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Creating a Partnership Agreement

Put the terms of your partnership in writing to protect your business.

If you and your partners don't spell out your rights and responsibilities in a written partnership agreement, you'll be ill-equipped to settle conflicts when they arise, and minor misunderstandings may erupt into full-blown disputes. In addition, without a written agreement saying otherwise, your state's laws will control many aspects of your business.

How a Partnership Agreement Helps Your Business

A partnership agreement allows you to structure your relationship with your partners in a way that suits your business. You and your partners can establish the shares of profits (or losses) each partner will take, the responsibilities of each partner, what will happen to the business if a partner leaves, and other important guidelines.

The Uniform Partnership Act

Each state (with the exception of Louisiana) has its own laws governing partnerships, contained in what's usually called "The Uniform Partnership Act" or "The Revised Uniform Partnership Act" (or the "UPA" or "Revised UPA"). These statutes establish the basic legal rules that apply to partnerships and will control many aspects of your partnership's life unless you set out different rules in a written partnership agreement.

Don't be tempted to leave the terms of your partnership up to these state laws. Because they were designed as one-size-fits-all fallback rules, they may not be helpful in your particular situation. It's much better to have an agreement in which you and your partners state the rules that will apply to your business.

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What to Include in Your Partnership Agreement

Here's a list of the major areas that most partnership agreements cover. You and your partners-to-be should consider these issues before you put the terms in writing:

- **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 that the name isn't already in use and then file a fictitious business name statement with your county clerk.
- **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.
- **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, so this is an area to which you should pay particular attention.
- **Partners' authority.** Without an agreement to the contrary, any partner can bind the partnership (to a contract or debt, for example) without the consent of the other partners. If you want one or all of the partners to obtain the others' consent before obligating the partnership, you must make this clear in your partnership agreement.
- **Partnership decision making.** Although there's no magic formula or language for making decisions among partners, you'll head off a lot of trouble if you try to work it out beforehand. You may, for example, want to require a unanimous vote of all the partners for every business decision. Or if that leaves you feeling fettered, you can require a unanimous vote for major decisions and allow individual partners to make minor decisions on their own. In that case, your partnership agreement will have to describe what constitutes a major or minor decision. You should carefully think through issues like these before you and your partners have to make important decisions.

- **Management duties.** You might not want to make ironclad rules about every management detail, but you'd 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've got everything covered.

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- **Admitting new partners.** Eventually, you may want to expand the business and bring in new partners. Agreeing on a procedure for admitting new partners will make your lives a lot easier when this issue comes up.
- **Withdrawal or death 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 agreement.
- **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, such as mediation or arbitration.

As you can see, there are many issues to consider before you and your partners open for business -- and you shouldn't wait for a conflict to arise before hammering out some sound rules and procedures. A good self-help book, such as *Form a Partnership: The Complete Legal Guide*, by attorneys Denis Clifford and Ralph Warner (Nolo), can help you think through the details and put them in writing.