Good Operating Agreements Make Good Partners

As good fences make good neighbors, so do good partnership agreements, make good partners. Too often as the excitement of a new enterprise drives dreams and aspirations of future success, commitments and promises between partners are never formalized. We have a handshake, takes the place of the time and effort to agree as partners on key issues such as job responsibilities such as who is the managing partner; what are the reporting responsibilities of the partners to each other, and perhaps most importantly the exit strategy or the buy-sell agreement between the partners.

Failure by partners to have an agreement in place can lead to distrust or animosity between partners, as partners typically have different personal goals, aspirations, and their own ideas of how things should be done. Failure to have an agreement will make it difficult to contain or channel personal goals or agendas, to meet the common goals every business should have. It is important for partners to have parameters and agreement on key operational issues, as well as rules around capital expenditures, commitment to debt or other issues that involve important or even legal obligations of the partners.

It is critically important for partners to note who is contributing how much money, assets or sweat equity to the partnership. It is important to know who owns what and how much. When we make money how will it be divided? How will day to day operating decisions be made? And, by whom? How will important strategic business decisions be made? Who has voting rights? Failure to codify these issues in a written agreement could cause a business too fail before it ever has success. Many stories exist about partners who took what they thought they deserved from a partnership without regard to the financial stability and financial needs of the company. Other stories about partners who thought the other partner or partners were not working as hard as they were. These types of issues cause greed and mistrust to kick in and can bring a business down,

It is important to start by noting in the agreement, the purpose of the partnership. This immediately establishes, the mission and the purpose of the operation. Don't underestimate the need for partners to have this understanding, for in the future, one partner will assuredly have a the next great idea that may not be at all in alignment with the core business of the company

(Think burrito stand here).

The legal form of the partnership must be established. A single proprietorship: a corporation; and a limited liability corporation are a few options available to a partnership. A lawyer and an accountant can help you understand what options are available and what the best options are for your particular enterprise.

Who is the managing partner, the one who will be responsible for handling the day to day affairs of the partnership? Managing or active partners should be noted for operational and legal reasons. Who will be an active part of the partnership and who will just be investing? For active and managing partners who will be responsible for what and what the compensation for each managing partner will be for the job they are performing? Rules as to what the managing partner can do, such as legally obligating other partners to debt, contracts, need to be established in writing as part of the agreement. Rules on reporting to other partners and establishment of regular meeting times will help partners stay informed about their partnership and should be included in an agreement.

Stock for the corporation needs to be established. Stock certificates should actually be giving to the owners representing their ownership. Sections of the agreement should include percentages of ownership; capital contributions all information that your accountants will need for tax and accounting purposes. Other inclusions in the agreement should center on if capital is needed for the future, how are the partners to contribute? This is no small matter as partners often bring different levels of wealth to the business. Nothing is worse as a partner to be the only one with money, and thus constantly have to take the risk of putting more money into the business while others cannot. Perhaps you take on new partners, if so percentage change in ownership percentage needs to be accounted for. An agreement allows you to have rules in place to address these very touchy subjects. Without an agreement these things become a fiscal cliff for a company, and no one likes to be held hostage or forced into decisions as a result of poor planning. Make no mistake failure to have a partnership agreement is very poor planning.

Another huge part of the agreement should address when and how profits are to be distributed. This is an area where many problems in businesses occur. It is not safe for a business to distribute all profits as these profits are a necessary part of cash flow for the business to survive. Rules for these profits will manage the expectations by all parties, and reduce the entitlement mentality that often takes over as partners expect a check every year. Having a formula in writing protects the partners, and protects the business-

"The Golden Goose" from being killed.

The Buy-Sell agreement or exit strategy is one of the most important elements of an agreement. How a partner can exit or sell their interests in the company. When a company is first starting no one thinks about this date somewhere off in the future. My friends, time passes, and that day will come when someone wants to get out. Frankly such agreement on an exit pathway is good for the partner leaving and those partners that remain. Such buy-sell information needs to be in writing and needs to be part of the partnership agreement.

It is essential that the partners hire an attorney to draft the partnership or operating agreement.

The price and time (these two issues will correlate) to draft an agreement can be mitigated by the partners if they take the time to meet, consider and discuss what they want individually and collectively before they meet with an attorney. Negotiating, brainstorming or hashing out the details at an attorney's office should be minimized, as these drive the cost of an agreement up considerably. Time with the attorney is best used to review rough drafts and final details of the agreement. Please note that I advocate the time and costs necessary in the attorneys presence, to draft an operating agreement, so I am not suggesting going cheap here. Just those meetings prior to meeting with the attorneys can get you the agreement everyone is satisfied with at a price that will make everyone happy.

Once the rough draft of the agreement is complete the partners should get together face to face, or via remote access to read through the agreement and understand it. This is the time for fine tuning and changing, Changes are then sent back to the attorney for comment and inclusion in the agreement. Once the agreement has been finalized it is necessary for all partners to review and sign the agreement. The signed agreement become part of the annual corporate minutes.

The partners should include a reading and review of the partnership agreement at the annual corporate meeting. This is a great way to discuss and determine if the managing partners and all partners are meeting the obligations of the agreement. Changes or updates can be made, if necessary at this time. This is a great process to have as often the only time a partnership agreement does come out is when someone is upset and wants to see what their legal rights are.

A review together each year will provide a healthy opportunity for the partners to discuss the business.

Attached is a prototype operating agreement that includes many of the above mentioned topics. It is provided as a "GUIDE ONLY" for partners to see what an agreement may consist of and what an agreement may look like. I AM NOT A LAWYER AND AM NOT GIVING LEGAL ADVICE. I am a soldier of many business campaigns, and through experience I have learned that good partnership agreements make good partners.