

Title:

When a handshake is not enough: why you need a Partnership Agreement

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771

Summary:

If you want to avoid uncertainty and the automatic application of unsuitable statutory law, a partnership agreement is a wise investment...

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Article Body:

If you set up in business with one or more other people but do not wish to set up a limited company, a partnership arrangement will be deemed to exist at law without the need for a formal contract. However, whilst a written partnership agreement is not required to form a partnership, if you wish to avoid uncertainty and the automatic application of potentially unsuitable statutory law, a formal agreement is a wise investment.

What happens if we don't sign a Partnership Agreement?

In the absence of a written agreement, the provisions of the 1890 Partnership Act will apply. In essence, these state that all the partners are equal and share profits, losses, start-up and running costs as well as the workload equally. Whilst the provisions are intended to provide an equitable framework for running your business, in reality, there are significant implications. For example;

- all partners will be entitled to share the profits equally regardless of how much capital, effort or skill they bring into the business
- any partner can bring the partnership to an end just by giving notice to all the other partners and the partnership will automatically dissolve if a partner dies
- all partners will be jointly and severally liable for the liabilities incurred by the company. This means that if one partner takes on a commitment and fails to deliver on it, you will be equally liable to remedy the situation. And if a debt cannot be paid, then the creditor may pursue each of you individually,

meaning that one of you may be forced into the position of paying the whole debt by yourself

- should a partner get into financial difficulties then his or her creditors can take assets from the partnership to settle them
- all partners will be considered "agents" of the business and so can act on behalf of the other partners. This means an individual may enter into contractual and financial arrangements which are not good for the business, but these will be binding
- all partners have an equal say in the business, which means that it can take time to reach decisions. Unresolved disputes may result in the break down of the business.

What benefits will a Partnership Agreement offer?

A partnership agreement will provide a written structure for your business clearly setting out each partner's responsibilities, rights, profit/liability sharing, rules relating to business entry and exit, and also the terms on which disputes are resolved and the partnership can be terminated. Carefully drafted, it will ensure that you have a common vision for the business with mutually agreed goals. Critically, it will help avoid costly misunderstandings and conflict.

Key areas to cover in your partnership agreement include:

- a) ownership interests, taking into account any cash, assets, loans or investments made by individual partners
- b) salaries and compensation: how will profits or losses be allocated?
- c) how the partnership will be managed
- d) each partner's specific responsibilities within the business, and what level of performance is expected from them
- e) whether partners expected to make a full-time commitment to the venture, or are permitted involvement in other business activities
- f) what processes should be followed if one partner wants to leave the partnership or a new partner is admitted
- g) whether partners will be allowed to sell their interests in the business to

outsiders and, if so, how will their share be valued

h) on what grounds a partner can be expelled from the partnership (e.g. misconduct, non-performance of duties)

How do I put a Partnership Agreement in place?

While there are many internet sites offering seemingly cheap pro forma partnership agreements, this can be a false economy for several reasons:

- 1) there are three different kinds of partnership: general partnerships, limited liability partnerships and limited partnerships - you need to be sure that you set up the appropriate vehicle for your needs;
- 2) no two partnerships will be alike in terms of specific requirements;
3. you are unlikely to reach amicable consensus on an agreement without involving an impartial third party advisor;
- 4) without using a solicitor, you can't be sure that the agreement complies with partnership laws.

A better way to save money is to do some preparation before instructing your solicitor: get together with your partners and compile a list of provisions that you wish to include in your partnership agreement. Your solicitor will then have a good starting point from which to clarify your requirements and draft a suitable agreement. However, since one lawyer cannot represent the interests of all partners, each partner will need to instruct their own solicitor to review the final document on their behalf.