

# Twenty-two Topics to Include in Your Business Partner Operating Agreement

Whether you are a startup or a business that has been around for decades, it's never too late to create one today. That's right, today! Although there is no magic formula or language for making decisions among partners, you will eliminate a lot of future drama if you try to work it out in advance. For clarity, the words: partners, shareholders, equity holders and members, have been used interchangeably. Here is a list of the 22 major areas and more than a hundred questions most partnership agreements should cover:

- 1. Name of the partnership.** One of the first things you must do is agree on a name for your partnership. You can use your own last names such as Smith & Wesson, or you can adopt and register a fictitious business name such as Westside Home Repairs. If you choose a fictitious name, you must make sure the name isn't already in use and then file a fictitious business name statement with your county clerk.
- 2. Contributions to the partnership.** It's critical that you and your partners work out and record who's going to contribute cash, property, or services to the business before it opens -- and what ownership percentage each partner will have. Disagreements over contributions have doomed many promising businesses. Shall interest be paid on the initial contributions to the capital of the partnership, or on any subsequent contributions of capital?
- 3. Allocation of profits, losses, and draws.** Will profits and losses be allocated in proportion to a partner's percentage interest in the business? Will each partner be entitled to a regular draw (a withdrawal of allocated profits from the business), or will all profits be distributed at the end of each year? You and your partners may have different financial needs and different ideas about how the money should be divided up and distributed making this is an area to which you should pay particular attention.
- 4. Salaries and Withdrawals.** Will the partners receive the same salary and equal distributions for services rendered to the partnership?
- 5. Accounting.** Who is the current CPA? What software will be used for accounting records? Does the firm use a fiscal year end of 12/31 or some other time frame? Will you compile taxes on a cash or accrual basis?
- 6. Partners' authority.** Can any partner bind the partnership (to a contract or debt, for example) without the consent of the other partners? Do you want one or all of the partners to obtain the others' consent before obligating the partnership? Can each partner make decisions on client projects?
- 7. Partnership decision-making.** Do you want to require a unanimous vote of all the partners for every business decision? Will you allow individual partners to make minor decisions on their own? How do you describe what constitutes a major or minor decision? Is verbal consent ok? Who can hire, fire and set raises?
- 8. Banking.** Will all funds of the partnership be deposited into the company's checking account? Who can sign checks and make withdrawals? Is there a limit that requires a second signature? Who will receive a company credit card? Who is the payroll signatory? Who is the backup signatory in the event the primary is not available?
- 9. Books.** Will the corporate books be secured at your lawyer's office? Will each partner have access to the books at all times? The books shall be kept on a fiscal year basis, and shall be closed and balanced at the end of each fiscal year. This is a good time to work with counsel to ensure the minutes of prior equity holder/board meetings are documented and equity has been formally issued.
- 10. Management duties.** You might not make ironclad rules about every management detail, but you would be wise to work out some guidelines in advance. For example, who will keep the books? Who will deal with customers? Supervise employees? Negotiate with suppliers? Think through the management needs of your partnership and be sure you have everything covered. Do you have job descriptions for each role?
- 11. Time off.** Is this defined in the employee handbook? How many weeks of vacation per calendar year? In addition to the vacation days, are partners entitled to take fixed company holidays, floating holidays or sick/personal days?
- 12. Sabbatical.** Can partners take a defined leave? Will a salary be paid during this time? During the sabbatical period, will all other partner-level benefits continue?
- 13. Non-competition.** If equity is sold, can a partner work for a competing company? Is there a waiting period? Can the departing partner contact or become employed by a former client, current client or prospect?
- 14. Withdrawal of a partner.** At least as important as the rules for admitting new partners to the business are the rules for handling the departure of an owner. You should set up a reasonable buyout scheme in your partnership. Is 100% effort required to remain a partner? Are partners expected to live within local commuting distance? Is there a semi-retirement option available? If an equity holder wants to retire, do they have to sell equity back to the corporation? Do the remaining partners have a right of first refusal to buy stock of the departing partner? Is there an initial period of time before the equity fully vests? Will the company value be set by a CPA, CVA or other predetermined method such as 1 times revenue? Can the buyout payments be made over time? Will interest be paid on any unpaid balances? Who will pay for the professional fees such as lawyers, accountants, resulting from this withdrawal sequence?

15. **Selling to an outside buyer.** Can any equity be sold externally? If so, are equal distributions required for all shareholders, or can a single partner sell their shares alone to an external buyer?
16. **Death of a partner.** Shall spouses or children be allowed to take over the deceased's role or make any decisions? Will the deceased's equity be sold back to the corporation? Will the deceased partner continue to receive a salary for some period of time? Will the firm require key man / buy-sell insurance? If the insurance policy is in excess of the partner's percentage of valuation, will the excess be returned to the deceased member's estate? If the insurance policy is less than the deceased partner's percentage of valuation, can the company pay the estate over time? Will interest be paid?
17. **Disability of a partner.** What if one of the equity holders is disabled or can no longer provide services to the business? Is the word disability defined in the employee handbook? Wording such as: (a) if partner is not able to perform their day-to-day management duties at the office 5 days per week or (b) be mentally able to perform the role as defined in the job description. Should you consider a waiting period before triggering this process? Should you tie in the start of this process to the start of the disabled members Long Term Disability Insurance coverage? Will the disabled equity holder's salary continue? How long? If the disability has started, will you require the sale of shares back to the firm?
18. **Admitting new partners.** Eventually, you may want to expand the business and bring in new partners. Who can submit new potential partners for consideration? Will the new partner be expected to buy equity from each member in proportion to their then-current percentage of ownership? Will you require a valuation by a mutually agreed upon CVA? Can the payments be made over time? Will interest be required?
19. **Termination for cause.** Is this event defined in the employee handbook? Since the employee handbook is normally used for W2 employees, are the partners held to the same ethical and moral standards? If a partner is terminated for cause or convicted of a felony, will this trigger a forfeit of all equity back to the company?
20. **Resolving disputes.** If you and your partners become deadlocked on an issue, do you want to go straight to court? It might benefit everyone involved if your partnership agreement provides for alternative dispute resolution process, such as mediation or arbitration using the American Arbitration Association (AAA). Will all mediator decisions be final (a/k/a binding arbitration)?
21. **Succession plan.** If the partners die simultaneously, who will become the acting partner to ensure a smooth transition? What process do you want them to follow to secure new equity holders and continue to operate the business?
22. **Estate planning.** The partners personal estate planning must be managed in concert with the company's partnership agreement. Have the partners completed a will? A healthcare proxy? A revocable trust? A power of attorney?

In summary, today is a great time to start a new corporate tune-up chapter of your business lifecycle. Literally, today ... schedule time to meet with your company's corporate growth advisors to clean-up the company books and financials. Literally, today ... meet with your business or personal attorneys to develop your estate planning needs and get it done. In addition, this may be a good point to pause and take an inventory of the insurance your firm currently has and meet with advisors to determine if any of your insurance is in need of an upgrade. Lastly, hire an advisor to meet with your ownership team to facilitate the discussion, document the decision-making process and drive the answers to the above that are needed to form your partnership agreement.



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