

Making Your Partnership a Success

By: Gerald A. Klein

Published by: *The Recorder*
October 11, 2013

My partner and I are celebrating our law firm's 20th anniversary. It occurred to me there are thousands of books on making marital partnerships work, but very few on making a business partnership work. Seeing what has worked and what hasn't over the past 20 years, I think the following 10 points can help you improve the longevity of your own partnerships.

1. RECOGNIZE THE IMPORTANCE OF PARTNERSHIP

Most professionals cannot succeed by themselves. Even the Lone Ranger had Tonto. A good partner shares financial burdens and work load. A good partner generates good ideas and discourages you from launching the "great ideas" that might not be so great. Good partners provide a well spring of ideas allowing you to pick the best one.

Partners help motivate you to continue to keep climbing when things are going well and provide necessary emotional support when they are not. If you do not recognize the value of having a partner, then you are not partnership material.

2. PICK PARTNERS YOU TRUST

No partnership can survive without a foundation of personal honesty, solid judgment, and reliability. If you feel compelled to check the books every week, then you have the wrong partner. Also, all businesses have key decision points. There will be times when your partner has more knowledge about a matter than you. You may need to make a leap of faith to follow your partner's recommendation without knowing whether the decision is correct. That foundation of trust is the essence of a successful partnership.

3. HAVE COMMON GOALS

Like most good marriages, partnership must be built on a foundation of common values and goals. Your partnership will fail if your partner wants to grow your business to 1,000 employees and your goal is to keep the company small. If your partner believes a little cheating now and then is something everyone does — and you do not agree — your partnership will fail. Always keep in mind that a partner who steals from customers and clients will eventually steal from you.

4. GIVE MORE THAN YOU TAKE

Like marriage, a successful partnership requires partners to give more than they take. The law requires that you think of your partners' interests as much as your own. There is a practical reason for this requirement. When partners believe they are getting less than their share of the pie, there will be resentment. Successful partners recognize that it is less about what share of the pie they receive and more about growing the size of the pie.

5. DEVELOP EFFECTIVE MANAGEMENT PLANS

No business succeeds without effective management. Many partnerships fail when no one is managing the ship or partners are over managing. Efficient management is key to a successful partnership. In small partnerships, the firm can be managed by the entire group. But when a partnership expands to five or more, group management is usually ineffective.

Making Your Partnership a Success (continued)

Research in group decision making shows that large groups find it difficult to resolve issues efficiently. Therefore, some partnerships choose a managing partner as first among equals. The managing partner formulates company policy and implements decisions in an even handed way. Other partnerships delegate management to a small committee. No matter what the structure, there should be no illusion that it will function as a democracy. Authority of the firm manager(s) must be respected.

6. DOCUMENT THE PARTNERSHIP APPROPRIATELY

Some partnerships are based on a handshake. Most partnerships require an explicit agreement laying out partnership structures. From a practical standpoint, it is prudent to discuss at the outset the basic rules of the partnership so everyone understands how it will operate, even if not every detail is addressed. Negotiating a partnership agreement should identify any serious points of contention before the partnership is launched.

7. PREPARE A FAIR AND APPROPRIATE EXIT STRATEGY

As in marriages, business partnerships often fail. The reasons for business partnership failures are often similar to marital failures: fights over money, trust issues, behavior problems, and divergent views of how the partnership should operate. Unfortunately, when a partnership fails, some partners believe they can simply pick up their toys and go. That decision often creates litigation. Partners are fiduciaries and therefore cannot simply leave with "their" money and clients.

A good partnership agreement addresses departing partners in a fair way rather than a punitive one. When a partner decides to leave, the departure should be discussed openly. Prior to discussing departure with your partners, it is prudent to meet with an attorney to understand the options available. Not doing so can result in substantial liability or even punitive damages being awarded against you. Partnership laws are complex and often difficult for even lawyers to navigate, especially in a business that has grown substantially

8. TRANSITION PLANS FOR RETIREMENTS

Partnerships must put transition plans in place for when a partner retires. Large partnerships, for example, used to have retirement plans that paid a retiring partner money for the rest of his or her life. Smaller partnerships do not generally have such plans and even larger partnerships are moving away from them. From a practical perspective, there may not be sufficient assets to buy out a retiring partner and the remaining partners may choose dissolution instead. One potential solution is purchasing an annuity paying a partner a stipulated sum upon retirement.

9. CONSIDER KEY PARTNER LIFE INSURANCE

The death of a partner can bring down the law firm, especially small partnerships. When a key partner dies, particularly a rainmaker, the business could find itself floundering. In addition, deceased partners' spouses may have a claim on the firm's assets which could trigger dissolution. Insurance policies, commonly referred to as "key man insurance policies," provide a death benefit that can pay off a spouse and provide working capital to the firm for transition.

10. CONSIDER A BUY-SELL AGREEMENT

A buy-sell agreement can be an effective way to terminate a partnership. In a general sense, a buy-sell agreement allows one partner to buy out the interests of the other and the procedure for doing so. Typically, one partner sets the price at which that partner will either buy all of the assets or sell them at the other partner's option. Where one partner controls most of the business,

Making Your Partnership a Success (continued)

or only one partner can afford to buy out the other, it is more difficult to formulate an equitable buy-sell arrangement. The partner who is controlling the business or has more money can set an unreasonably low price to buy out assets as the other partner will be disinclined to be a purchaser.

Generally, a buy-sell agreement contains a covenant not to compete with the remaining partners. Each state has its own laws as to whether such agreements are enforceable and the terms which would make them unenforceable. Typically, they are enforceable where there has been a sale of assets and the terms of the covenant not to compete are reasonable in terms of scope and duration.

If you take to heart the points set forth in this article, you will increase the odds you and your partners will operate a profitable partnership and separate without destroying the business.



Gerald A. Klein is a Partner at Klein & Wilson, a business trial law firm located in Orange County. He represents both plaintiffs and defendants in business litigation, partnership disputes, trade secrets cases and legal malpractice cases. He can be reached at klein@kleinandwilson.com or (949) 631-3300.