

PERFECT PARTNERS

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Many dentists choose to carry on their business through partnerships. However, problems do occur and the impact of a major partnership dispute on a business cannot be understated. In general, the smaller the partnership, the greater the negative impact of a partnership dispute on the business and the more embittered the dispute becomes. This is probably because larger partnerships are more likely to have agreed procedures to deal with circumstances giving rise to disputes. Plus, the greater the number of individuals in a partnership the less personal a dispute should become and the more likely it is that a sensible solution can be found by negotiation.

Why do disputes arise?

The reasons that partners fall out can usually be summarised into these main areas:

- An actual or perceived inequality in input to the business linked to partners being unhappy with profit-sharing arrangements
- One or more partners drawing too much cash from the business. This is often linked to a downturn in profitability or cash generation and partners being reliant upon particular drawing levels to maintain their lifestyle.
- External factors such as marriage breakdown, illness or financial problems
- The impact of one or more partners wishing to leave the business and the arrangements surrounding this departure

The importance of a partnership agreement

A well-structured partnership agreement is the best way to prepare for any issues that might arise between partners. It enables the partners to agree procedures to be applied if certain potentially contentious situations arise - for example, if a partner is unable to work for a long period of time. It also enables the partners to consider and agree how differing input to the partnership should be rewarded.

In the event of any dispute, the partnership agreement enables the route to resolution to be set out. This will encompass the voting requirements for different categories

of partnership decision and will usually specify how any residual grievances should be dealt with.

There is, however, no requirement for partners to have a formal written agreement. Too few partners seek legal advice when a partnership is formed. Many professional advisers are familiar with the vision of fresh-faced, eager new business partners (usually two, three or four in number) unable to see any need to have a formal agreement because "they get on and work so well together". Sadly time and the pressure of business can often cloud the rosy spectacles.

However keen, optimistic and trusting new partners may be, the professional adviser should be able to convince them that equal profit share and majority rule can and do precipitate dispute and dissatisfaction between partners. Partners must be encouraged to think through potential scenarios - eg long-term illness or unequal input, and to discuss and agree what should happen in those circumstances.

Fundamentally, the individuals involved need to consider whether partnership is the correct medium for their business as opposed to a limited company or sole traders sharing resources.

Profit sharing - the 'input' problem

Equality is still the most common form of profit sharing arrangement in the smaller partnership. This can work very successfully when all partners trust each other and value their respective inputs into the business. However, it does not take much to upset the equilibrium.

The partners need to consider how differing input might be dealt with. Unfortunately there is no easy way to define how profits should be shared between partners in different circumstances. In most cases the solution will be a combination of reward based on financial contribution (eg billing and individual client profitability) and recognition of management and business development input.

The practical problem for the smaller partnership is that non-financial input is difficult to measure. A common solution for the first tranche of profit to be shared on an equal basis with a second tranche of profit based on relative financial contribution.

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Benefits of a partnership agreement

A number of benefits are achieved by the partners agreeing in advance, by stating in a partnership agreement how profit share should be dealt with:

- It encourages the partners to accept that, during the life of any partnership, it is quite usual for partners to contribute to the business in different ways and with differing levels of respective input. There is nothing wrong in this provided the reward system is appropriate.
- It forces the prospective partners to sit down together and discuss a difficult issue. If they cannot agree how varying input should be rewarded, then this highlights that they should reconsider whether partnership is the correct route for them.
- If a profit share method is agreed by all at the outset, then this minimises the likelihood of future dispute.
- This initial outline framework for sharing profits can in any case be revisited in future years if necessary.

Overdrawn partners - the 'outflow' problem

Another prime cause of partnership dispute is one or more partners drawing out more from the business than their profit share permits or than their fellow partners. This problem is highlighted when there are business difficulties or financing problems.

A number of steps can be taken, within the partnership agreement or in the general management of the partnership, to minimise the likelihood of a dispute being triggered by excess drawings:

- Set conservative drawings levels for the partners that are linked to profitability. These can use a formula based on anticipated profit levels less taxation and a contingency reserve just in case things go wrong.
- Ensure that the partners have regular financial management information so that any possibility of excess drawings can be identified and corrected at the earliest opportunity. Even for the smallest partnership, the level of fees, work and cash received should be monitored at least on a quarterly basis and probably monthly.
- Ensure that the partnership retains sufficient funds to meet partners' business taxation liabilities and that these can be paid out of retention of historic profits as opposed to an anticipation of future profits, which may not

materialise.

- Incorporate interest on a partnership capital within the profit sharing arrangements so the partners with the greater financial interest in the business are appropriately rewarded and overdrawn partners are penalised.

What to do when it all goes wrong

However good the partnership agreement and management style, disputes can still arise. Ultimately a partnership dispute can only be resolved by a combination of:

- Negotiation
- Mediation
- Legal action
- Dissolution

However, when it seems inevitable that a dispute will escalate, what can be done to aid a speedy resolution?

Nip the dispute in the bud - if it is allowed to fester, it will be much harder to find a solution that all parties are comfortable with. Partners and their professional advisers should ensure that any grievances are aired at the earliest opportunity and can be resolved swiftly if at all possible.

If matters cannot be resolved among partners, seek professional help at an early stage. In particular, most partnership disputes are linked to financial and profitability issues. Advice from an accountant to explain the financial implications is vital. Often the partnership accountants and tax advisers can provide this expert input. However, sometimes a partner may perceive that the partnership accountant is more loyal to one party than another. In this case, a neutral adviser acting for both parties can aid a speedy resolution. Early neutral evaluation of the problems is a form of 'alternative dispute resolution' that can be particularly useful in these circumstances. Alternative dispute resolution (ADR) is the collective term for the ways that parties can settle civil disputes, with the help of an independent third party and without the need for a formal court hearing.

Keep talking and negotiating and take full advantage of mediation and ADR. If dissolution is unavoidable, ensure there is appropriate accountancy advice as regards taxation issues and other complexities such as valuation and assignment of ongoing contracts.