honorary or nominal partners. However, neither is a limited partner. A secret partner is not known to the public, but does take an active role in the management of the business and is considered a general partner in the eyes of the law. The honorary or nominal partner lends his or her name to the business, even though he is not an owner and does not take an active part in the firm’s management. The honorary partner is generally paid for the publicity or public relations value of his name.

Choosing a business partner is much like choosing a marriage mate. It is one of the most critical tasks an entrepreneur faces. “It’s important for a set of partners to have personal and business values that click,” says a partner in a computer software company. Making sure partners’ work habits, ethics, and general business philosophy are compatible can go a long way toward avoiding a nasty breakup. The accompanying “Gaining and Competitive Edge” feature offers practical guidelines for keeping a partnership together.

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| **GAINING THE COMPETITIVE EDGE:** |
| HOW TO AVOID A BUSINESS DIVORCE |

***C***o-owners of businesses are very much like marriage partners. Together they experience ups and downs, happiness and heartbreak, success and failure. Some co-owners spend more time with each other than they do with their spouses. Unfortunately, like some marriages, business relationships can end in divorce. Even when a business is succeeding, the relationship that built-it may be failing.

Although every business dispute is unique, most have one common element: no written agreement spelling out the rights, duties, privileges, and obligations of the owners. In a start-up's early phases, co-founders are immersed in details and are too busy to prepare a document defining the major components of their business relationship. They believe that they can work out any disputes that arise; after all, that’s what friends do, right? Stressing the importance of a written agreement, one expert advises, "Don't be [deluded] by the fact that you and your partners are best friends. As a practical matter, partners have fallings out that need to be handled in a practical way"

How can co-owners avoid such disputes? The following tips will help:
Make sure that you and your business partners have common business objectives. One entrepreneur who was too insecure to launch a telecommunications company alone persuaded three friends to join him. Looking back, he realizes his mistake. "I didn't screen our business goals," he admits. "They wanted the company to pay for their cars and to conduct meetings in the Bahamas. I wanted to plow the money back into the business." Outvoted by his partners, this entrepreneur could only watch as they drained the company's capital to the point that the business collapsed.

*Divide responsibilities on the basis of ability and interest and stick to the agreement.* When the four Sasson brothers created Scorpus Technology, they acknowledged the potential problems their strong egos might cause in their business relationship. To minimize conflicts, each committed to a particular function—one to sales and marketing, another to operations, a third to technology, and the fourth to finance. Their strategy worked, and within three years, the company had 70 employees and sales of $8 million.

Share and share alike. Make sure that everyone involved understands the hard work, commitment, and risk required to launch a company. Clarify beforehand the roles and expectations of each owner involved in the business. The philosophy that "some of us are more equal than others" does not mate for a lasting business.

Don't lie. Resist the temptation to "protect" the other owners from bad news. News, both good and bad, provides useful feedback to owners, who must adjust their company to shifting market conditions.

Get it in writing. Once owners agree to their responsibilities, duties, and expectations, they should put them in writing, Avoid the tendency to go into business with nothing more than high hopes and a handshake. It's a recipe for disaster.

Realize that conflict will occur. Conflict is a natural part of any business relationship; co-owners will never agree on everything. The key to avoiding a business divorce is to manage that conflict and not merely cover it up. That requires communication. One consultant says, "Partners are afraid that bringing up disagreements will ruin the relationship. So they ruin the relationship anyway by not talking."

Cultivating a business relationship with other co-owners requires time, energy, and hard work—just as cultivating a lasting marriage does. Sometimes, however, things just don't work out, and business owners decide to go their separate ways, How do you know when ifs time to leave? One counselor suggests asking yourself the following questions:

◆ Do you and your co-owners still share the goals that brought you together?

◆ Have you resolved difficult problems before?

◆ Do you still basically respect and trust each other?

◆ When you imagine the future, does it seem brighter if you see yourself working with your partners than without them?

If the answer to at least three of these questions is yes, the co-owners can probably salvage their relationship. Bringing in a mediator to help resolve the problem may not be necessary, but it is worth a try.

SOURCES: Adapted from Tom McGrath,"How to Fire Your Partner," Success, February 1998, pp. 30-31; Robert A. Mamis , " Partner Wars," Inc., June 1994, pp. 36-40; Robert A. Mamis/Two Who Made Good," Inc., June 1994, pp, 40-44; Richard J. Maturi, "Firing Squad," Entrepreneur, May 1993, pp. 152-155; Eric L Chase, "Owner vs. Owner," Small Business Reports, September 1990, pp. 69-76; Stephen Davis," Why Partnerships Break Up," Inc., July 1981, pp. 67-70; Frances Huffman," Irreconcilable Differences," Entrepreneur, February 1992, pp. 108-113; Jerry Useem, "Partners on the Edge," Inc., August 1998, pp. 52-64

 A common denominator in many partnership battles is the lack of a written agreement clearly spelling out each partner’s roles, rights, and responsibilities. To be effective, a partnership agreement must be comprehensive and thorough in its coverage, and every partnership agreement must be comprehensive and thorough in its coverage, and every partner must consider it to be fair and equitable to everyone involved. Table 4.2 offers advice on maintaining a positive working relationship with a partner.

