PRACTICAL CONSIDERATIONS IN DRAFTING PARTNERSHIP AGREEMENTS and COMPANY AGREEMENTS

THE ECONOMICS OF THE DEAL

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As business structures have become more sophisticated and creative in the last 30 years, there is an increasing dependence on forms of pass through business entities (partnerships and LLC's).

As a result, there has been an increased demand on lawyers to think through and design documents that would address the particular needs of these creative business structures.

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Partnerships and Limited Liability Companies require the drafter to consider:

1. The capitalization and maintenance of capital accounts.
2. The methods and priorities for contributions.
3. The sharing of profits.
4. The sharing of losses.
5. The methods and priorities of distributions.
6. The economics of the departure of an owner.
7. The economics of the termination of the venture.
8. The management of each of the business to accomplish these goals.

We are going to discuss 1-7

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<u>WARNING</u>:

Some of the materials consist of actual example of language used in entity documentation.

The very flexibility which makes these entities so useful also makes it difficult to devise a form that may be useful for parties or practitioners.

This language is not intended to be used as a form. It is only an example of language used in prior transactions.

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WARNING:

The laws relating to the formation and operations of Partnership, Limited Partnerships and Limited Liability Companies will vary from state to state.

As you encounter issues with the formation of these entities please consult the application of the local laws in particular state

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Much is said of capital accounts - What are they and are they important?

Capital accounts track the economic attributes to be shared among the owners of these entities. Its your bank account in the business transaction

The capital accounts of owners will generally be:

(i) increased by sums contributed by the Owner and the profits allocable to the Owner and

(i) decreased by sums distributed to the Ownerand the losses allocable to the Owner.

They do not dictate the economics of the deal – they only track the economics of the deal – it's the accounting system for contributions, distributions, profits and losses.

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CONTRIBUTIONS

The first issue in formation - is how much money (or other property) will be required to contribute to the business, and when the capital will be required to be contributed. Does your entity agreement address:

- ✓ What is to be contributed – money, property, services?
- ✓ What conditions must arise before an owner can be required to contribute to the entity?
- ✓ When is the contribution to be made?

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General Issues- Contributions

- ✓ Define the nature of the Contribution.
- ✓ Define when and under what conditions will the contribution be required.
- ✓ If it to be contributed in installments or on conditions, state the conditions clearly.
- ✓ Consider the timing element and need to address entity obligations.